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Determinant of Net Profit Margin in Islamic Bank: Evidence From Indonesia

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Abstract

This study investigates the factors influencing the Net Profit Margin (NPM) of Islamic banks in Indonesia, focusing on risk aversion (CAP), default risk (NPF), liquidity (FDR), and operational size (SIZE). The research aims to explore how these variables affect profitability in the Indonesian Islamic banking sector. The study uses balanced panel data from Islamic banks over the period 2014–2023 and applies panel regression analysis to examine the relationships between the variables. The findings indicate that risk aversion negatively affects NPM, while liquidity and operational size have a positive influence on NPM. Default risk does not significantly impact NPM. Additionally, the study includes a dummy variable for the COVID-19 pandemic, which shows a negative effect on NPM, reflecting the adverse impact of the pandemic on bank margins. This research contributes to the literature on the determinants of profitability in Islamic banking by providing new insights into how risk aversion, default risk, liquidity, and operational size influence NPM, particularly during periods of economic disruption.

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INTRODUCTION

Islamic banking has grown significantly over the past few decades, establishing itself as a key component of the global financial system, particularly in countries with large Muslim populations (Mat Nor et al., 2018). The rise of Islamic banking is driven by the increasing demand for Shariah-compliant financial services and evolving regulatory environments that support ethical and non-interest-based financial models. These distinct characteristics differentiate Islamic banks from their conventional counterparts, especially in their approach to profit generation, risk-sharing, and ethical investment.

In Indonesia, the world's largest Muslim-majority country, Islamic banking continues to expand and plays an increasingly vital role in promoting financial inclusion and sustainable economic development. As this sector grows, there is a need to assess the financial performance of Islamic banks more critically, particularly in terms of their ability to generate consistent profits while adhering to Shariah principles (Banna & Alam, 2020).

A key indicator of financial performance is the Net Profit Margin (NPM), which reflects how efficiently a bank converts its revenue into net income. NPM is widely used to evaluate profitability and operational effectiveness. While a lower NPM is often seen in more competitive and active markets that stimulate economic growth, an excessively high NPM may indicate inefficiencies or limited market activity (Nghiem et al., 2023). In the context of Islamic banking, profitability is further influenced by the requirement to align with ethical mandates and Shariah law, creating a delicate balance between financial returns and social responsibility (Adam et al., 2023b, 2023a; Khan & Jalil, 2020).

Numerous studies have examined the determinants of NPM in banking, identifying factors such as risk aversion, liquidity risk, credit risk, capital adequacy, and bank size as key influences (Agoraki & Kouretas, 2019; Akasumbawa, Mainuddin, et al., 2024; Asmar, 2018; Lestari et al., 2021; Mariam et al., 2021; Obeid, 2024; Tubastuvi & Pratama, 2020). However, the empirical findings across contexts remain inconclusive. For example, Lestari et al. (2021) found that larger bank size, higher capital adequacy, and inflation reduce NPM in Indonesian banks, while liquidity increases it. In contrast, Megawaty & Ugut (2022) found capital adequacy improves NPM, while bank size and liquidity have no significant effect.

Although agency and efficiency theories predict consistent relationships between capital adequacy, liquidity, and bank profitability, empirical studies on Islamic banks in developing economies reveal considerable inconsistencies (Agoraki & Kouretas, 2019; Fersi & Boujelbène, 2023; Lee & Isa, 2017; Mariam et al., 2021; Tubastuvi & Pratama, 2020). These deviations may arise from contextual differences in regulatory frameworks, ethical finance models, or market maturity, thereby justifying the need for context-specific research. In particular, the unique operational model of Islamic banks—centered on profit-and-loss sharing, risk-avoidance, and asset-backing—may create performance dynamics that differ from conventional banking systems.

