

CHAPTER I

INTRODUCTION

1.1. Background

Banking is one of the institutions that play an important role in the economic system of a country including Indonesia. This is because in the economic system, funds are needed. Banks can be a mediating institutions between parties who have excess funds with other parties who need funds. Indonesia is one of country that uses a dual banking system. There are two types of banks operating, namely conventional banks and Islamic banks. That is, in addition to recognizing the existence of conventional banks, the government also recognizes the existence of Islamic Banks that run their operational systems with Islamic principles. The existence of Islamic banking in Indonesia is expected to be one solution of Indonesian economy and also be able to answer the wishes of Indonesian people to run the economic system based on the guidance of Islamic religion. The Islamic banks is one of the tools for the Islamic world to realize the independence in their economic system.

Islamic banking is expected to grow rapidly in Indonesia. One of the supporting factor is that Indonesia is the country with the largest Muslim population in the world. The number of Muslim population in Indonesia reached 207.18 million people or about 87.18 percent of the total population of Indonesia (*Badan Pusat Sstatistik*, 2010). Large population numbers indicate that Indonesia is a very potential market for the development of the Islamic economic system, including Islamic bank.

The development of Islamic banking in Indonesia began with the establishment of the Sharia Rural Bank (BPRS) in 1988, namely *BPR Berkah Amal Sejahtera*. In 1991 there were three BPRs operating in accordance with sharia principles, namely *BPR Berkah Amal Sejahtera*, *BPR Dana Mardhatillah* and *BPR Amanah Rabbaniyah* (Bank Indonesia, 2015). However, the Islamic banking system in Indonesia was officially recognized since March 25, 1992, with the enactment of law number 7, 1992. So that with this foundation *Bank Muamalat* as the first Sharia Commercial Bank in Indonesia could begin its operations on May 1, 1992.

Based on the latest data that published by the OJK in August 2018, there are already 13 Sharia Commercial Banks, 168 Sharia Rural Banks, and 21 Sharia Business Units that have operated in Indonesia. Although the number of Sharia Commercial Banks is less than the other types of Islamic banks, Sharia Commercial Banks have the largest market share with 65.46%, followed by the Sharia Business Unit by 31.90% and the lowest is Sharia Rural Banks by 2.63% (*Statistik Perbankan Syariah*, August 2018).

The growth of total assets of Islamic banking in Indonesia in the last ten years can be seen in table 1.1. In the period 2008-2017, the Sharia Business Unit had the most rapid asset growth compared to other type of Islamic banks with 28.74%. Meanwhile, the Sharia Commercial Bank is in second place with 28.01%, and is followed by Sharia Rural Bank with 23.07%. Overall assets of Islamic banking in Indonesia in the period 2008-2017 grew by 27.50%. Meanwhile in the same period, conventional banks only grew 15.54% (*Statistik Perbankan Indonesia*, 2014-2017). Thus it can be concluded that in the last ten years, the assets of Islamic

banking in Indonesia have grown more rapidly if compared to conventional banking assets.

Table 1.1
The Asset Growth of Sharia Banks in Indonesia on period 2008-2017

Year	BUS		UUS		BPRS		TOTAL	
	Total Assets	Annual Growth Rate (%)	Total Assets	Annual Growth Rate (%)	Total Assets	Annual Growth Rate (%)	Total Assets	Annual Growth Rate (%)
2008	34,036.41	-	15,518.71	-	1,693.33	-	51,248.45	-
2009	48,013.65	41.07	18,076.32	16.48	2,125.78	25.54	68,215.75	33.11
2010	79,185.91	64.92	18,333.43	1.42	2,738.74	28.83	100,258.08	46.97
2011	116,930.41	47.67	28,536.26	55.65	3,520.42	28.54	148,987.09	48.60
2012	147,581.00	26.21	47,437.21	66.23	4,698.95	33.48	199,717.16	34.05
2013	180,360.00	22.21	61,916.09	30.52	5,833.49	24.14	248,109.58	24.23
2014	204,329.74	13.29	67,382.84	8.83	6,573.33	12.68	278,285.91	12.16
2015	212,412.68	3.96	82,838.95	22.94	7,739.27	17.74	302,990.90	8.88
2016	253,903.28	19.53	102,319.76	23.52	9,157.80	18.33	365,380.83	20.59
2017	287,554.40	13.25	136,154.01	33.07	10,840.37	18.37	434,548.79	18.93
Mean	156,430.75	28.01	57,851.36	28.74	5,492.15	23.07	219,774.25	27.50

