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ISLAMIC BANKING CAPITAL CHALLENGES TO INCREASE BUSINESS EXPANSION (INDONESIA CASES)

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Abstract

In the case of Indonesia regarding capital sources in Islamic Banks, all Islamic Banks are subsidiaries of Conventional Banks (except Bank Muamalat). Bank Syariah Mandiri which is the only Islamic Bank that meets capital ownership with Business Category Bank Level III (BUKU III) is also a subsidiary of Bank Mandiri (conventional bank). In the same way, conventional banks become essential to meet the capital requirement to improve the business of Islamic Bank. This article aims to determine the role of capital and operating profit for business expansion (financing) in Bank Syariah Mandiri. The method used is the quantitative method by using statistical tool STATA version 13. The result of regression test is known that capital and profit have a significant influence in increasing financing expansion in Islamic Bank. Also, the price of the number of bad debts causes the lack of public confidence in the Islamic bank. The alternative to increasing the capital and public trust is government policies to support Islamic bank become independent.

Keywords: *Capital, Profit, Business Expansion, Non-Performing Financing, Government Policies*

1. Introduction

Islamic banks in Indonesia should be the locomotive of development and national economic growth because of Indonesia as a country with the largest population in the world and as the Muslim majority country. The existence of Islamic banking as a solution of the existing economic system is expected to contribute positively to the maslahat ummah (Sukmadilaga & Nugroho, 2017; Shidiq, 2017; Arafat and Nugroho, 2016; Nugroho, 2014).

The welfare of the ummah is the implementation of the maqhasid shariah (Prastowo, 2015) that consists of several elements namely keeping the religion, keeping the soul, keeping the mind, keeping the descendants, keeping the property, and keeping the environment. Therefore maqhasid sharia has similarity regarding the purpose with the sustainability principles triple bottom line (profit, people, and the planet) but beyond of it because the maqhasid sharia laws are also ensuring all activity achieve not only the world objectives but also achieve hereafter objectives. Moreover, Islam is a way of life (Bilal, 1999) including business transactions activities that require the Muslims use Islamic Bank. Furthermore, according to (Febianto & Kasri, 2007) the general principles of Islamic banking is anti maghrib (maysir, gharar, and riba) which is considered to be the limitation of greedy human nature (Masyita, 2015). Based on these matters, the primary role of Islamic banking in the economy is to prevent the occurrence of injustice, equal distribution of income, and gender equality (Permana & Purba, 2008). Moreover, according to Dhumale and Sapcanin (1998) Islamic banking has the goal not only to achieve the goal in the world but also to reach the purpose of the hereafter. Furthermore, the Islamic banking system is one of the implementation aspects of the Islamic life view that aims not only to achieve profit but also achieve social performance. According to Setiawan (2006), the objectives and critical functions of the Islamic banking system are as follows:

- Socio-economic justice and equitable distribution of income and wealth;
- Create a stability of the value of money (means of exchange) aimed at making it a reliable unit of accounting, as a fair standard of payment and as a stable store value (stability in the value of money);
- Mobilize savings funds in the form of economic development investments by using specific means to ensure that interested parties get a fair share of returns (mobilization of savings);
- Providing adequate services for all financial services contained in the banking system (sufficient other financial services).

In the opinion of some shariah banking experts, some of the main issues of Islamic banking in expanding financing are insufficient capital, transaction complexity and unavailability of adequate reserve losses (Vogel 1997; Iqbal & Mirakhor 1999). The same thing was also expressed by Abdul-Gafoor (2003), Alam (2000) and Haron (1995) that the operation of Islamic banking is very dependent on the capital paid by shareholders and also from third-party funds collected from savers. The phenomenon of Islamic banking business expansion in Indonesia in the last 5 (five) years has decreased growth. The primary indicator of the decline in an expansion of Islamic banking business is shown by the drop in asset growth from 2011 to 2016 with the following data:

Table 1. Asset Growth Analysis with
Compound Annual Growth Rate (CAGR) Method

	CAGR	CAGR
	2006-2011	2011-2016
Islamic Bank Asset Growth	**40,34%**	**16,20%**

Source: Indonesian Islamic Banking Statistics Data that have been processed

The current BUS number is 13 which consists of:

1. Bank Muamalat;
2. Bank Syariah Mandiri (BSM);
3. Bank Rakyat Indonesia Syariah (BRIS);
4. Bank Negara Indonesia Syariah (BNIS);
5. Mega Syariah;
6. Panin Syariah;
7. BCA Syariah;
8. Victoria Syariah;
9. Bukopin Syariah;
10. Maybank Syariah;

11. BJB Syariah;
12. BTPN Syariah;
13. BPD Aceh.

Based on the above list of banks only Bank Muamalat stand-alone, while the 12 (twelve) other banks owned by the holding company's parent bank which is also a conventional bank. Therefore, the 12 (twelve) banks will be highly dependent on their capital stock from shareholders. Bank Syariah Mandiri as an Islamic bank with the most extensive financing portfolio in Islamic banking industry or 22.41% of total financing portfolio has a significant impact on Islamic banking sector. Based on this, the object of this research is the expansion of financing from Bank Syariah Mandiri. Regarding Nugroho et al. (2017), the existence of Islamic Bank in Indonesia not yet got full support from the government than the presence of conventional Bank because of until now there isn't Islamic bank that directly owned by the government (state own Islamic bank) therefore government intervention in public policy crucial.

2. Literature Review

The Islamic banking system has proven itself to be a terrible system through the monetary and banking crisis in Indonesia. The excellence of Islamic banks is to channel their financing to the real sector. The background of the establishment of Islamic banks in Indonesia by Antonio (2001) is inseparable from the influence of the development of Islamic banks in Islamic countries. In the early 1980s, discussions on Islamic banks as pillars of Islamic economics began. The figures involved in the study were Karnaen A. Perwataatmadja, M. Dawam Rahardjo, A.M. Saefudin, M. Amien Rais and others. Several trials on a limited scale have been realized. Among them is Baitut Tamwil-Salman, Bandung which had grown impressive. In Jakarta also established similar institutions in the form of cooperatives, namely Cooperative Ridho Gusti.

However, more individual initiatives to establish Islamic banks in Indonesia were only made in 1990. The Indonesian Ulema Council (MUI) on 18-20 August 1990 held workshops related to bank interest in Cisarua, Bogor, West Java. The results of the workshop were discussed more deeply in the National Conference (Munas) IV Majelis Ulama Indonesia which took place at Sahid Jaya Hotel Jakarta, 22-25 August 1990. Based on the mandate of National Assembly IV of the Majelis Ulama Indonesia, a working group was formed to study the establishment of an Islamic bank in Indonesia. The established working group is called the MUI Banking Team in charge of approaching and consulting with all related parties in developing an Islamic bank. The result, in November 1991 signed the establishment of PT. Bank Muamalat Indonesia (BMI) which began operation in May 1992 whose activities are based on Law No. 7 year1992 and PP No.72 year 1992.

Antonio (2001) said that Bank Syariah Mandiri (BSM) is the first government-owned bank to base its operations on sharia principles. Structurally BSM is derived from Bank Susila Bakti (BSB), as one of the subsidiaries in the scope of Bank Mandiri (ex.BDN) which is then converted into a full Islamic bank. To launch the conversion process into an Islamic bank, BSM cooperates with Tazkia Institute, especially in the field of training and conversion assistance. As one bank owned by Bank Mandiri which has hundreds of trillions of assets and networking so broad that BSM has some comparative advantage compared to its predecessor BMI. Cihak and Hesse (2010) in his research on all shariah banks across the country concluded that:

- Islamic banks that have a small business scale financially will be stronger than conventional banks with small business sizes;
- Conventional banks with large enterprise scale will be economically stronger than Islamic banks with large business scale.