Despite the growth of Islamic banking in Indonesia, there remains a gap in empirical research on how these specific factors influence the NPM of Islamic banks. Much of the existing literature focuses on conventional banks or broader macro-level analysis, without accounting for the institutional uniqueness of Islamic finance (Lee & Isa, 2017). Furthermore, few studies incorporate external shocks or stress conditions into the profitability analysis of Islamic banks. This lack of nuanced, context-specific investigation leaves regulators and practitioners with limited guidance for strengthening the sector (Fauziah et al., 2020).

In the wake of the COVID-19 crisis and increased volatility in global financial markets, understanding how Islamic banks in Indonesia maintain profitability under stress becomes essential. This study is especially timely as regulators and financial managers seek to enhance resilience in Sharia-compliant institutions amid shifting economic conditions. The economic disruption caused by the pandemic and prolonged low interest rate environments globally have compressed profit margins, prompting banks to reassess their strategies (Cruz-García & Fernández De Guevara, 2020). Exploring how Islamic banks respond to these challenges is crucial for building long-term financial stability.

This study aims to investigate the determinants of Net Profit Margin in Indonesian Islamic banks, focusing on both traditional financial factors—such as risk aversion, default risk, liquidity risk, and operational size—and external shocks, specifically the impact of the COVID-19 pandemic. By incorporating a dummy variable for the COVID-19 period, this research offers a more comprehensive view of how global crises affect profitability. The originality of this study lies in its specific focus on Islamic banks in Indonesia, a segment with significant growth potential that remains underexplored (Fauziah et al., 2020). The findings are expected to provide valuable insights for regulators, policymakers, and financial practitioners in improving the performance and resilience of Islamic banking in emerging economies.

METHODS

This study employs an explanatory quantitative research design to examine the causal relationships between various internal and external factors and the net profit margin (NPM) of Islamic banks in Indonesia. The research utilizes secondary data in the form of annual financial reports published by Islamic banks and macroeconomic indicators obtained from the official websites of Bank Indonesia (BI) and the Central Bureau of Statistics (BPS). The data are structured as balanced panel data covering the period from 2014 to 2023, with a total of 70 observations derived from 7 Islamic banks over 10 years. These banks were purposively selected based on the availability of consistent and complete annual financial reports during the study period. The unit of analysis in this study is each bank-year, allowing for a dynamic assessment of trends over time.

The dependent variable in this study is the Net Profit Margin (NPM), which is calculated as the ratio of net financing income to total assets. This measure is consistent with prior research (Lee & Isa, 2017; Mat Nor et al., 2018; Stapah et al., 2018) and reflects the efficiency with which Islamic banks convert assets into net earnings. The independent variables include several bank-specific risk indicators. Risk aversion is proxied by the Equity to total Assets (CAP), representing the bank's reliance on equity financing; higher CAP values indicate a more conservative financial stance, which may reduce profitability but enhance stability. Default risk is measured by the Non-Performing Financing (NPF) ratio, where higher values are expected to reduce NPM due to impaired income from financing activities. Liquidity risk is proxied by the Financing-to-Deposit Ratio (FDR), capturing the bank's short-term liquidity management; suboptimal liquidity can constrain profit generation. Operational size, measured by the natural logarithm of total assets, accounts for economies of scale and the potential for greater profitability in larger banks.

To control for external influences, the study includes several macroeconomic control variables, namely economic growth, inflation rate, tax, and a COVID-19 dummy variable (coded 1 pasca covid-19 and 0 otherwise). Economic growth is expected to increase financing activities and enhance profitability, while inflation may exert mixed effects by

either increasing revenue through higher rates or reducing customer purchasing power. A higher tax burden reduces retained earnings and compresses profit margins. The inclusion of the COVID-19 dummy variable accounts for the extraordinary shocks brought by the pandemic, which may have adversely affected banks' financial performance. These variables are included to ensure the robustness of the regression model in explaining variations in NPM across time and institutions. Table 1 provides the operational definitions of all variables used in this study.