Source : Statistik Perbankan Syariah 2014-2018 published by OJK, data processed

Explanation :

BUS : Sharia Commercial Bank

UUS : Sharia Business Unit

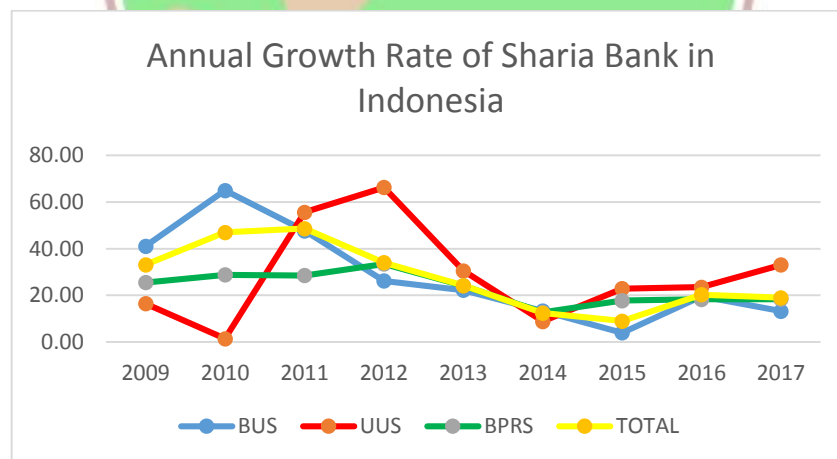
BPRS : Sharia Rural bank

The value of total assets are in billion rupiah.

The growth rate of Islamic banking assets increased from 2009 to 2011, but tended to slow down on 2012 to 2017 as shown in picture 1.1. In 2009-2010, the growth of sharia banking assets was driven by the high growth rate of BUS with 41.07% and 64.92%, while overall sharia bank asset growth was only 33.11% and 46.97% in the same year. One of reason that caused the growth of BUS assets exceeded sixty percent in 2010 was because of the establishment of five new commercial banks that operated with sharia principles that year, they were; *Bank Victoria Syariah, Bank BCA Syariah, Bank Jabar Banten, Bank BNI Syariah and Bank Maybank Syariah Indonesia*. This made the number of Islamic commercial banks in Indonesia in 2010 increased to eleven units from six unit before.

In 2011, BUS assets were still able to grow by 47.67%. Then it can be stated indirectly that the five Sharia Commercial Banks that were established in 2010 could have good financial performance. But this growth tends to slow down in the next period. Even in 2014-2017, BUS's asset growth was below 20%. Similar conditions also occur in UUS and BPRS, but the slowdown in asset growth in these two types of banks only occurred until 2014 and has increased again in the following period. This indicates that there are still unresolved problems in the BUS. It is needs to be watched out and examined the factors that cause the growth slowdown. So that it can be anticipated by OJK, industry and all stakeholders to be able to recover the high growth of Islamic banks. If it is not anticipated as soon as possible, then Islamic banking will be more lagging behind the conventional banking.

