SHARIA BANKING IN INDONESIA: WHAT WENT WRONG?

Hery Syafril
Wiwiek Mardawiyah Daryanto

ABSTRACT

As the largest Moslem country in the world, Indonesia should have been the perfect place for Sharia Banking. With full support from: 1) the Central Bank and 2) the Financial Authority Services, Sharia Bank in Indonesia growth in number from only one full flag Sharia Bank in 1992 to fourteen Sharia Banks and twenty Sharia Business Units in 2019. However, the market share of Sharia Banking is still below six percent of total banking industry. This study aims to analyze and evaluate the financial soundness of the two largest Sharia Banks in Indonesia: 1) Bank Sharia Mandiri (BSM) and 2) Bank Muamalat Indonesia (BMI) for the periods of 2014 -2018. The results of investigating of selected financial ratios: 1) Capital Adequacy Ratio (CAR), 2) Non-Performing Financing Ratio (NPF), 3) Cost Income Ratio (BOPO), 4) Return on Asset (ROA), 5) Financing Deposit Ratio (FDR), and then the result is compared with the performance of the two largest Conventional Banks: Bank Rakyat Indonesia (BRI) and Bank Central Asia (BCA) to conclude the weakness points of BSM and BMI. The result shows that the performances of BSM and BMI were far below the two largest Conventional Banks, BRI and BCA. The main drivers of the low performances were limited Capital, high NPF, high BOPO which at the end resulted low Return on Assets (ROA) of BSM and BMI.

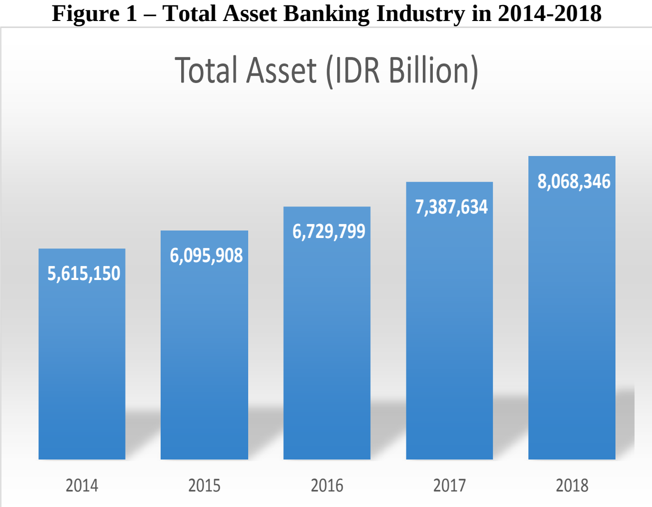
Key words: Sharia Bank, CAMEL, Bank soundness

A. INTRODUCTION

Indonesia is the world's 4th most populous country as well as the most populous Moslem-majority country. Badan Pusat Statistik (BPS) or Indonesia Central Bureau of Statistic (2019) estimated that total population Indonesia by the end of 2019 will be around 268 million. And approximately 87 percent of them are Moslem (Wikipedia-The Indonesian Census 2010). With a Gross Domestic Product (GDP) of USD 1,042.17 billion in 2018, Indonesia is one of the important members of G20. In average GDP Annual Growth Rate of Indonesia average was 5.27 percent from 2000 until the third quarter of 2019, reaching an all-time the highest of 7.16% in the fourth quarter of 2004, and a record of lowest of 1.56% in the fourth quarter of 2001. Various reputable consultants have been predicted Indonesia will become the key player in the global economic in coming years. One of the significant reports produced by McKinsey Global Institute in 2012, “The archipelago economy: Unleashing Indonesia’s potential”. McKinsey predicted Indonesian economy is the 7th largest economy in the world by 2030.

In line with economic growth as shown in Figure 1, Indonesian Banking industry also showed a steady growth. The average growth of the Total Asset of Commercial Banking in Indonesia during the period of 2014-2018 was ten percent. Total Asset in 2018 was IDR 8,068,346 billion, the growth was approximately 44% compared to IDR 5,615,150 billion in 2014. Number of commercial banks in Indonesia in 2018 was 115 units, includes 14 full flag Sharia Bankings.

Figure 1 – Total Asset Banking Industry in 2014-2018



Source: Indonesia Financial Authority Services, Otoritas Jasa Keuangan - Statistic Data, 2018

The asset size of Sharia Banking in Indonesia as of December 2018 was still below six percent of the total asset Banking Industry. While other countries such as Saudi Arabia and Malaysia has a significant of size market share of Sharia Banking. This reality was also reflected in the Islamic Finance Factsheet in 2016 produced by ICD-Thompson Reuters. In 2016 total Sharia Banking Assets in Indonesia was only USD 20,081 million or 1.4% of the total global market assets of USD 1,451,087 million.

In compare with Saudi Arabia and Malaysia Sharia Banking Assets size was USD350,128 and USD159,986 or 24.1% and 11% of total Global market respectively in 2016.

1. SHARIA BANKING IN INDONESIA HISTORY AND DEVELOPMENT

The First Sharia Banking in Indonesia is Bank Muamalat Indonesia (BMI). BMI was established in November 1991 and started its operating in April 1992. The Sharia Banking in Indonesia was introduced without complete regulation and infrastructure at that time. The main reference at that time was Banking Law 1992 (UU 7/92) which amended in 1998 (UU 10/98). Sharia Banking Law was introduced only in 2008 (UU 21/2008).

Sharia Banking in Indonesia has been the center of attention in recent years. The Central Bank or *Bank Indonesia* (BI) and Financial Authority Services, or *Otoritas Jasa Keuangan* (OJK) have provided full support to the development of Sharia Banking in Indonesia. In 2008, Bank Indonesia released a Grand Strategy of Islamic Banking Market Development. Key strategies were defined into three phases. The first phase was to build understanding of Islamic Banking and Beyond Banking with specific asset target of IDR 50 trillion and growth rate of 40% in 2018. The second phase was to make Indonesian Islamic Banking as the most attractive Islamic Banking in ASEAN in 2019. The target asset for the second phase was IDR 87 trillion with growth rate of 75% by 2019. The third phase was to make Indonesian Islamic Banking as the leading Islamic Banking in ASEAN in 2010. The target asset of the third phase was IDR 124 trillion with growth rate of 81%.