Table 1. Variables Definition

Variables	Notation	Measurement	Sign	Sources
Dependent				
Net Profit Margin	NPM	Net Financing Income to Total Assets		Annual Report
Independent				
Risk Aversion	CAP	Equity to Total Assets	(+)	Annual Report
Default Risk	NPF	Non-Performing Financing	(-)	
Liquidity	FDR	Financing to Deposite Ratio	(+)	
Operational Size	SIZE	Logaritma Natural of Total Assets	(+/-)	
Control				
Covid-19	COV	Dummy 1; pasca covid-19, 0; other	(-)	Annual Report
Taxation	LnTAX	Logaritma Natural Tax	(+/-)	
Economic Growth	LnGDP	Logarima Natural Gross Domestic Product	(+/-)	Central Bureau of Statistics (BPS)
Inflation	INF	Inflation Rate	(+/-)	Bank Indonesia

Source: Authors processed, 2025

To analyze the collected data, we developed econometric models aligned with the research objectives. These models examine the factors influencing the net profit margin of Islamic banks. The econometric models are specified as follows:

$$NPM_{it} = \alpha_i + \beta_1 CAP_{it} + \beta_2 NPF_{it} + \beta_3 FDR_{it} + \beta_4 SIZE_{it} + \beta_5 CONTROL_{it} + \varepsilon_{it} \quad (1)$$

Net profit margin (NPM) represents the profitability measure of the banks, while CAP reflects the level of risk aversion. NPF serves as a proxy for default risk, and FDR captures liquidity risk. SIZE represents the operational size of the bank. Meanwhile, the control variables include COVID-19 (COV), taxation (LnTAX), economic growth (LnGDP), and inflation (INF), which are incorporated to account for external macroeconomic and institutional factors influencing the net profit margin.

For the purpose of this study, we employed a static panel regression method. To address potential issues of autocorrelation and heteroskedasticity, which are critical for ensuring the reliability of the results, we calibrated the model using Generalized Least Squares (GLS) (Wu et al., 2022). GLS is particularly advantageous in panel data analysis as it adjusts for both cross-sectional and time-series correlations in the error terms, thereby providing more efficient and unbiased estimates compared to Ordinary Least Squares (OLS). Moreover, GLS allows for the incorporation of weights in the estimation process, which helps in mitigating the effects of non-constant variance (heteroskedasticity) and serial correlation. This is particularly important for our dataset, where variability across

banks and time is expected due to differences in operational size, financial conditions, and macroeconomic environments. The econometric model are written as:

$$NPM_{it} = \alpha_i + \beta_1 CAP_{it} + \beta_2 NPF_{it} + \beta_3 FDR_{it} + \beta_4 SIZE_{it} + \beta_5 LnTAX_{it} + \beta_6 COV_{it} + \varepsilon_{it} \quad (2)$$

To further validate the reliability of the results, we assessed the robustness of the model using the robust least squares method. This additional step ensures that the findings remain consistent even in the presence of outliers or deviations from standard regression assumptions, enhancing the credibility of our conclusions (Akasumbawa, Haryono, et al., 2024). The econometric model for robustnest test are written as:

$$NPM_{it} = \alpha_i + \beta_1 CAP_{it} + \beta_2 NPF_{it} + \beta_3 FDR_{it} + \beta_4 SIZE_{it} + \beta_5 LnTAX_{it} + \beta_6 LnGDP_{it} + \beta_7 INF_{it} + \varepsilon_{it} \quad (3)$$

RESULT AND DISCUSSION

RESULT

Descriptive Statistics

Table 2 presents the descriptive statistics for all variables used in the study, providing insights into their distribution, central tendency, and variability over the 70 bank-year observations. The Net Profit Margin (NPM) has a mean of 0.0709 with a relatively low standard deviation of 0.0752, suggesting consistent profitability across Islamic banks in the sample. The minimum value of 0.0031 and maximum of 0.2795 indicate modest variation in profit margins, likely reflecting the relatively stable nature of Islamic banking operations in Indonesia.

