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Analysis of Islamic bank's performance and strategy after spin-off as Islamic full-fledged scheme in Indonesia

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Abstract

This paper analyses the performance and strategy of Islamic banks after the spin-off and establishment of a full-fledged Islamic bank (separated from the parent bank). Siswantoro (2012) stated that one good strategy was to acquire a good conventional bank then convert it into a full-fledged Islamic bank. The research methodology used is descriptive with graph analysis (a) after spin-off and (b) after September 2010. The sample in this research is eight Islamic banks that were recently established as full-fledged Islamic banks. Most Islamic banks that have been converted in the full-fledged scheme could optimize some source of funding such as capital injection and increasing temporary investment deposit. *Murabahah* (selling activity) still dominated their loan due to low risk and fixed income.

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Keywords: Islamic bank; spin-off; full-fledged; performance; accounting;

1. Introduction

The growth and development of Islamic banks in Indonesia has been quite surprising. From one Islamic bank in 1992, Bank Muamalat, in 2013 there were 11 full-fledged Islamic banks and 24 Islamic unit banks. The interesting issue is that many Islamic banks converted and operated under a full-fledged system that is separate from their conventional parent company. The previous success stories are those of Bank Syariah Mandiri (BSM), established

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in 1999, and Bank Mega Syariah Indonesia (BSMI), established in 2004, which have grown very rapidly. This phenomenon may attract Islamic unit banks to convert into the full-fledged scheme.

Research in Islamic bank spin-offs is quite rare because it occurs only in specific countries such as Indonesia, which permits a dual banking system under full-fledged or Islamic units. In Indonesia, there are no different treatments from the central bank for either bank. Interestingly, many Islamic units separated and converted under the full-fledged scheme. Siswantoro (2012) found that Islamic banks may be better off if they acquire a good conventional bank to be converted into an Islamic bank with a full-fledged scheme. However, with a new Islamic bank, capital injection would be effective if it was used to expand the bank's strategy and to strengthen the network. This paper aims to analyse the performance and strategy of Islamic banks after spin-offs (or opened as a full-fledged Islamic bank) are established as independent Islamic banks. The paper includes historical background in Indonesia and related research into spin-offs in any business aspect, not just cases of Islamic banks. It also discusses spin-offs' strategy (acquisition, phase) and research method. Then the analysis describes the spin-offs' effect in equity, unrestricted investment funds, and the ratio of *murabahah* (selling) to funding (*mudharabah* and *musharakah* (profit sharing scheme), then conclusion.

2. Historical and literature background

The main issue with spin-off Islamic banks is the purity concern regarding interest rates from the customers' perspective. Some Muslims may not be comfortable if an Islamic bank operates as a single unit with a conventional bank (operating under one roof) that charges an interest rate, which is prohibited by Islamic teaching.

However, existing full-fledged Islamic banks can grow remarkably, such as Bank Muamalat as the first Islamic bank; Bank Syariah Mandiri, which was converted from a conventional bank (Bank Susila Bakti) into an Islamic bank after the monetary crisis in 1999; and Bank Syariah Mega Indonesia, which converted in 2004 from a conventional bank, Bank Umum Tugu. These banks showed promising and significant growth in equity and savings accounts, especially Bank Syariah Mandiri.

Bank Syariah Mandiri grew much more rapidly than Bank Mega Syariah Indonesia, especially in the area of unrestricted investment accounts. The bigger the account, the more efficient has been Islamic bank management, which commands a bigger fee. Siswantoro (2012) highlighted that having many branches also can support Islamic bank growth because it becomes easy for customers to open accounts and conduct related activities.

In the case of Islamic bank development, Indonesia's central bank, Bank Indonesia, permits a conventional bank to open an Islamic unit that operates under the Islamic unit scheme and does not convert directly into a full-fledged Islamic bank. Previously, it only allowed separate branches for Islamic banks. It was Bank IFI Syariah, opened in 1999 in one Islamic branch in Jakarta. After the Islamic unit scheme was permitted, other conventional banks opened Islamic units, which meant operating under the same roof with the conventional bank. For instance, Bank Negara Indonesia and Bank Jabar opened Islamic units in 1999. By 2008, there were 27 Islamic unit banks, and the number of full-fledged Islamic banks grew from three to five. By 2013, there were 11 full-fledged Islamic banks and 24 Islamic unit banks in Indonesia.