The concluded in line with previous research of Shaban et al. (2014), and Aysan et al. (2016) that founded Islamic Bank focuses in the retail segment in another word tends to serve micro and small clients segments. Related to the

Regulation of the Financial Services Authority No. 6/POJK.03/2016, concerning Business Activities and Office Networks Based on the Bank's Core Capital:

- BUKU I is a Bank with a Core Capital up to less than Rp1,000,000,000,000, - (one trillion rupiah);
- BUKU II is a Bank with a Core Capital of at least Rp1,000,000,000,000, - (one trillion rupiah) up to less than Rp5,000,000,000,000,- (five trillion rupiahs);
- BUKU III is a Bank with a Core Capital of at least Rp 5,000,000,000,000, - (five trillion rupiahs) up to less than Rp30,000,000,000,000,- (thirty trillion rupiahs); And
- BUKU IV is a Bank with a Core Capital of at least Rp 30,000,000,000,000,- (thirty trillion rupiah).

Based on the regulation and classification of Core Capital, there are some limitation bank business activities, higher the classification such as BUKU IV. Therefore the bank permitted to conduct all banking activities both in rupiah and in foreign currency and capital participation in financial institutions in Indonesia and/or all regions abroad with more significant amount than BUKU III such as fundraising, fund disbursement, trade finance, treasury activities, foreign exchange activities, agency activities and cooperation, payment system and electronic banking activities, equity participation activities, temporary equity participation activities in the context of rescue credit, other services and other activities commonly performed by the Bank as long as it is not incompatible with regulations and legislation. Therefore the expansion business of Islamic bank has not been able to compete with conventional banks that have the capital category in BUKU IV because of the biggest Islamic Bank in Indonesia only appropriate in BUKU III classification. Several previous studies have suggested that bank capital has a significant relationship with the distribution of financing (Voutsinas and Werner, 2011; Becker and Ivashina, 2014), the capital requirement is primarily determined by the volume of financing distribution and the segment focus of the Bank's financing portfolio.

Several previous studies have stated that bank capital has a significant relationship with the distribution of loans to banks (Voutsinas and Werner, 2011; Becker and Ivashina, 2014). Each bank has different internal policies over capital requirements determined by the volume of financing disbursement and the focus of the Bank's financing segment. Moreover, according to Ashraf & Cheng (2015) increased profits of the Bank's lending business, the larger the size of the company the more likely it is for a company to generate profits to improve the company's ability to grow its business (Fama & French 2001)

3. Methodology

The research method used is a quantitative method with multiple regression test techniques and using statistical tools Stata version 13. The equation formula used is:

$$\mathbf{Y = B0 + B1\,X1 + B2\,X2 + E}$$

Where:

Y = Bank Syariah Mandiri financing expansion (BSM)

Bo = Coefficient

X1 = Equity or Capital

X2 = Net Profit

E = Error

The sample used in this research is the distribution of financing, equity and Net Profit of Bank Syariah Mandiri in 12 (twelve) years since 2005 until 2016.

Table 2. Distribution of Financing, Equity and Net Profit of BSM 2005-2016

Billion Rp

Year	Equity	Profit	Financing
2005	632	17	5.847
2006	697	65	7.412
2007	811	115	10.297
2008	1.208	196	13.241
2009	1.600	290	15.979
2010	2.020	418	23.968
2011	3.073	551	36.727
2012	4.180	805	44.755
2013	4.861	651	50.460
2014	4.937	(45)	49.133
2015	5.613	290	51.089
2016	7.221	325	55.580

Source: Annual Report of Bank Syariah Mandiri

Further discussion of this research will be limited by some research questions consisting of:

- What is the role of capital and profit on financing expansion?
- What are the challenges of Islamic banks to increase business expansion?

4. Discussion And Findings

4.1. Role of Capital and Profit on Financing Expansion

Capital in Islamic banking is sourced from equity participation and undistributed profits. According to Holmstrom and Tirole (1997), capital increase will affect the growth in financing volume that similar with research results from practitioners and experts who argue that increased capital will create financial stability at the Bank and become agile in its expansion (Oliveira-Santos, Andre & Elliott, 2012; Hanson et al. 2011). Furthermore, to know the role of capital and profit to financing expansion in BSM, then used multiple regression statistical tests with tool statistic Stata version 13 with the result as follows:

The explanation of the results of multiple regression statistics test above is as follows:

- Number of obs = 12, which means the sample used in this observation amounts to 12 samples;
- F (2, 9), shows the F test on DF 2 and 9, DF 2 means the number of tested variables is reduced by 1, i.e., 3-1 = 2. Whereas 9 is the number of observations, i.e., the total number of samples is reduced by all 12-3 = 9;
- R-Squared is the coefficient of multiple determinations, which means how much simultaneously all independent variables can explain the dependent variable. Above the value of 0.9673 which means all the independent variables can explain the dependent variable of 96.63%. Therefore the remaining 100% - 96.73% = 3.27% influenced by other variables outside the regression model;

Table 3. Statistical Test Results of Stata Multiple Regression Version 13

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. regress Financing Equity Profit, beta

      Source |       SS       df       MS              Number of obs =      12
-------------+------------------------------           F(  2,     9) =  133.32
       Model |  4.0055e+09     2  2.0027e+09           Prob > F      =  0.0000
    Residual |   135194972     9  15021663.6           R-squared     =  0.9673
-------------+------------------------------           Adj R-squared =  0.9601
       Total |  4.1407e+09    11   376425505           Root MSE      =  3875.8

------------------------------------------------------------------------------
   Financing |      Coef.   Std. Err.      t    P>|t|                     Beta
-------------+----------------------------------------------------------------
      Equity |   7.804682   .5763414    13.54   0.000                 .8997575
      Profit |   13.19692   5.165285     2.55   0.031                 .1697572
       _cons |   2231.645   2147.497     1.04   0.326                        .
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- In the column, t is a partial t-test value. It is said to be significant at 5% level if in the right column is P> [t] or also called p-value / significance <0,05. So that variable of capital has positive and significant effect to the expansion of financing, as well as profit variable, have the positive and significant effect on financing;
- In the Coef column is the Unstandardized Coefficient Beta value. The value of this beta coefficient is used as the value in the regression equation. Based on the above results, then the regression equation made is: Y = 2231,645 + 7,805 X1 + 13,197 X2 + e. Where Y is the dependent variable, 2231,645 are constants, X1 equity variables, X2 profit variables, and e are errors.

Based on the results of data processing above, the value of regression coefficients on the independent variables describes if the estimated independent variables rise by one unit, and the value of other independent variables is determined to be constant or equal to zero, then the value of the dependent variable is expected to rise or may fall in accordance with the sign Regression coefficient of independent variables. Base multiple linear regression equations above obtained constant value equal to 2231,645. That is if the variable of Financing Expansion (Y) is not influenced by the two independent variables that are Equity (X1) and Profit (X2) is zero, then the amount of financing expansion is Rp2,231,645 Billion. The sign of the independent variable regression coefficient shows the direction of the relationship of the variables concerned with the Equity. The regression coefficient for the independent variable X1 is positive, indicating a direct correlation between Equity and Expansion (Y). The regression coefficient of variable X1 of 7,805 means that every increase of Equity (X1) of one unit will cause the growth of financing Expansion (Y) of Rp7,805 Billion. The regression coefficient for the independent variable X2 is positive, indicating a direct relationship between Profit (X2) and Expansion Financing (Y). The regression coefficient of X2 variable of 13,197 means for each increase of Profit (X2) of one unit will cause the growth of financing Expansion (Y) of Rp13,197 Billion.

4.2. Challenges of Islamic Banks to Increase Financing Expansion

The effort to increase the current Islamic Bank capital depends heavily on the shareholder policy which is also as a conventional bank with the same core business and services as its subsidiary, the Islamic Bank. While competition between conventional banking with Islamic banking in expanding financing is still in the same market, so it is somewhat tricky for Islamic banking with the current condition as a subsidiary of the conventional bank to get the flexibility of capital. Besides, the higher the capital owned, it also affects the increased ability of the Bank in absorbing the potential risks that occur, as known today NPF Islamic banking financing is higher than the NPF in conventional banks as shown in Table 4:

Table 4. NPF Comparison Islamic Bank Financing with Conventional Bank Financing NPF

	2012	2013	2014	2015	2016
NPF/NPL of Islamic Bank	2,22%	2,62%	4,33%	4,34%	4,16%
NPF/NPL of Conventional Bank	1,85%	1,72%	2,04%	2,38%	2,85%

Source: Indonesian Islamic Banking Statistics Data that have been processed

The increasing number of Islamic banking NPF caused profit generated by Islamic banking to fall. The declining profit from Islamic banking has resulted in reduced ability to expand. Even with the increasing number of NPF or non-performing financing has resulted in lower public trust (owner of funds) to place their funds in Islamic Banks.