Risk Aversion (CAP), shows a mean of 0.1588 and a narrow range between 0.0621 and 0.4095, implying that most banks maintain a conservative capital structure. In contrast, Non-Performing Financing (NPF), which reflects default risk, exhibits considerable variation (mean = 1.6456, standard deviation = 1.6507). The maximum value of 4.95 is particularly high compared to the minimum of 0.00, suggesting significant disparities in credit quality among banks. This high standard deviation may indicate skewness and the presence of potential outliers, which could affect model estimation and may require robustness checks.

Financing-to-Deposit Ratio (FDR), representing liquidity risk, also shows wide dispersion (mean = 85.90, max = 196.73, min = 38.33), indicating divergent liquidity strategies across the sample banks. The variable LnTAX (log of tax burden) has a mean of 19.11 and a moderate standard deviation, reflecting relatively consistent but slightly varying tax expenses. Bank size (SIZE) varies considerably (mean = 25.25, SD = 4.82), confirming heterogeneity in operational scale, which could influence cost efficiency and profit margins. Regarding macroeconomic variables, GDP shows extremely high dispersion (mean = 10,412,463, SD = 1,139,617), which is expected due to the absolute value of national GDP over time. Inflation (INF) ranges from 1.68% to 8.36% with a mean of 3.59%, capturing macroeconomic fluctuations during the 2014–2023 period.

Overall, the descriptive statistics highlight notable variability in both bank-specific factors and macroeconomic indicators, with some variables such as NPF and FDR displaying high dispersion that may impact the distribution normality. These observations underscore the importance of conducting further diagnostic tests (e.g., normality, multicollinearity, and outlier checks) and, if necessary, applying transformations or robust

estimators in the regression analysis to ensure valid and reliable results..

Table 2. Descriptive Statistics

Variables	Mean	Sd. Dev.	Max	Min	Obs.
NPM	0.070916	0.075179	0.279544	0.003059	70
CAP	0.158767	0.086109	0.409470	0.062103	70
NPF	1.645571	1.650746	4.95	0.000000	70
FDR	85.90186	19.06155	196.7300	38.33	70
LnTAX	19.11498	4.584926	25.76456	10.41595	70
SIZE	25.24815	4.829234	31.04777	15.14537	70
GDP	10412463	1139617.	12301394	8564867.	70
INF	3.586	1.893934	8.36	1.68	70

Source: Authors processed, 2025

Correlation Matrix

Table 3 presents the correlation matrix among the independent and control variables used in the regression model. The results show that none of the pairwise correlation coefficients exceed the critical threshold of 0.80, suggesting that serious multicollinearity is unlikely to be present among the explanatory variables (Akasumbawa, Haryono, et al., 2024). Most correlations are weak to moderate in magnitude. For instance, the correlation between CAP and NPF is −0.456, indicating a moderate negative relationship, while FDR and NPF exhibit a positive correlation of 0.352, suggesting that higher default risk may be associated with increased liquidity utilization.

A notable exception is the relatively high correlation between SIZE and LnTAX (0.731), which, although still below the multicollinearity threshold, indicates a strong positive relationship. This suggests that larger banks may be subject to proportionally higher tax burdens, a relationship worth considering in the interpretation of regression results due to the possibility of partial redundancy between these variables. To further confirm the absence of multicollinearity, a Variance Inflation Factor (VIF) analysis was conducted. All VIF values were found to be below the commonly accepted threshold of 10, indicating that multicollinearity does not pose a significant threat to the validity of the regression estimates. This strengthens the confidence in using these variables together in the model. Overall, the correlation analysis supports the appropriateness of the selected variables and their inclusion in the econometric specification, while also highlighting the need to interpret closely related variables, such as SIZE and LnTAX, with caution.