The significant growth of full-fledged Islamic banks in the early 2000s convinced other banks to spin off their Islamic bank unit. However, such growth is only possible if Islamic banks have an effective strategy and management to meet their goals. Research on this issue is quite rare. Siswantoro (2012) analysed the strategy of Islamic banks to expand their business after spin-offs from their parent company. To accelerate such spin-offs, one Islamic bank generally acquires an existing conventional bank to be converted into a full-fledged Islamic bank, so long as the acquired bank is in good condition and has good future prospects. In this case, Bank Rakyat Indonesia is better performance than Bank Bukopin because it acquired a better bank than Bukopin did.

Not many papers have studied spin-offs of Islamic banks. Others were generally on the effect on stock prices after spin-offs. Abarbanell *et al.* (2003) found no correlation between abnormal return and event after spin-offs for institutional investors. However, they said that previous researchers had found a response with positive abnormal return after spin-off transactions in general. Jongbloed (2004) found that spin-offs can create an abnormal return of the company in the stock market. This may be caused by a positive response from shareholders because of benefits from spin-off transactions, though in other cases it occurred differently. However, spin-offs can create hope for better management, directors, and culture, which has a positive tendency. After spin-offs, a company can determine policy based on its intention and objectives. Islamic banks learned this may occur if they are listed on the stock exchange.

Veld and Veld-Merkoulova (2004) identified that the spin-off effect in Europe does not have a long-running association with performance when compared to the United States. In general, spin-offs have a positive abnormal return on stocks. Other reasons are (a) asymmetric information, which can lower the value, (b) increasing corporate governance, (c) geographical focus, and (d) tax issues. Similarly, Yoon and Ariff (2007) analysed the effect of company spin-offs in Malaysia and found effects similar to those in the United States and Europe. They also found that market capitalization has a positive correlation with abnormal returns, while age has a negative one. The bigger and newer the company, the greater the positive abnormal return.

In addition to stock price reaction, bond price after spin-offs can be an indicator. Veld and Veld-Merkoulova (2008) found that bondholders are not affected by company spin-offs and that not only do stocks have an abnormal return but also bond prices. Maxwell and Rao (2003) analysed the price of bond movement after spin-offs and found different results in share prices. Negative abnormal returns in bond prices may be caused by downgrades from spin-offs, but then would be upgraded. In addition, there is a negative relationship between leverage ratios and abnormal bond return. So far, there has been no further research in the case of Islamic bank spin-offs by parent banks.

Other researchers analysed the effect of spin-offs on company performance itself. Yagüe-Perales and March-Chordà (2012) analysed the development and growth of spin-off companies in the biotechnology industry and found more challenges and disadvantages, while the advantages are attracting more capital and increasing turnover. Chemmanur and Liu (2011) found that spin-offs can increase information production through restructuring issues by institutional investors. Similarly, Chemmanur and Yan (2004) analysed that spin-offs can affect the performance of a company in the long run, increase the possibility of takeover by management, and affect the management of the company. Gertner *et al.* (2002) found that, after spin-offs, a company has more opportunity to expand its investment by improving the company because it can manage the company independently and set incentives, which can inspire trust in investors. In addition, the capital market responds differently to spin-offs transaction. Patro (2008) identified benefits of spin-offs such as (a) expansion opportunity, (b) fewer problems, and (c) efficiency in governance. Shares also can be sold by employees to increase a sense of belonging and motivation. Therefore, Islamic banks that have been spun off should prepare a good strategy to boost their performance and penetration in the market with varied funding sources.

Moreover, Iturriaga and Cruz (2008) found that spin-offs can enhance network and strategic alliances. In addition, a company can focus on its objective and increase incentives for employees. Mehrotra et al. (2003) found that, after spin-offs, a company can have more leverage because of a greater cash flow, return of asset, stable operating income, and bigger fixed assets. Some Islamic banks have similar patterns to increase their networks after spin-offs.

However, problems may occur after spin-offs. Sahaym (2012) argued that a company may face a new and unclear identity in the industry after a spin-off, while leverage by the parent company may be eliminated. Dittmar (2004) found that profitability of the company does not correlate with the leverage choice of the company after a spin-off. The growth has a negative correlation with leverage choice but not for collateral value. Colak and Whited (2007) analysed the difference between divestments and spin-offs and found, in general, no significant differences and no improvement in investment efficiency. This may not occur at Islamic banks as they have a captive market and a positive trend in Indonesia.

From previous studies, we can see that what was relevant to Islamic bank spin-offs were (a) increasing financial performance, (b) opportunity to expand the investment as well as network alliance, and (c) financial restructuring and independent management. After spin-offs, Islamic banks can have a separate business and policy from the conventional parent company. In this way, customers would be comfortable and free from involvement in conventional activities.