Picture 1.1
The Asset Growth of Sharia Banks in Indonesia 2009-2017



Source : Statistik Perbankan Syariah 2014-2018 published by OJK, data processed

When compared with conventional banking, based on data from OJK in August 2018 the total assets of Islamic banking were 445.24 trillion rupiah, while conventional bank assets were 7,483.54 trillion rupiah. So it can be concluded that, the market share of Islamic banking is only 5.62% while conventional banks have

94.38%. From these data, it can be seen that there is still a very long gap to catch up with Islamic banks from conventional banks in terms of market share. Other facts about the condition of Islamic banking in Indonesia can also be seen from the 2016 OJK Financial Literacy National Survey which states that only 6.63% of the Indonesian population who have understood about Islamic banking services and 9.61% of the population who have used Islamic banking services. While overall in the same year, the number of Indonesians who have understood banking services is 21.80% and those who have used banking services are 28.94%.

All of the fact above are an irony considering that majority of Indonesia's population is Muslim, but majority still prefers to use the services of conventional banking compared to Islamic banking. Therefore, the performance of Islamic banking in Indonesia especially Sharia Commercial Bank needs to be evaluated and corrective steps are taken to further encourage the development of the Islamic banking industry in Indonesia to have sustainable growth and achieve the objectives of establishing Islamic banks in Indonesia.

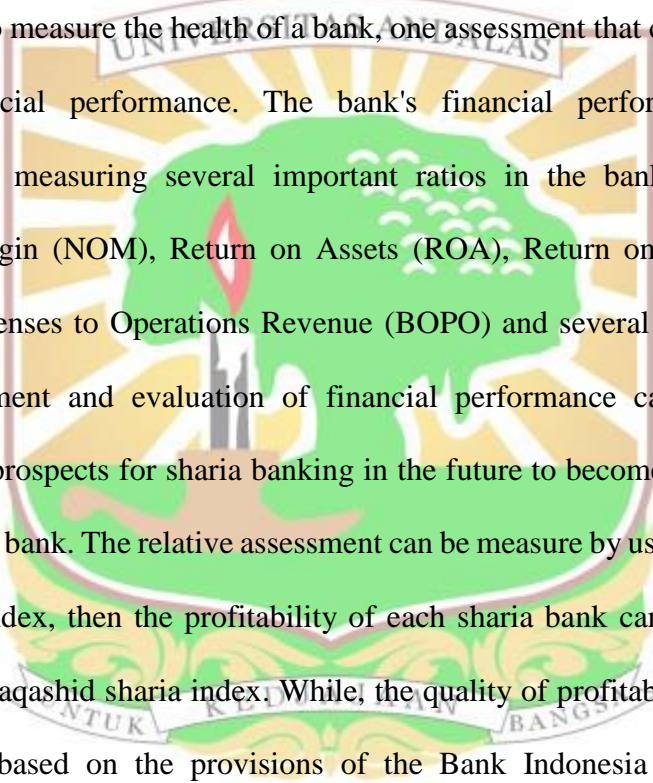
Islamic banking must be able to attract public trust in using sharia bank services, by proving that sharia banks have good financial performance and have also carried out operational activities in accordance with the provisions of Islamic religion. As a business entity that is based on sharia, the financial health of the bank is very important to maintained as well as possible, so that operational activities can run smoothly. However, besides of that the sharia banks must also have sharia compliance performance that is has a social oriented. It becomes the evidence to distinguish both conventional and sharia bank.

Wahyu (2016) stated that Banking business is a business that relies heavily on trust, namely the trust of the public as users of banking services. The nature of bank business is different from manufacturing companies and other service companies. Most of bank assets are liquid assets. The turnover rates of the asset and liability are very high. If there are few issues related to the bank's unhealthy condition, so the public will flock to withdraw their funds from the bank, so that it will further worsen the condition of the bank.