Table 3. Correlation Matrix

	CAP	NPF	FDR	SIZE	LnTAX	COV	LnGDP	INF
CAP	1							
NPF	-0.456	1						
FDR	0.287	0.352	1					
SIZE	-0.485	0.065	-0.113	1				
LnTAX	-0.309	-0.081	-0.041	0.731	1			
COV	0.119	-0.211	-0.228	0.048	0.067	1		
LnGDP	0.138	-0.271	-0.286	0.056	0.051	0.759	1	
INF	-0.107	0.083	0.022	-0.026	-0.026	-0.29	-0.449	1

Source: Authors processed, 2025

Regression Result

Table 4 presents the results of the Generalized Least Squares (GLS) regression analysis used to examine the determinants of net profit margin (NPM) among Islamic banks in Indonesia. The GLS method effectively addresses issues of heteroskedasticity,

autocorrelation, and non-normality, ensuring reliable and efficient estimates (Gujarati, 2012; Wu et al., 2022). The model demonstrates strong explanatory power, as evidenced by the adjusted R-squared of 0.9886, indicating that approximately 98.86% of the variation in NPM is explained by the included variables. The F-statistic of 500.24 ($p < 0.01$) further confirms that the overall model is statistically significant and fits the data well.

Among the explanatory variables, Risk Aversion (CAP) is found to have a significant negative effect on NPM (coefficient = −0.0738; $p < 0.05$), implying that a 1% increase in capital ratio (a proxy for risk aversion) is associated with a 0.074 decline in profit margin, holding other factors constant. This suggests that while maintaining higher capital buffers may enhance stability, it can suppress profitability due to reduced leverage and risk-taking. Default Risk (NPF) has a positive but statistically insignificant effect on NPM ($p = 0.3321$), suggesting that variations in non-performing financing levels do not materially influence profitability within the observed sample. In contrast, Liquidity (FDR) exerts a significant positive impact on NPM (coefficient = 0.000190; $p < 0.01$), although the magnitude is minimal. This indicates that a better liquidity position slightly enhances profitability, possibly through improved intermediation capacity.

Operational Size (SIZE) is also positively and significantly associated with NPM (coefficient = 0.008979; $p < 0.01$), suggesting that larger banks benefit from economies of scale that can enhance profitability. Meanwhile, Taxation (LnTAX) does not exhibit a statistically significant relationship with NPM ($p = 0.5065$), possibly due to tax optimization strategies among banks or variability in tax exposure. Among control variables, Covid-19 (COV) has a significant negative impact on NPM (coefficient = −0.007459; $p < 0.01$), reinforcing the detrimental effect of the pandemic on Islamic banks' profitability. This likely reflects the contraction in financing activities, increased provisioning, and operational disruptions during the crisis period.

Table 4. Regression Result

Variables	Coefficient	t-Statistic	Probability
Constant	-0.152722***	-3.051659	0.0035
Risk Averse (CAP)	-0.073813**	-2.441375	0.0178
Default Risk (NPF)	0.000598	0.978299	0.3321
Liquidity (FDR)	0.000190***	6.182676	0.0000
Operational Size (SIZE)	0.008979***	4.276462	0.0001
Taxation (LnTAX)	-0.000295	-0.668491	0.5065
Covid-19 (COV)	-0.007459***	-3.686378	0.0005
F-Statistic (Prob)	500.2359***		0.0000
Adjusted R-Squared	0.988614		
Observation	70		

Note: ***$p < 0.01$, **$p < 0.05$, *$p < 0.10$

Source: Authors

DISCUSSION

Risk Averse in this study was found to have a negative impact on the Net Profit Margin of Islamic banks in Indonesia. Several factors can explain this negative relationship. Firstly, stringent capital requirements can increase risk aversion among banks, prompting them to raise their capitalization levels, which ultimately reduces the bank's margin (Abbas et al., 2019). Additionally, better-capitalized banks may face regulatory and market pressures to lower loan rates, which in turn can compress margins (Cruz-García & Fernández De Guevara, 2020). Furthermore, banks with stronger capital tend to take fewer risks and

offer more competitive interest rates to attract higher-quality customers, which also reduces margins. Literature suggests that such banks, with robust capital, may focus more on diversifying income sources and non-interest services, which lessens their reliance on operational income, thus reducing NPM (Saleh & Abu Afifa, 2020). These findings contradict Lestari et al. (2021), who observed a positive effect of equity capital on net margin in banks.