Currently, from 13 BUS, only 1 (one) shariah bank is included in the category of BUKU III (three), namely BSM. Therefore, if Islamic banking industry competes with conventional banking that already has 5 (five) banks included in the category BUKU IV (four) will give impact Islamic banking will be far behind. Banks with BUKU IV category can conduct their business activities more freely, either from network expansion, financing expansion, collecting third-party funds, innovating products and services such as digital banking.

To be able to compete with conventional banking, Shariah banking should stand alone, not as a subsidiary to increase the flexibility to get capital. Currently, the Financial Services Authority (OJK) recommends that Islamic banks can perform corporate actions to seek money, either through Initial Public Offering (IPO), seeking strategic partners or investors and issuing Sukuk. Some of these alternatives can be pursued by Islamic banking that is tailored to the internal capabilities and business prospects to come.

Also, the planned merger of Islamic banks can also be used as an alternative to increasing Islamic banking capital. According to Gupitasari, et al. (2016) in his study related to the incorporation of Islamic banking from the juridical aspect is permission so that the current or not the merger is dependent on government policy. Also, according to Yudistira (2004) said the merger of Islamic banks could also increase efficiency. Nevertheless, according to Nugroho, et al. ([a]2017) the merger action become establish state own Islamic Bank is going to provide maslahah to the community and as the implementation of Islamic law in totality (kaffah).

5. Conclusion and Recommendation

5.1. Conclusion

The strength of capital and profit generated by Islamic banking significantly influences the expansion of financing. Therefore, the Islamic bank structure which under supervised from the conventional bank as the parent's company should be separated. The objectives of segregated Islamic Bank from the parent's company that also as conventional bank are:

- Eliminating dependency of Islamic Bank capital from conventional;
- avoid violations of Shari'ah compliance because the source of capital comes from a conventional bank which can not be guaranteed halal;
- Providing flexibility of sharia banks in running their business to accelerate the expansion of its business.

Nevertheless, the policy intervention from government very urgent to implement this corporate action because of the status of the conventional bank is state own company. Determine of public policy should be base on the need of the Muslim community in term doing their thought in totality (kaffah) and the Islamic bank existence not only for giving beneficiaries to the Moslem but also for all community because of the Sharia principles presence to provide the advantage to all people (rahmatanlilalamin). Nevertheless, the high level of problem financing also resulted in lower public trust on Islamic Bank because of the impact is decreasing the profit. The profit for the company has a role in empowering the Islamic Bank to increase the business thus the Islamic Bank needs the professional team to manage the operation also the consciousness of the community either that debts must be pay off. There are 3 (three) aspects that must be improved by Islamic banks to be able to compete are the quality of human capital, a simple organization and a qualified information technology (IT).

Besides, the tight banking competition in Indonesia requires all banks to be able to run their activities efficiently. This condition causes banks to apply the principle of prudentiality and carefully in channeling their financing to segments that have good prospects for the future. The selection of prospect segment main is to avoid rising problematic financing that will lead to high capital needs of a bank to cover the bad debt, if The bad debt in bank increases will undoubtedly be coupled with policies to reduce the supply of financing. There is an alternative for Islamic banks to improve competitiveness by increasing the scale of their business through mergers so that competitiveness and profitability ability can enhance (Nugroho et al., [b]2017).

Results give us confidence that it is socially beneficial to change legislation and attract non-residents to establish private foundations in a country to address their business and wealth succession issues.

5.2. Recommendation

The dependence of Islamic banks is related to the increase of capital to the parent company; namely conventional banks become a challenge for the government to be able to take decisions related to the planned merger of Islamic banks under state-owned banks. The policy should also consider that the contribution of Islamic banking with its Sharia principles can provide benefits to the community.

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