

## **ABSTRACT**

*Islamic banking faces considerable challenges to maintain the existence of its business. OJK data in October 2017 shows that Islamic banking only has a market share below 6% of the total banking industry in Indonesia. Although sharia commercial banks and sharia business units show a significant increase in assets of 856% in the 2008-2017 period, this amount is still very small compared to conventional commercial bank assets. Performance indicators and profitability such as Return on Assets (ROA), Net Operating Margin (NOM), and the ratio of Operational Costs to Operating Income (BOPO) are still lagging behind conventional commercial banks.*

*This study aims to analyze the profit efficiency and cost efficiency of Islamic banks, and measure its effect on the level of profitability in Islamic banks in Indonesia. By using a sample of 11 Islamic Commercial Banks in the 2011-2017 period, this research was conducted through 2 stages. The first stage is to measure the level of profit efficiency and the level of cost efficiency using the parametric Stochastic Frontier Analysis (SFA) method which regresses 3 input variables, namely the price of funds, price of labour and price of physical capital; 3 output variables, namely channeled loans, securities, and other operating income; and 2 environmental variables namely inflation rate and equity. In the second stage, the effect of profit efficiency and cost efficiency variables on the ROA profitability ratio variable using the Ordinary Least Square (OLS) regression method and several tests such as the descriptive statistical test and the classic test are measured.*

*From the results of the study, Bank Panin Syariah at the highest position (55.16%) and Maybank Syariah Bank at the lowest position (0.43%) in profit efficiency, while Mega Syariah Bank at the highest position (97.71%) and Bank Jabar Banten Syariah at the lowest position (71.60%) in cost efficiency. Variable price of labour, other incomes, and equity have a significant positive effect, while the price of funds, price of physical capital, securities have a significant negative effect on profit efficiency. Variable price of labour, price of funds, prices of physical capital, channeled loans, securities, other income, and equity have a significant positive effect on cost efficiency. Furthermore, the profit efficiency variable and cost efficiency have no significant effect on the level of profitability of Islamic banks.*

*Keywords: Efficiency, Profitability, Stochastic Frontier Analysis (SFA), Islamic Bank, Input, Output, Environment, Return on Asset*