The impact of the implementation of those strategies showed a positive result whereby the number of Sharia Bank increased from three full flag banks at the beginning of 2008 became 11 banks by the end of 2010, or almost quadruple growth. The total asset of Sharia Bank by the end 2010 was IDR 98 trillion, which was lower than the initial target of IDR 124 trillion.

The OJK in 2015 released Indonesian Sharia Banking Roadmap 2015-2019, a five year strategic plan to support the development of Sharia Banking. This was a comprehensive plan which includes detail action plan to be executed by stakeholders of Sharia Banking during 2015-2019. Most of the plans were to increase quality of the Sharia Banking industry. There was no specific target asset growth in the roadmap. One of key plans in the roadmap was the establishment of the National Committee for Sharia Finance, or *Komite Nasional Keuangan Syariah* (KNKS).

In year of 2016 President Joko Widodo formed KNKS thru President Regulation number 91/2016. The main duty of KNKS is to accelerate, expand and advance Sharia Finance development in order to support national economic development. There are four main functions of KNKS:

1. Providing recommendation of policy direction and strategic program of national development in Sharia finance sector.
2. Coordinating the preparation and implementation of the plan for Policy direction and strategic program in the sharia financial sector.
3. Formulation and recommendation of problem solving in Sharia finance sector.
4. Monitoring and evaluation on the implementation of strategic direction of policies and programmed in the sharia finance sector.

As of 31 December 2018, the complete list of full flag Sharia Bank in Indonesia is shown in the Table 1.

Table 1 – List of Sharia Banks in Indonesia 2018

No	Sharia Bank	Year Of Establishment
1	PT. Bank Muamalat Indonesia	1991
2	PT. Bank Syariah Mandiri	1999
3	PT. Bank Mega Syariah	2004
4	PT. Bank BRISyariah	2008
5	PT. Bank Panin Dubai Syariah	2009
6	PT. Bank Syariah Bukopin	2009
7	PT. Bank BNI Syariah	2010
8	PT. Bank Jabar Banten Syariah	2010
9	PT. Bank Victoria Syariah	2010
10	PT. BCA Syariah	2010
11	PT. Maybank Syariah Indonesia	2010
12	PT. Bank Tabungan Pensiunan Nasional Syariah	2014
13	PT. Bank Aceh Syariah	2016
14	PT BPD Nusa Tenggara Barat Syariah	2017

Source: OJK Statistic Data 2018

2. PREVIOUS RESEARCH ON BANK SOUNDNESS

Banking industry is one of the most attractive industries for global scholars and there are many research and analysis about it (J.A. Bikker, K. Haaf, 2002; N Cetorelli, 1999; EL Yeyati, A Micco, 2007). There is strong evidence that the banking markets in the industrial world are characterised by monopolistic competition, where competition is stronger for large banks (which operate more in international markets) and weaker for small banks (which operate more on local markets) (J.A. Bikker, K. Haaf , 2002). A small number of large firms may be able to cooperate and act as a monopoly (cartel). National banks may be seen as imperfect substitutes of foreign branches or subsidiaries, because of actual differences in their menu of products as well as in terms of the value of the brand name and the perception of an implicit insurance provided by their parents (EL Yeyati, A Micco, 2007). Alternatively, one or more firms together may be large enough to set higher than competitive prices (acting as a dominant firm), while the other (smaller) firms would act as a competitive fringe, following the dominant firms' behaviour (N Cetorelli, 1999).

Financial healthiness in banking industry is widely known as Bank soundness. The growth and financial stability of the country depends on the financial soundness of its banking sector (M Altan, H Yusufazari, A Bedük , 2014). A Demirguc-Kunt, E Detragiache, T Tressel, 2006 (AET) defined three set control of variables which affected banks soundness; (1) financial strength: size, measured by the logarithm of bank assets; profitability, measured alternatively as return on assets or return on equity; and capitalization, measured by the ratio of equity to total assets, ratio of bank loans to total assets and the ratio of deposit to total liabilities to control for the type of intermediation and funding sources; (2) The overall quality of the institutions; (3) The macroeconomic outlook. Bank soundness is the result of qualitative assessment of various aspects that affect the condition or performance of the bank thru assessment of financial factors and factors management (Bank Indonesia Circular Letter No.9/24/DPbS/2007 re Sharia Bank Assessment System).

Lending (credit) and funding (deposit) activity is the main business activity in banking industry. Rapid credit growth tend to weakened banks and it has significant impact during financial crisis (D Igan, M Pinheiro, 2011). To anticipate Bank's financial deterioration, procedures have been developed to identify banks approaching financial distress (D Gasbarro, IGM Sadguna, JK Zumwalt, 2002). These procedures, though varying from country-to country, are designed to generate financial soundness ratings and are commonly referred to as the CAMEL rating system. This rating system is made up of five components: capital adequacy, asset quality, management competence, earnings, and liquidity with the associated acronym (D Gasbarro, IGM Sadguna, JK Zumwalt, 2002).

CAMEL created in 1979 in USA by the bank regulatory agencies, and afterwards its use extended, being consider a useful tool for the supervisor authorities from different countries in order to assess the soundness of the financial institutions (A Roman, AC Sargu, 2013). Numerous prior studies have examined the efficacy of CAMEL ratings and they generally conclude that publicly available data combined with regulatory CAMEL ratings can identify and/or predict problem or failed banks (D Gasbarro, IGM Sadguna, JK Zumwalt, 2002). The results show that the factors, Capital Adequacy, Quality Management and Asset Quality are the most important issues of Iranian banks in banking soundness management (M Bastan, MB Mazraeh, AM Ahmadvand, 2016). Based on coefficient correlation calculation among financial ratios in the CAMEL components, it revealed that between ROA and BOPO has strong negative correlation (Susanti, YF & Daryanto, WM, 2017). Daryanto, WM & Arrifai, MA (2019) using multivariate regression in proving that there was significant indication that Non-Performing Loan affected ROA performances.

RESEARCH METHODS

This study aims to analyze key financial ratios of BMI and BSM, the two largest Sharia Bank in Indonesia. Then the results will be compared with the financial ratios of two largest Conventional Banks, BRI and BCA. Period of coverage is 5 (five) years from 2014-2018. The main research methodology used in this study is financial performance assessment based on CAMEL method. The five components of CAMEL are Capital (C), Asset Quality (A), Management (M), Earning (E), and Liquidity (L). The regulatory reference being use in assessed the financial soundness are: Bank Indonesia Circular Letter No.9/24/DPbS/2007 re Sharia Bank Assessment System.