Default Risk, measured as the non-performing financing ratio, does not show a significant impact on NPM in Islamic banks in Indonesia in this study, though the relationship is positive. This suggests that an increase in default risk could lead to higher NPM. One theoretical explanation is that higher financing risk, driven by the volume of financing extended, may result in increased profitability (Do et al., 2020). However, the study found no significant effect, likely because effective risk management practices and cautious lending policies may neutralize the adverse impact of credit risk on bank margins (Stapah et al., 2018). This finding is consistent with Pham Hoang & Vo Thi Kim (2017), who argued that variations in financing risk do not significantly affect net margins in banks.

Liquidity was found to have a positive and significant impact on NPM in Islamic banks in Indonesia. A higher liquidity ratio indicates that banks are more efficient in meeting short-term obligations and utilizing depositors' funds for lending. This enhances the productivity of depositors' funds, leading to higher bank income, which, in turn, improves profit margins (Lestari et al., 2021). From a theoretical perspective, higher liquidity enables banks to maintain better relationships with customers and investors, thereby boosting market confidence, which positively impacts the margin (Saleh & Abu Afifa, 2020). These results align with Gazi, Nahiduzzaman, Harymawan, Masud, & Dhar (2022), who found liquidity to have a positive effect on bank profitability. However, this finding contradicts Lee & Isa (2017), who suggested that liquidity tends to reduce bank profitability.

Operational Size has a positive and significant effect on NPM, indicating that the larger the operational size of the bank, the greater the potential for an increase in NPM. The operational size reflects the scale of a bank, including financial aspects, resources, and other assets (Ram & Mesfin, 2019). Larger banks, with greater assets, are able to enhance asset productivity to generate higher profits, thus improving net margins. Furthermore, economies of scale allow larger banks to reduce operational costs per unit, enhance efficiency, and offer a broader range of products, all contributing to higher net margins (Saleh & Abu Afifa, 2020).

Tax, as a control variable, was found not to have a significant effect on NPM in Islamic banks. This can be explained by the argument that banks are able to pass on the tax burden to customers through adjustments in interest rates and service charges, thus diminishing the direct impact of tax burdens on margins (Mehzabin et al., 2023). While tax is an important factor in operational management, it appears to have minimal direct influence on the margin of Islamic banks in Indonesia. The COVID-19, also treated as a control variable, showed a negative impact on NPM in Islamic banks. The pandemic significantly disrupted economic activity, including through lockdowns, leading to a reduction in economic activity. This decreased demand for financing and heightened credit risk, while low interest rates further suppressed bank income, collectively compressing margins (Haris et al., 2024). These results are consistent with studies by Abbas et al. (2019); Chaudron, De Haan, & Hoeberichts (2020); and Gazi et al. (2022), which found that global crises such as COVID-19 can negatively impact bank net margin.

Overall, this study provides valuable insights into the factors influencing the Net Profit Margin of Islamic banks in Indonesia, with a focus on risk aversion, liquidity, default risk, and operational size. The findings suggest that risk aversion and liquidity have a significant impact on NPM, with stronger capital leading to lower margins, while higher liquidity ratios improve net margin bank. Interestingly, default risk does not show a significant effect, indicating that effective risk management can mitigate the potential negative impact of non-performing financing. The positive relationship between operational size and NPM further underscores the importance of scale in driving profitability. Additionally, the study highlights the minimal effect of tax on margins, suggesting that banks can pass on tax burdens to customers. Finally, the negative impact of COVID-19 on NPM emphasizes the vulnerability of Islamic banks to external shocks. Overall, this research contributes to the literature on Islamic banking by addressing an underexplored area in the context of developing countries and providing practical implications for enhancing profitability in the sector.