3. Research methodology

The research methodology used is descriptive and graph analysis. The sample is all Islamic banks in Indonesia that are spin-offs from an Islamic unit or have gone directly to full-fledged. The period is from March 2009 to September 2012. The analysis started from the first period after spin-offs for each Islamic bank and during the specific period. The separation is first to see the proper comparative moment (first analysis period), while the second one examines updated performance.

Table 1. Sample of spin-offs date

Bank	Date of spin-offs	Information
BRI	January 2009	Spin-offs
Bukopin	July 2009	Spin-offs
Paninbank	January 2010	Directly full-fledged
Bank Victoria	February 2010	Directly full-fledged
BCA	Maret 2010	Directly full-fledged
BJB	April 2010	Spin-offs
BNI	May 2010	Spin-offs
Maybank	October 2010	Converted

The first period analysis covered the movement of funds after spin-offs for each Islamic bank. There are three types of Islamic banks in the full-fledged scheme:

a. Islamic unit to spin-offs to be converted as full-fledged Islamic scheme, such as BRI (previously Bank Jasa Arta), Bukopin (Bank Persyarikatan Indonesia).
b. Acquire to convert to open directly as a full-fledged Islamic scheme, such as Paninbank (Bank Harfa), Bank Victoria (Bank Swaguna) and BCA (Bank Utama Internasional Bank).
c. Spin-offs from conventional parent bank such as BJB and BNI and converted to all parent conventional bank, such as Maybank.

Then second analysis (specific period) captured the condition of Islamic banks from October 2010 to September 2012, this analysis covered the same period.

4. Analysis

The analysis of equity growth after spin-offs for each Islamic bank would be compared from when they spun off. The earliest capital injection was conducted by BRI at the 13th month. It was followed by Bank Panin Syariah at the 17th month and Bank Bukopin Syariah at the 21st month. The latest was Bank Jabar and Banten Syariah (BJB) at the 26th month (see Fig.1). The faster the Islamic bank injects its capital, the faster it can strengthen its network and grow.

Without capital injection, the growth of capital remains steady and stable. This may be because the natural capital growth of Islamic banks is not fast enough. Yagüe-Perales and March-Chordà (2012) commented that spin-offs can attract investors to add capital, which can improve financial performance. However, in the case of Islamic banks, attracting new investors is difficult in Indonesia because new capital injection was from their parent companies. In addition, no Islamic bank in Indonesia went to an initial public offering (IPO) to issue shares to add capital. This may require momentum to expand and develop Islamic banks after spin-offs transactions.

Banks with small capital amounts also increased their capital. These include Panin Bank and Bank Bukopin, but not Bank Victoria. Islamic banks with the most capital, such as Maybank and BNI, did not add capital. This shows that large Islamic banks assumed their capital was strong enough (see Fig.1).

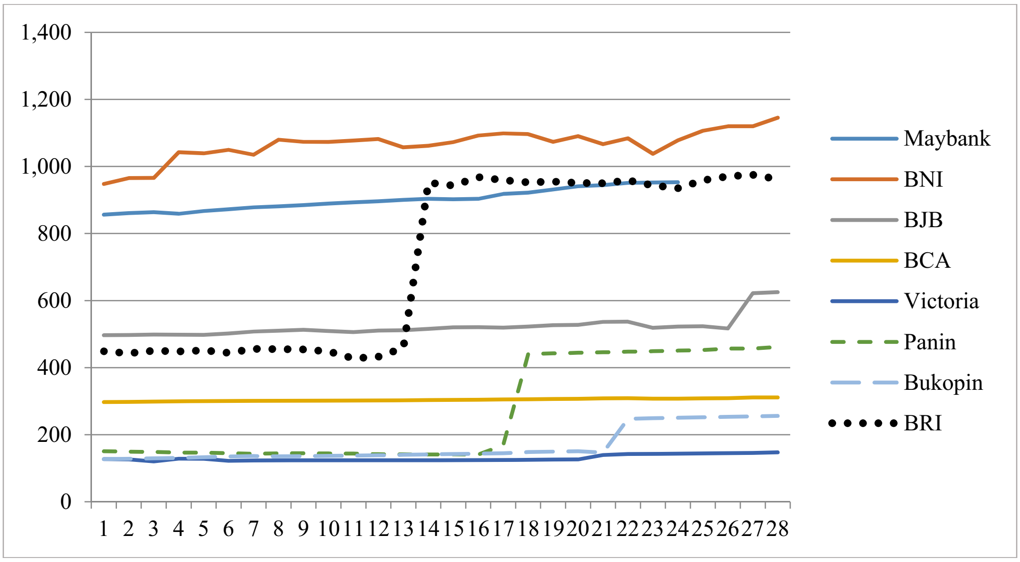

Fig 1. Equity Growth after Spin-offs (in Rp bn)