1. CAPITAL ADEQUACY

Capital Adequacy Ratio (CAR) is used to assess capital element. In this ratio, bank's capital (tier 1 and tier 2) is compared to bank's percentage of risk weight credit exposures. The higher the percentage of CAR, the better for a bank. It shows that the bank has a strong capital base and that bank can absorb a reasonable level of losses before becoming insolvent. Higher CAR also allowing the bank to continue growing their business i.e. provide financing to debtors. Based on circular letter of Bank Indonesia No. 9/24/DPbS/2007, bank has to have maintain minimum CAR of 8%-9%.

$$Capital\ Adequacy\ Ratio = \frac{Tier\ 1\ Capital + Tier\ 2\ Capital}{Risk\ Weighted\ Assets}$$

Based on the formula of CAR calculation there two key parameters, capital and risks weighted assets. Capital key factor is Tier 1 Capital, which consist of Paid-Up Capital and Accumulated Retained Earnings. Paid Up Capital is representing investment made by the shareholders, while Accumulated Retained Earnings is the accumulation profit or loss made by the bank from the inception till last fiscal year.

Table 2 - CAR Rating Criteria

Rank	Criteria	Category
1	CAR ≥ 12%	Very Good
2	9% ≤ CAR ≤ 12%	Good
3	8% ≤ CAR ≤ 9%	Acceptable
4	6% ≤ CAR ≤ 8 %	Poor
5	CAR ≤ 6 %	Very Poor

Source: Bank Indonesia Circular Letter No.9/24/DPbS/2007

2. ASSET QUALITY

Asset (financing) quality is defined based on analysis of three assessment factors namely business prospects, performance of debtor, and ability to pay. (Bank Indonesia Circular Letter No.15/28/DPNP/2013 re Asset Quality Assessment for Commercial Bank). BI has define five category of Asset Quality: Current, Special Mention, Substandard, Doubtful and Loss (SE No.15/28/DPNP/2013). Non-Performing Financing (NPF) is financing that fall under category classified as Substandard, Doubtful and Loss. NPF ratio is use to assess as set quality element. In this ratio, bank's total NPF is compare to total financing. The higher number of NPF ratio, shows that the higher number of bad quality financing of that bank. NPF ratio shows how a bank manage and distribute it financing. Based on circular letter of Central Bank of Indonesia No. 9/24/DPbS/2007, every bank has to maintain NPF Gross ratio maximum between 5%-8%.

$$NPF\ Gross = \frac{Total\ Non - Performing\ Financing}{Total\ Financing}$$

Table 3 - NPF Ratio Rating Criteria

Rank	Criteria	Category
1	NPF < 2%	Very Good
2	2% ≤ NPF < 5%	Good
3	5% ≤ NPF < 8%	Acceptable
4	8% ≤ NPF < 12%	Poor
5	NPF > 12%	Very Poor

Source: Bank Indonesia Circular Letter No.9/24/DPbS/2007

3. MANAGEMENT

The key ratio to measure management capability in running the Bank is BOPO ratio. The definition of BOPO ratio (Cost Income Ratio) is the measurement bank productivity, how a Bank able to convert all cost spending (operating/capital expenditure) into revenue generation. BO or Biaya Operational is the total Bank's Operating Expenses includes loan loss provision expenses. PO or Pendapatan Operasional is the total Banks Operating Income. Lower BOPO ratio confirming the efficiency process of the Bank in running business activity. In the opposite higher BOPO ratio showing Banks failure to generate revenue after all investment.

$$BOPO\ Ratio = \frac{Total\ Operation\ Expense}{Total\ Operating\ Income}$$

Table 4 - BOPO Ratio Rating Criteria

Rank	Criteria	Category
1	BOPO ≤ 83%	Very Good
2	83% ≤ BOPO < 85%	Good
3	85% ≤ BOPO < 87%	Acceptable
4	87% ≤ BOPO < 89%	Poor
5	BOPO > 89%	Very Poor

Source: Bank Indonesia Circular Letter No.9/24/DPbS/2007

4. EARNING

Return on Asset (ROA) is used to assess earning element. This ratio is calculated by dividing income before taxes and total assets. The greater the percentage of ROA, the better for the bank since it shows that the bank successfully manage to gain more profit from its assets, or in other word the banks successfully exploit it assets optimally.

$$Return\ on\ Asset\ Ratio = \frac{Income\ Before\ Taxes}{Total\ Assets}$$

Table 5 - ROA Ratio Rating Criteria

Rank	Criteria	Category
1	ROA > 1.5%	Very Good
2	1.25% ≤ ROA < 1.5%	Good
3	0.5% ≤ ROA < 1.25%	Acceptable
4	0 % ≤ ROA < 0.5%	Poor
5	ROA < 0%	Very Poor

Source: Bank Indonesis Circular Letter No.9/24/DPbS/2007

5. LIQUIDITY

Financing to Deposit Ratio (FDR) is a traditional measurement that third party funds (deposit) that used in to finance Banks main businesses which is lending or financing. FDR is measured by divided the total amount of financing to the total amount of third party funds.

$$Financing\ to\ Deposit\ Ratio = \frac{Total\ Financing}{Third\ Party\ Funds}$$

Financing as Bank key business activities is the main component of operating income, while deposit is the main driver of operating costs. Bank who fail to maximizing available funds from deposit will suffer loss. FDR is a similar concept with Loan to Deposit Ratio (LDR) which applicable to conventional bank. Bank Indonesia establish a fair ratio for bank's FDR/LDR, 78%-92% (SE BI No. 9/24/DPbS/2007)

6. THE COMPANIES

a. PT Bank Muamalat Indonesia, Tbk

PT Bank Muamalat Indonesia Tbk (BMI) commenced its journey as the first Sharia bank in Indonesia on November 1, 1991. Since it officially began operating on May 1, 1992 or Syawal 27, 1412 H, BMI keeps on innovating and releasing sharia financial products such as Sharia Insurance (Asuransi Takaful), Muamalat financial institution pension fund (DPLK Muamalat) and sharia multi-finance company (Al-Ijarah Indonesia Finance), all of which are breakthroughs in the country. On October 27, 1994, Bank Muamalat Indonesia obtained its Foreign Exchange Bank license and was listed as a public company without being listed on the Indonesia Stock Exchange (IDX). In 2003, the Bank confidently conducted 5 (five) instances of Rights Issue with Pre-emptive Right, and is the first bank in Indonesia to issue a Subordinated Mudharabah Sukuk. The corporate action set the position of Bank Muamalat Indonesia in the Indonesia banking industry. As of December 31, 2018, the Bank had 83 branch offices, 150 sub-branch offices, 43 cash offices.