Robustness Test

Table 5 presents the results of the Robust Least Squares (RLS) estimation conducted using the MM-estimator method. This approach was chosen to validate the consistency and reliability of the Generalized Least Squares (GLS) results by reducing the influence of potential outliers and model misspecification. The rationale for applying the robust estimator is to ensure that the key findings remain stable and trustworthy, even in the presence of data anomalies or deviations from standard assumptions. Unlike GLS, which assumes homoscedasticity and normality of residuals, RLS with MM-estimator provides robustness against violations of these assumptions, making it suitable for verifying model robustness.

To statistically compare the models, we assessed measures such as the Adjusted R-Squared and F-statistic values. The RLS model exhibits an Adjusted R^2 of 0.9877 and an F-statistic of 428.94 ($p < 0.01$), indicating an excellent model fit that is consistent with the GLS results. Although GLS and RLS differ in estimation techniques, the similarity in coefficient signs, magnitude, and significance levels confirms the robustness of our main findings.

The robust regression results reaffirm that Liquidity (FDR) and Operational Size (SIZE) are significant positive drivers of the Net Profit Margin (NPM) in Indonesian Islamic banks. This highlights the importance of maintaining sufficient liquidity and scaling operational activities to enhance profitability. Conversely, Risk Aversion (CAP) negatively impacts NPM, reflecting the trade-off between conservative risk management and profit generation. Notably, Default Risk (NPF) is statistically insignificant in this model, suggesting that Islamic banks' unique risk-sharing frameworks may mitigate default-related impacts on profitability. These insights emphasize the necessity for balanced management strategies that consider liquidity, operational scale, and risk aversion to optimize Islamic banks' profitability.

Table 5. Robust Least Square Test

Variables	Coefficient	t-Statistic	Probability
Constant	0.390883**	2.532931	0.0141
Risk Averse (CAP)	-0.060522*	-1.994448	0.0510
Default Risk (NPF)	0.000168	0.274919	0.7844
Liquidity (FDR)	0.000186***	6.164601	0.0000
Operational Size (SIZE)	0.010316***	5.173063	0.0000

Variables	Coefficient	t-Statistic	Probability
Taxation (LnTAX)	-0.000538	-1.303577	0.1977
Economic Growth (LnGDP)	-0.035747***	-3.860851	0.0003
Inflation (INF)	0.000165	0.320858	0.7495
F-Statistic (Prob)	428.9410***		0.0000
Adjusted R-Squared	0.987749		
Observation	70		

Note: ***p < 0.01, **p < 0.05, *p < 0.10
Source: Authors processed, 2025

CONCLUSION

This study identifies key factors influencing the Net Profit Margin (NPM) of Islamic banks in Indonesia. The findings show that risk aversion (CAP) negatively affects profitability, while liquidity (FDR) and operational size (SIZE) have positive impacts. Meanwhile, default risk (NPF), inflation, and tax burden do not significantly affect NPM, whereas economic growth and the COVID-19 pandemic negatively influence it. These results suggest that Islamic banks should balance capital adequacy with efficient capital deployment, optimize liquidity management, and scale operations to improve profitability. Furthermore, effective risk management and pricing strategies appear to mitigate potential negative effects from default risk and taxation.

The negative impact of economic growth and COVID-19 highlights challenges from increased competition and external shocks, emphasizing the importance of enhancing operational efficiency, service differentiation, income diversification, and digital transformation. This study offers practical guidance for bank managers to improve financial performance and for policymakers to support a regulatory environment that fosters both stability and profitability. Future research is recommended to apply advanced econometric methods to address endogeneity, explore additional risk management dimensions, and expand analysis to cross-country comparisons or specific Islamic banking sectors for deeper insights.

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