Karim (2007) states that there are seven things that cause a decline in reputation or public trust in sharia banks, namely; management errors, violating regulations, violating DSN fatwas, financial scandals, lack of competence in the field of management and service, doubtful integrity and poor financial performance. From these seven things, it can be seen that the biggest influence is from the financial and bank identity with the sharia principle. If the financial performance is going well, the risk of falling reputation can be minimized. Likewise, the application of sharia principles must be carried out consequently in order to achieve Maqashid Sharia (sharia purposes) so that there is no negative judgment from the community towards the sharia bank. Good performance in these two aspects namely sharia and financial performance, will increase public trust in Islamic banks. The higher the level of public trust in Islamic banks, the more rapid their development will be. But if the opposite happens, it will be dangerous to the operational continuity of Islamic banks in Indonesia.

The measurement of sharia compliance performance can be measure by Maqashid Sharia Index (MSI) that is developed by Omar Mohamed et al (2008). This theory is a development of the maqashid sharia concept described by Prof.

Muhammad Abu Zahrah (1997) in his book entitled "*Ushul Fiqih*". He classified maqashid sharia into three broad areas, namely : *Tahdhib al-Fard* (Educating the individual), *Iqamah al-`Adl* (Establishing justice), and *Jalb al-Maslahah* (Promoting Welfare). Then, Mustafa Omar Mohammed et al. had done a combination with the Sekaran method, so that it could be a measurable parameter. This model has been widely applied in several literature reviews to measure the performance of Islamic Banking in various countries.



Next, to measure the health of a bank, one assessment that can be done is to measure financial performance. The bank's financial performance can be determined by measuring several important ratios in the banks such as Net Operating Margin (NOM), Return on Assets (ROA), Return on Equity (ROE), Operating Expenses to Operations Revenue (BOPO) and several other important ratios. Assessment and evaluation of financial performance can also help to determine the prospects for sharia banking in the future to become a fast-growing and sustainable bank. The relative assessment can be measure by using comparative performance index, then the profitability of each sharia bank can be ranked and compared to maqashid sharia index. While, the quality of profitability assessment can be made based on the provisions of the Bank Indonesia Circular Letter number.13/24/DPNP concerning "*Health Assesment for Commercial Bank*", issued on October 25, 2011 and also the provisions of the OJK Circular Letter number.10/SEOJK.03/2014 concerning "*Health Assesment for Sharia Commercial Bank and Sharia Business Unit*", issued on June 11, 2014 that is replace the Bank Indonesia Circular Letter number.9/24/DPbs concerning "*Rating System for Commercial Banks Based on Sharia Principles*".

Based on the description above, the writer is interested in writing a research entitled **"Maqashid Sharia Index and Profitability Analysis of Sharia Commercial Banks in Indonesia 2014-2017 "**. This study will be tried to comparing both syariah maqashid index and also the profitability of each Sharia Commercial Bank in Indonesia on period 2014-2017.

1.2 Research Problem

Based on the description above, then in this study can be drawn some questions as follows:

1. How is the performance of Sharia Commercial Banks in Indonesia based on Maqashid Sharia Index?
2. How is the profitability of Sharia Commercial Banks in Indonesia?
3. How is the profitability trend of Sharia Commercial Bank in Indonesia?
4. Is there a correlation between sharia compliance and profitability of sharia bank?
5. How to grouping of Sharia Commercial Banks in Indonesia based on efficiency and maqashid indeks?

1.3 Research Objectives

Based on the research problem the basic objective of this study are:

1. To find out how is the performance of Sharia Commercial Banks in Indonesia based on the Maqashid Sharia Index, then ranking Sharia Commercial Banks in the achievement of masalah according to Maqashid Sharia Index.

2. To analyze how is the profitability of each Sharia Commercial Banks in Indonesia, then ranking Sharia Commercial Banks based on the level of profitability that is achieved
3. To analyze the the profitability trend of Sharia Commercial Bank in Indonesia
4. To know about the correlation between sharia compliance and profitability of the sharia bank.
5. Grouping the sharia commercial bank based on sharia compliance and profitability index that are achieved during period 2014-2017 by use klassen typology framework.