b. PT Bank Mandiri Syariah Indonesia

PT Bank Syariah Mandiri (BSM) was originally a conventional bank established in 1955 under the name PT Bank Industri Nasional abbreviated as PT BINA or also called PT National Industrial Banking Corporation Ltd., headquartered in Jakarta. After experiencing a change of owner and name, based on Bank Indonesia Governor Decree No. 1/24 / KEP.GBI / 1999 dated October 25, 1999 as BSM become a commercial bank based on sharia principles and began operating on November 1, 1999. As of December 31, 2018, the Bank had 129 branch offices, 389 sub-branch offices, 53 cash offices.

c. PT Bank Rakyat Indonesia (Persero), Tbk

PT Bank Rakyat Indonesia (BRI) was established in 1895 in Purwokerto who formed by Raden Aria Wiriatmaja. BRI went to public listed on 10 November 2003, with code BBRI. Since its establishment, BRI consistently focuses on micro, small and medium enterprises (MSME), and became the pioneer of microfinance in Indonesia. The Bank maintains its commitment until today, and with the support of its experience in delivering banking services, especially in the MSME segment. BRI serve its customers thru 22,884 units of ATM, EDC of 284.425 units, also 401,550 BRILink agents. These E-channel networks spread across Indonesia are the evidence of BRI consistency in reaching the then unreachable. To address the market developments and the diversity of people's needs for financial products and services, BRI has a target to become an integrated financial service group, namely a group of companies that provide various financial services to its customers, in banking, insurance, remittance and other financial services. As of December 31, 2018, the Bank had 462 branch offices, 609 sub-branch offices, 1137 cash offices.

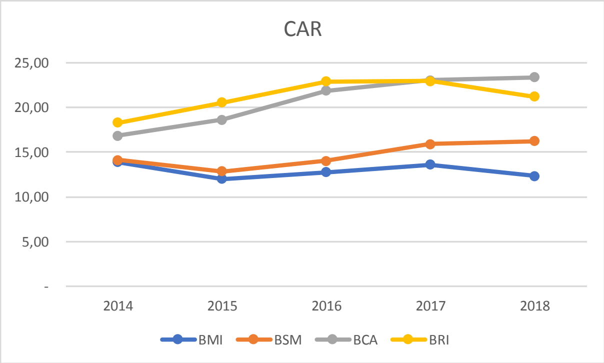
d. PT Bank Central Asia, Tbk

BCA was founded by Sudono Salim on February 21, 1957 and based in Jakarta. In the early 1980s, BCA submitted an application to Bank Indonesia to be allowed to issue and distribute credit cards in the name of BCA which is internationally accepted. BCA also aggressively expanded its branch network in line with the deregulation of the banking sector in Indonesia. BCA develops a variety of products and services as well as information technology development. In the 1990s BCA developed alternative service networks through ATMs (Automated Teller Machines. In the 2000s BCA strengthened and developed products and services, especially electronic banking by introducing BCA Debit, BCA Cash, KlikBCA internet banking, m-BCA mobile banking, EDCBIZZ, and others. In 2007, BCA became a pioneer in offering fixed-rate home loan products. BCA launched a prepaid card, Flazz Card and began offering Weekend Banking services to continue to build excellence in the field of transaction banking. BCA proactively manages lending and liquidity in the midst of the global crisis, while at the same time strengthening core competencies as a transaction bank. BCA strengthened its transaction banking through further development of innovative products and services, notably with mobile banking applications in the latest Smartphones, with payment settlement services through e-Commerce, and through a new concept of Electronic Banking Center which equips ATM Centers with additional technology backed features. BCA continued developing various methods of payment for online transactions. In 2018 BCA launched a peer-to-peer transfer feature using QR code technology, applicable on m-BCA and Sakuku. BCA launched the OneKlik service, a payment features available at online merchants. OneKlik offers speed and convenience. In 2018 BCA launched the VIRA virtual assistant, accessible through a number of popular chat apps, utilizing artificial intelligence technology. As of December 31, 2018, the Bank had 137 branch offices, 865 sub-branch offices, 247 cash offices.

RESULT AND DISCUSSION

1. CAPITAL ADEQUACY

Figure 2 - CAR Graph 2014-2018



Source: OJK Statistic Data 2014-2018

Table 6 - CAR 2014-2018 (in %)

	2014	2015	2016	2017	2018
BMI	13,91	12,00	12,74	13,62	12,34
BSM	14,12	12,85	14,01	15,89	16,26
BCA	16,86	18,65	21,90	23,06	23,39
BRI	18,31	20,59	22,91	22,96	21,21

Source: OJK Statistic Data 2014-2018

CAR Reference formula:

$$Capital\ Adequacy\ Ratio = \frac{Tier\ 1\ Capital + Tier\ 2\ Capital}{Risk\ Weighted\ Assets}$$

Based on Capital Adequacy Ratio table and graph above it shown disparity of between Sharia Banks (BMI & BSM) with Conventional Banks (BCA & BRI). Year of 2014 all banks are still comparable to each other, where BMI has the lowest ratio of 13.91% and BRI with the highest ratio 18.31%. Beginning of 2015 until 2018 there were major differences. Sharia Banks struggling to improved CAR ratio while Conventional Banks were able to continue strengthen its ratio. By end of 2018, BCA and BRI maintain ratio above 20%, where BCA reach 23.39% while BRI 21.21%. The two largest Sharia Banks having difficulties to improve its ratio, especially BMI with CAR only 12.34% by end 2018.

CAR soundness of all Banks with the reference Bank Indonesia Circular Letter No.9/24/DPbS/2007 re Sharia Bank Assessment System, are:

Table 7 - CAR Soundness 2014-2018

	2014	2015	2016	2017	2018	Average	Soundness
BMI	13.91	12.00	12.74	13.62	12.34	12.92	Very Good
BSM	14.12	12.85	14.01	15.89	16.26	14.63	Very Good
BCA	16.86	18.65	21.90	23.06	23.39	20.77	Very Good
BRI	18.31	20.59	22.91	22.96	21.21	21.20	Very Good

Source: OJK Statistic Data 2014-2018

Based on ratio calculation, all banks CAR rated ‘’very good’’, above 12%, while minimum CAR itself is 8%. Although the expectation that CAR should have upward trend as a confirmation of positive performance of all banks. There was some volatility on Shari Banks ratio. While Conventional Banks showing upward trend. CAR is a snapshot, which may not provide complete pictures of the strength or weaknesses of banks capital. In order to understand the actual condition of banks capital there should be further analysis of capital key components which is Retained Earnings (RE).

Table 8 - Retained Earnings 2014-2018 (in Million IDR)

	2014	2015	2016	2017	2018	growth	%
BMI	- 801.258	- 1.196.801	- 1.244.175	- 1.205.878	- 1.046.197	- 244.939	-31%
BSM	2.840.167	2.944.698	3.170.112	3.435.278	3.940.491	1.100.324	39%
BCA	67.850.758	81.184.733	96.443.304	113.223.474	131.282.617	63.431.859	93%
BRI	72.813.856	88.078.932	121.306.122	139.297.048	157.950.582	85.136.726	117%

Source: OJK Statistic Data 2014-2018

Indonesian Banking industry has been known as the profitable banking business in Asia market due to high net interest margin. This reflected in the accumulated profit which known as retained earnings. RE of Sharia Banks in the last five years shown two different condition, where BMI decreased by 31% while BSM growth by 39%. Conventional Banks are in better position, BCA increase it RE for almost IDR63 Trillion or 93% and BRI increase sharply by 117% or IDR85 Trillion. The above RE figures revealed that Sharia Banks has not been able to produce sustained profitability compared with Conventional Banks. With low CAR, Sharia Banks have a difficulty to grow and expand their business which at the end will impact their profitability and RE.

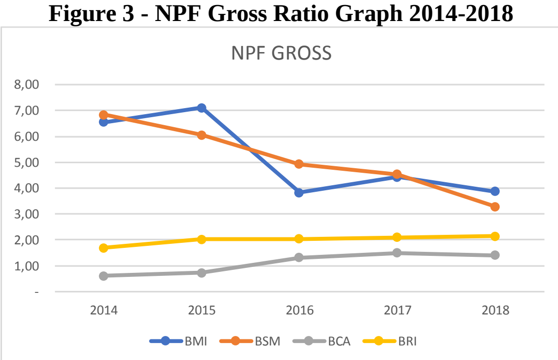
2. ASSET QUALITY

Table 9 - NPF Gross Ratio 2014-2018 (in %)

	2014	2015	2016	2017	2018
BMI	6.55	7.11	3.83	4.43	3.87
BSM	6.84	6.06	4.92	4.53	3.28
BCA	0.60	0.72	1.31	1.49	1.41
BRI	1.69	2.02	2.03	2.10	2.14

Source: OJK Statistic Data 2014-2018

Figure 3 - NPF Gross Ratio Graph 2014-2018



Source: OJK Statistic Data 2014-2018

NPF Gross Ratio Reference Formula

$$NPF\ Gross = \frac{Total\ Non-Performing\ Fnancing}{Total\ Financing}$$

Sharia Banks shown some issues with relates to asset quality as reflected in the NPF gross ratio. Where in 2014, both BMI and BSM has gross NPF above 5% while Conventional Banks (BCA & BRI) has NPF ratio below 2%. By end 2018, both BMI and BSM manage to improve their NPF ratio to below 4% while BRI slightly above 2% and BCA still below 2%. Banks with high NPF ratio tends to have difficulties to generate profitability. Whereby the margin income will be lower than the usual due to less income and payment received from debtors. In addition, high NPF ratio will require asset impairment provision. Bank with strong CAR has better position in dealing with NPF. As discussed previously most Bank with higher CAR is driven by high RE. The higher RE, the higher capacity for Bank to absorb loss from NPF. NPF ratio soundness of all Banks with the reference: Bank Indonesia Circular Letter No.9/24/DPbS/2007 re Sharia Bank Assessment System, are:

Table 10.1 - Asset Quality Soundness 2014-2018

	2014	2015	2016	2017	2018	Average	Soundness
BMI	6,55	7,11	3,83	4,43	3,87	5,16	Acceptable
BSM	6,84	6,06	4,92	4,53	3,28	5,13	Acceptable
BCA	0,60	0,72	1,31	1,49	1,41	1,11	Very Good
BRI	1,69	2,02	2,03	2,10	2,14	2,00	Good

Source: OJK Statistic Data 2014-2018

Sharia Banks NPF ratio soundness only at acceptable level, while BRI at good level and BCA at very good level. The important matters are whether Bank's income got negative impact from NPF and whether Banks has the capacity to provide asset impairment provision. The answer is reflected in the actual RE of each bank as discussed in the Capital section.

One additional parameter in measuring asset quality is Low Quality Financing (LQF) or Loan at Risks (LAR). LQF is combination of NPF and Financing which fall under category Special Mention. The comparison between LQF amount against total Financing called LQF ratio. This ratio measured potential risks face by the banks due to declining of asset quality.

Table 10.2 – LQF Ratio 2014-2018

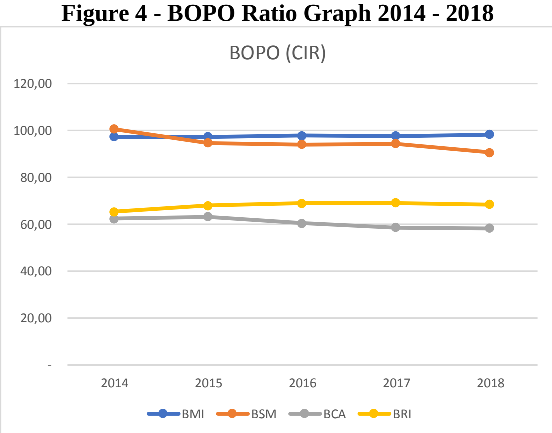
		2014	2015	2016	2017	2018
BMI	LQF	9.436.897	7.938.441	5.583.750	7.976.767	5.340.459
	Total Financing	43.086.719	40.734.754	40.050.449	41.331.822	33.566.180
	LQF Ratio	21,9%	19,5%	13,9%	19,3%	15,9%
BSM	LQF	6.727.479	7.373.614	6.637.110	5.881.751	4.187.773
	Total Financing	48.937.425	50.893.511	55.388.246	60.471.600	67.502.866
	LQF Ratio	13,7%	14,5%	12,0%	9,7%	6,2%

Source: OJK Statistic Data 2014-2018

Sharia Banks has significant LQF ratios which range from 6.2% to 21.9% during 2014-2018. This indicates both BMI and BSM are having problems in (1) managing asset quality (2) providing impairment provision for NPF (3) income generation.