1.4 Research Advantages

This research is expected to be benefits for writers and be concerned for other parties. As for the benefits of this research include :

1. As the partial fulfillment of the requirements of the Bachelor degree in economics.
2. For writers, improving the writer's ability in writing reports and doing research, especially in this research analysis.
3. For the reader is expected to get understanding gain the knowledge regarding the economic analysis about the context of the analysis of Maqashid Sharia Index and profitability of Sharia Comercial Banks on period 2014-2017.
4. For a researcher in the field of economics and finance is expected this study can be a reference for next research.
5. For government or Sharia Comercial Bank Stakeholder will be recommended to take better policy about how to reach a better performance of Sharia Bank.

1.5 Scope of Study

Sharia Commercial Banks in Indonesia are still experiencing a slowdown in asset growth, while other types of banks (UUS and BPRS) have been able to rise in 2014. So, the authors are interested in knowing how Sharia Commercial Banks perform from 2014 to 2017 when viewed from sharia compliance and performance finance. In addition, the total assets of Sharia Commercial Banks reached 65.46% of the total sharia banking assets in Indonesia. Thus, the performance of Sharia Commercial Banks will greatly influence the overall Islamic banking system.

There are thirteen Sharia Commercial Banks in Indonesia on August 2018 when this paper is written. But this research will be focused to analyze Maqashid Sharia Index and also profitability for twelve Sharia Commercial Banks in Indonesia. These banks are ; *Bank Muamalat Indonesia, Bank Syariah Mandiri, Bank Mega Syariah, Bank BRI Syariah, Bank Panin Dubai Syariah, Bank Victoria Syariah, Bank BCA Syariah, Bank Jabar Banten Syariah, Bank BNI Syariah, Bank Maybank Syariah Indonesia and Bank BTPN Syariah*. While *Bank Aceh Syariah* which was established in 2016 was not included in the sample due to insufficient period of data. The data for this analysis is annually data from 2014-2017. So, the data that use in this research is the latest data which comes from the official website of each bank.

The method used as a guide in measuring the achievement of shariah banking objectives is the Maqashid Sharia Index (MSI) method developed by Omar Mohammed, et al (2008). While the measurement of profitability is limited to measuring the ratio of NOM, ROA, ROE and BOPO by using the Comparative

Performance Index (CPI) method. There are no time requirements in measuring MSI and CPI. Although the research period is only four years from 2014 to 2017, it will not affect the validity of the research results.

Next, correlation analysis between sharia compliance and profitability of the bank will be done by using pearson correlation analysis. At the end of data analysis, bank grouping will be carried out to classified the sharia bank in Indonesia based on maqashid sharia and profitability that are achieved. It will be analyzed by using Klassen Typology framework. This framework classified the bank into 4 (four) categories, they are ; 1) advanced sharia and fast growing bank, 2) advanced sharia but weak growing bank, 3) sharia retarded but fast growing bank, 4) relatively backward sharia bank.

1.6 Writing Systematic

The study consists of 6 chapters from introduction to the conclusion and recommendation. The complete lists of this research as follows:

Chapter 1: Introduction

In this chapter includes background of the research why choose this topic, research problem, research objective, research advantage, limitation of study in this study.

Chapter 2: Theoretical Framework and Review Literature

This chapter includes reference and review literature which are related with sharia bank, profitability, Maqashid Index theory and klassen typology theory.

Chapter 3: Research Method

This chapter explains about research methods, operational definition of the variables study, collect all data, source of data, method and data analysis method.

Chapter 4: General Overview

This chapter describes about the trend that happened in each variable that is affect the profitability and Maqashid Index of Sharia Comercial Bank.

Chapter 5: Empirical Result and Analysis

This chapter endwise of the outline result, discussion of description in object research, data analysis and description.

Chapter 6: Conclusion and Recommendation

This chapter consists of conclusion of the analysis carried out, suggestion, and implication arising from the conclusion of the problem.