3. MANAGEMENT

Figure 4 - BOPO Ratio Graph 2014 - 2018



Source: OJK Statistic Data 2014-2018

Table 11 - BOPO Ratio 2014 – 2018 (in %)

	2014	2015	2016	2017	2018
BMI	97,38	97,36	97,76	97,68	98,24
BSM	100,60	94,78	94,12	94,44	90,68
BCA	62,43	63,22	60,44	58,65	58,24
BRI	65,42	67,96	68,93	69,14	68,48

Source: OJK Statistic Data 2014-2018

BOPO Reference Formula:

$$BOPO\ Ratio = \frac{Total\ Operation\ Expense}{Total\ Operating\ Income}$$

Sharia Banks BOPO ratio significantly high in compare with Conventional Banks as shown in the above table and graph. BMI BOPO in the last five years ranging between 97%-99%. BSM once has the ratio above 100% (in 2014) it means the Bank in loss position. In contrast, Conventional Banks has BOPO ratio between 58%-69%. BCA shown positive trend in the last five years whereas BOPO ratio decreased every year. While BRI maintain BOPO ratio between 65%-69% and managed to maintain high profitability (high RE). Sharia Bank may fail to generate enough revenues or fail to control their expenses. Referring to high NPF Gross ratio of BMI and BSM in 2014 -2015, it is high probability created scissor effect to BOPO ratio. Whereby Operating Revenue is decreasing due to lower interest income and Operating Expenses increased due to additional impairment provision for NPF. With low BOPO both BCA and BRI shown the ability to maximizing their investment and gaining profit from business activities. The operating revenues of both banks are high enough to cover operating expenses. Specially with low NPF ratio, operating expenses from NPF are manageable.

The following tables shown challenges face by Sharia Banks in managing BOPO ratio.

Table 11.1 - Expenses 2014 - 2018

		2014	2015	2016	2017	2018	Incr/Decr	%
BMI	IE	3.352.239	2.853.894	2.302.328	2.541.320	2.162.970	-1.189.269	-35,48%
	OPEX	2.217.751	2.264.724	1.756.128	1.601.141	1.689.693	- 528.058	-23,81%
	Total	5.569.990	5.118.618	4.058.456	4.142.461	3.852.663	-1.717.327	-30,83%
BSM	IE	2.549.697	2.492.363	2.383.694	2.578.630	2.696.863	147.166	5,77%
	OPEX	3.983.747	4.045.087	4.534.100	5.581.408	5.303.716	1.319.969	33,13%
	Total	6.533.444	6.537.450	6.917.794	8.160.038	8.000.579	1.467.135	22,46%

Table 11.2 - Income 2014 - 2018

		2014	2015	2016	2017	2018	Incr/Decr	%
BMI	II	5.214.864	4.949.360	3.801.051	3.709.827	3.220.190	-1.994.674	-38,25%
	FBI	504.777	336.391	343.171	476.126	701.343	196.566	38,94%
	Total	5.719.641	5.285.751	4.144.222	4.185.953	3.921.533	-1.798.108	-31,44%
BSM	II	5.659.449	6.099.161	6.627.418	7.493.417	7.976.256	2.316.807	40,94%
	FBI	834.752	798.611	722.217	1.124.339	843.397	8.645	1,04%
	Total	6.494.201	6.897.772	7.349.635	8.617.756	8.819.653	2.325.452	35,81%

BMI has managed to improve cost management and able to reduce it cost in the last five years. Total expenses decreased by IDR1.7 Trillion or 31% from IDR5.5 Trillion in 2014 to IDR3.8 Trillion in 2018. However, on the income side BMI failed to improve. Total income in 2018 IDR3.9 Trillion a decreased of IDR1.8 Trillion or 31% comparing with income in 2014 of IDR5.7 Trillion.

BSM has different situation, whereby they have managed to increase total income from IDR6.5 Trillion in 2014 to IDR8.8 Trillion in 2018 an increment of IDR2.3 Trillion or 36%. Increment in income are compensated by increment in expenses. Total expenses continue to rise from IDR6.5 Trillion in 2014 to IDR8 Trillion in 2018. This is explained why BOPO ratio still at the highest level for BMI and BSM as the leaders in Sharia Banking.

With reference to Bank Indonesia Circular Letter No.9/24/DPbS/2007 re Sharia Bank Assessment System, BOPO soundness of all banks are:

Table 12 - BOPO Ratio Soundness 2014 - 2018

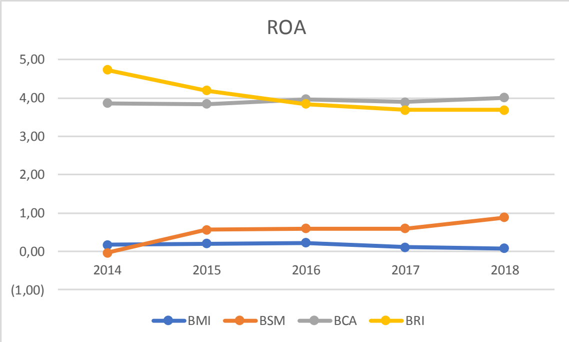
	2014	2015	2016	2017	2018	Average	Soundness
BMI	97,38	97,36	97,76	97,68	98,24	97,68	Very Poor
BSM	100,60	94,78	94,12	94,44	90,68	94,92	Very Poor
BCA	62,43	63,22	60,44	58,65	58,24	60,60	Very Good
BRI	65,42	67,96	68,93	69,14	68,48	67,99	Very Good

Source: OJK Statistic Data 2014-2018

BOPO soundness of Sharia Bank categorized as very poor in contrary Conventional Banks Very Good. This indicates how efficient Conventional Banks in converting earning asset into income generation. Sharia Banks with high BOPO will not generate high profitability and will end up with low RE. Conventional Banks has achieve very good level and allow them to produce significant profit form year on year.

4. RENTABILITY

Figure 5 - ROA Ratio Graph 2014 - 2018



Source: OJK Statistic Data 2014-2018

Table 13 - ROA Ratio 2014 – 2018 (in %)

	2014	2015	2016	2017	2018
BMI	0,17	0,20	0,22	0,11	0,08
BSM	(0,04)	0,56	0,59	0,59	0,88
BCA	3,86	3,84	3,96	3,89	4,01
BRI	4,73	4,19	3,84	3,69	3,68

Source: OJK Statistic Data 2014-2018

ROA Ratio Reference Formula

$$Return\ on\ Asset\ Ratio = \frac{Income\ Before\ Taxes}{Total\ Assets}$$

Rentability Sharia Bank are low as shown in the above ROA table and graph. The ratio is marginal below 1%, which in line with high BOPO ratio. Conventional Banks managed to provide reasonable return with ratio between 3%-5%. ROA ratio confirming the reality of Sharia Banks which has low capital level, high NPF and high BOPO. The following table provide actual Profit Before Tax (PBT) numbers of all four Banks in the last five years.

Table 14 - PBT 2014-2018 (in Million IDR)

	2014	2015	2016	2017	2018	Average
BMI	99.045	108.910	116.459	60.268	45.806	86.098
BSM	(25.679)	374.126	434.704	487.060	815.733	417.189
BCA	62.442.190	57.172.588	55.786.398	61.696.920	57.227.276	58.865.074
BRI	66.955.671	70.369.709	78.831.722	87.915.020	98.341.116	80.482.648

Source: OJK Statistic Data 2014-2018

BMI average PBT below IDR100 billion per annum, while BSM managed to generate PBT per annum of IDR417 billion. BCA and BRI produce significant PBT, in average per annum is IDR55 Trillion and IDR80 Trillion, respectively. Those figures confirm the soundness of ROA in accordance to Bank Indonesia Circular Letter No.9/24/DPbS/2007 re Sharia Bank Assessment System, follows:

Table 15 - ROA Ratio Soundness 2014-2018

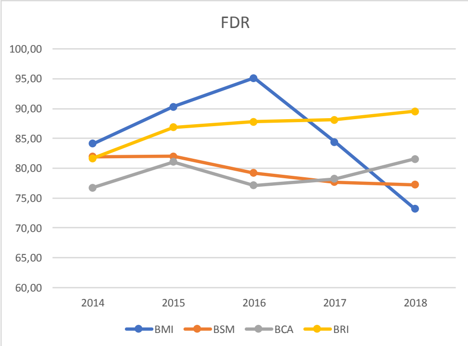
	2014	2015	2016	2017	2018	Average	Soundness
BMI	0,17	0,20	0,22	0,11	0,08	0,16	Poor
BSM	(0,04)	0,56	0,59	0,59	0,88	0,52	Acceptable
BCA	3,86	3,84	3,96	3,89	4,01	3,91	Very Good
BRI	4,73	4,19	3,84	3,69	3,68	4,03	Very Good

Source: OJK Statistic Data 2014-2018

The soundness of ROA is reflection of problem existence in Sharia Banks. Where high NPF and BOPO reduce the ability to generate reasonable profit. Difference situation with Conventional Banks, with low NPF and low BOPO, easy for them to generate decent numbers of profit

5. LIQUIDITY

Figure 6 - FDR Graph 2014 - 2018



Source: OJK Statistic Data 2014-2018

Table 16 - FDR 2014-2018 (in %)

	2014	2015	2016	2017	2018
BMI	84,14	90,30	95,13	84,41	73,18
BSM	81,92	81,99	79,19	77,66	77,25
BCA	76,77	81,06	77,12	78,22	81,58
BRI	81,68	86,88	87,77	88,13	89,57

Source: OJK Statistic Data 2014-2018

FDR Reference Formula

$$Financing\ to\ Deposit\ Ratio = \frac{Total\ Financing}{Third\ Party\ Funds}$$

All four Banks, BMI, BSM, BCA and BRI are in control on their liquidity management which clearly reflected in the above table and graph of FDR. They able to utilize liquidity availability and converting into earning asset. Although the challenges of each banks is to get low cost fund from deposit activities and high yield return on the financing side.

Table 17 - FDR Soundness 2014-2018

	2014	2015	2016	2017	2018	Average	Soundness
BMI	84,14	90,30	95,13	84,41	73,18	85,43	Very Good
BSM	81,92	81,99	79,19	77,66	77,25	79,60	Very Good
BCA	76,77	81,06	77,12	78,22	81,58	78,95	Very Good
BRI	81,68	86,88	87,77	88,13	89,57	86,81	Very Good

Source: OJK Statistic Data 2014-2018

FDR soundness of all banks categorized as very good. This is positive indicators that both Sharia Banks and Conventional Banks has reasonable customer base on funding side. At the same time all banks able to fulfil intermediary function to provide lending to debtors. The implication of pricing of funding and lending is reflected on Banks profitability as discussed in earning section.

The summary financial ratio soundness during the period 2014-2018of all Banks are follows;

Table 18 – Banks Soundness 2014-2018

	C	A	M	E	L	Overall
BMI	Very Good	Acceptable	Very Poor	Poor	Very Good	Acceptable
BSM	Very Good	Acceptable	Very Poor	Acceptable	Very Good	Acceptable
BCA	Very Good	Very Good	Very Good	Very Good	Very Good	Very Good
BRI	Very Good	Good	Very Good	Very Good	Very Good	Very Good

Source: OJK Statistic Data 2014-2018

LIMITATION

This study is focused on two largest Sharia Banks (BMI and BSM) and two largest Conventional Banks (BCA & BRI) as representative of banking industry. This study provides analysis based on published available data such as annual report and OJK statistic report. It will be valuable if to explore further with more Banks in both segments.

In near future, it is suggested to carry out research with more variable and parameters to obtained better picture of banking industry. It is also suggested to involve more literatures which update with current environment. Also, its suggested to observe impact of Banking 4.0 and digital banking that might affect and related to the study.

CONCLUSION AND RECOMMENDATION

Sharia Banks key financial performance and soundness are far below Conventional Banks. CAR of BMI and BSM for the last five years are above minimum requirement but the strengths of the capital much weaker compared with Conventional Banks. The key factor is the size of retained earnings of Sharia Banks are much lower. With small amount of RE, Sharia Banks has the limitation to absorb loss from business activities.

Asset quality of Sharia Banks are faces challenges during 2014-2018 which reflected in high NPF Gross ratio. Despite there were improvement of the quality, high NPF ratio pressure the revenue generation of the Banks and resulted additional impairment costs. In contrary, Conventional Banks managed to control NPF ratio. One of the benefits of having high RE and profitability for Conventional Banks is the ability to provide impairment provision which at the end will reduce NPF amount.

Conventional Banks already achieved sustained efficiency level as shown in BOPO ratio below 70% for the last five years. Sharia Banks still struggling in managing cost income ratio, whereby the ratio above 90% during 2014-2018. The higher BOPO ratio the lower profit produce by the Banks. Higher BOPO also confirming inefficiency in Sharia Banks.

Earning ability of Sharia Banks are low whereby ROA ratio below one percent in the last five years, whilst Conventional Banks managed to record ROA almost 5%. The key factor is the profit of the banks. Sharia Banks only managed to create marginal profit. Conventional Banks with the back of strong capital and low NPF and BOPO managed to maintain high profit from year on year.

Both Sharia Banks and Conventional Banks managed to maintain its liquidity. The ability to collect funding and providing lending shown the intermediary function are fulfilled. The only differences of each Bank to get low cost of fund and producing good quality asset.

Sharia Banks weakness points are in the asset quality and management (efficiency). High NPF ratio during 2014-2018 is the key problems for BMI and BSM. The fact that LQF ratio are also high shown both banks facing similar problems. Low asset quality reduced income generation as debtors failed to pay profit sharing or margin income. Inefficiency of Sharia Banks clearly reflected in BOPO ratio. BMI had issue with income generation despite managed to cut expenses. BSM income improvement are followed by rise in expenses. High BOPO ratio lowering the profit of the Bank.

Overall Conventional Banks soundness are very good which reflected on each key financial parameter. In the opposite, Sharia Banks soundness only achieve acceptable level. This truly a big challenge for Sharia Banks. If Sharia Banks fail to improve Bank soundness it will be difficult to improve the market share.

Banking industry is a heavy capital base business due to the high inherent risks in the industry such as credit risks. Sharia Banking in Indonesia is still young and facing the same level of risks with other conventional banks. Therefore, it is imperative for all bank stakeholders to continue pay attention on the capital adequacy. Bank with higher CAR has the capacity to grow its business at the same time able to absorb loss from business risks. Banks with lower CAR will experience multiple problems form the limited opportunity to grow, less capacity to absorb loss. As the result NPF ratio continue to increase and reducing operating revenue. Which at the end pressure the BOPO ratio and Return On Asset.

REFERENCES

Altan M, Yusufazari H, Bedük A (2014) Performance analysis of banks in Turkey using CAMEL approach. In *Proceedings of International Academic Conferences. International Institute of Social and Economic Sciences* 2: 21-32.

Annual Report of PT. Bank Muamalat Indonesia, Tbk, (2014-2018).

Annual Report of PT. Bank Syariah Mandiri (2014-2108)

Annual Report of PT. Bank Central Asia, Tbk, (2014-2018)

Annual Report of PT. Bank Rakyat Indonesia (Persero) Tbk, (2014-2018).

Badan Pusat Statistik, Indikator Strategis Nasional. Retrieved from https://www.bps.go.id/QuickMap

Bank Indonesia, Circular Letter No.9/24/DPbS/2007 re Sharia Bank Assessment System. Retrieved from www.bi.go.id/en/peraturan/perbankan

Bank Indonesia, Circular Letter No.15/28/DPNP/2013 re Asset Quality Assessment for Commercial Bank. Retrieved from www.bi.go.id/en/peraturan/perbankan

Bastan, M., Bagheri Mazrae, M. & Ahmadvand, A. Dynamics of banking soundness based on CAMELS rating system. *The 34th International Conference of the System Dynamics Society*, 2016 Delft, Netherlands. System Dynamics Society.

Cetorelli, Nicola. Competitive Analysis in Banking: Appraisal of the Methodologies. *Economic Perspectives, Federal Reserve Bank of Chicago* (1999), 2–15.

Daryanto, W.M. and Arrifai, M.A.(2019). Measuring and evaluating state-owned banking industry in Indonesia using risk based bank rating (RBBR). *International Journal of Business, Economics and Law*, Vol .18, Issue 1 (April). ISSN 2289-1552

Demirgüc-Kunt, A., Detragiache, E., Tressel, T., 2008. Banking on the principles: compliance with Basel Core Principles and bank soundness. *Journal Financial Intermediation*, 17, 511– 542.

Gasbarro, D., Sadguna, I., & Zumwalt, J. K. (2002). The changing relationship between CAMEL ratings and banking soundness during the Indonesian banking crisis. *Review of Quantitative Finance and Accounting*, 19(3), 247-260

Igan, D. & Pinheiro, M., 2011. *Credit Growth and Bank Soundness: IMF Working Papers* WP/11/278, pp. 4-8.

J.A. Bikker, K. Haaf , 2002, Competition, concentration and their relationship: an empirical analysis of the banking industry. *Journal of Banking & Finance,* 26, 2191-2214.

Levy-Yeyati, Eduardo, and Alejandro Micco, 2003, "Concentration and Foreign Penetration in Latin American Banking Sectors: Impact on Competition and Risk," Inter-American Development Bank Research Department Working Paper No. 499 (Washington: Inter-American Development Bank).

Otoritas Jasa Keuangan (OJK) Data and Statistic 2014-2018. Retrieved from https://www.ojk.go.id/.

McKinsey Global Institute, "The archipelago economy: Unleashing Indonesia's potential". September 2012, https://www.mckinsey.com/featured-insights/asia-pacific/ the-archipelago-economy

Roman, A., & Şargu, A. C. (2013). Analysing the financial soundness of the commercial banks in Romania: an approach based on the camels framework. *Procedia Economics and Finance*, 6, 703712

Susanti, Y.F and Daryanto, W.M. (2017). Financial performance analysis of Bank Rakyat Indonesia using CAMEL model. *International Journal of Business Studies*, Vol. 1, No. 2(October 2017). ISSN: 2580-0132

Wikipedia, Indonesia 2010 census, en.wikipedia.org

Hery Syafril
Sekolah Tinggi Manajemen IPMI
Jl. Rawajati Timur I No.1, DKI Jakarta, Indonesia
Email: hery.syafril@ipmi.ac.id

Wiwiek Mardawiyah Daryanto
Sekolah Tinggi Manajemen IPMI
Jl. Rawajati Timur I No.1, DKI Jakarta, Indonesia
Email: wiwiek.daryanto@ipmi.ac.id