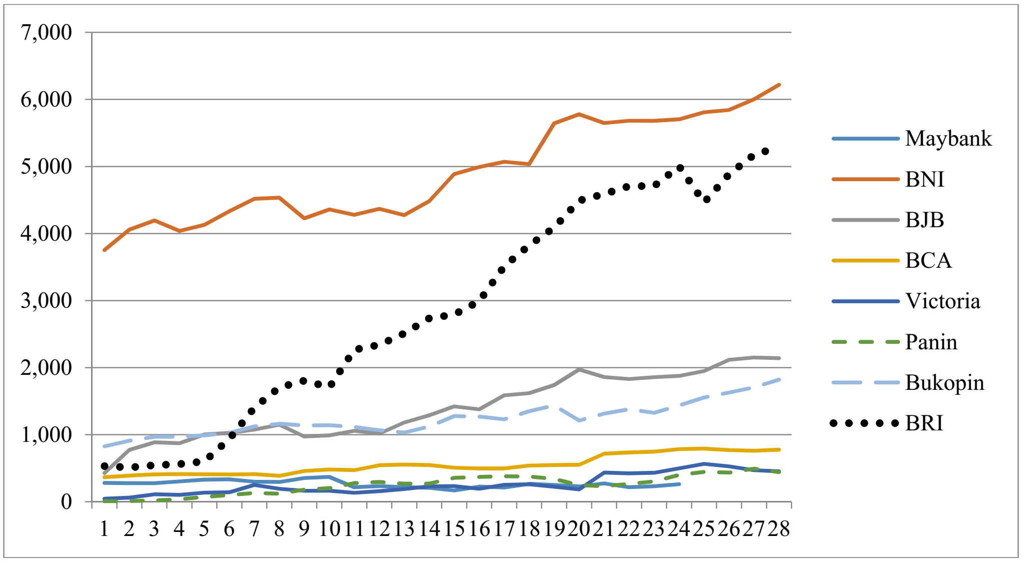

Fig. 2. Unrestricted Temporary Fund Growth after Spin-offs (in Rp bn)

The most aggressive Islamic bank in unrestricted temporary fund (savings account) growth was BRI. This phenomenon may be supported by its capital injection. The bank can manage and allocate its capital effectively to increase its savings account (unrestricted temporary fund). After BRI, only Bukopin and BJB show promising savings account increase compared to other Islamic banks. Bank BJB increased its savings account without capital injection, and the capital injection at the 26th month did not directly affect its savings account, which remained steady (see Fig.2). Gertner *et al.* (2002) said that spin-offs can improve management and independent policy. Islamic banks with effective management can attract customers to invest in them.

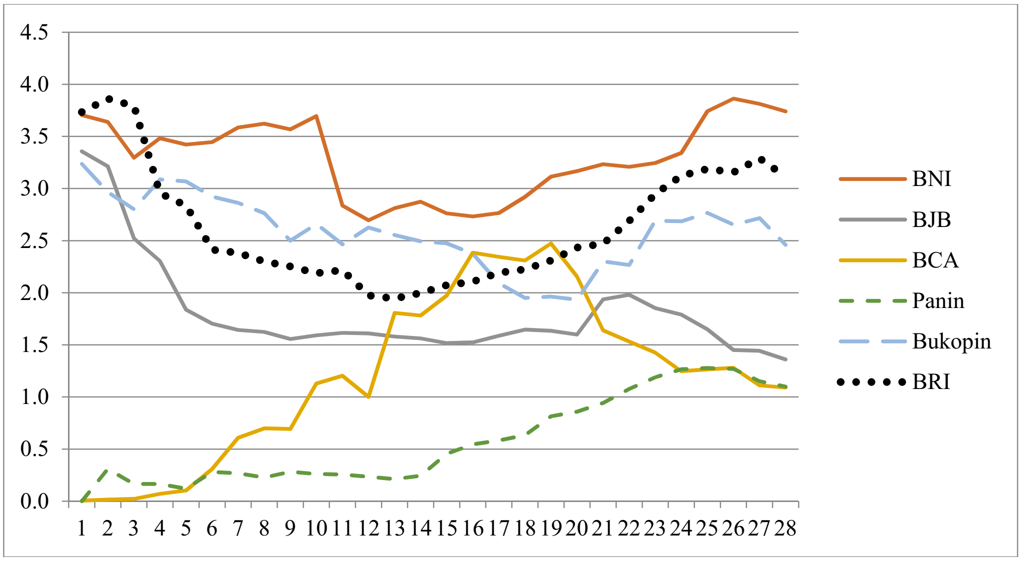

Fig. 3. Ratio of Murabahah/Funding after Spin-offs

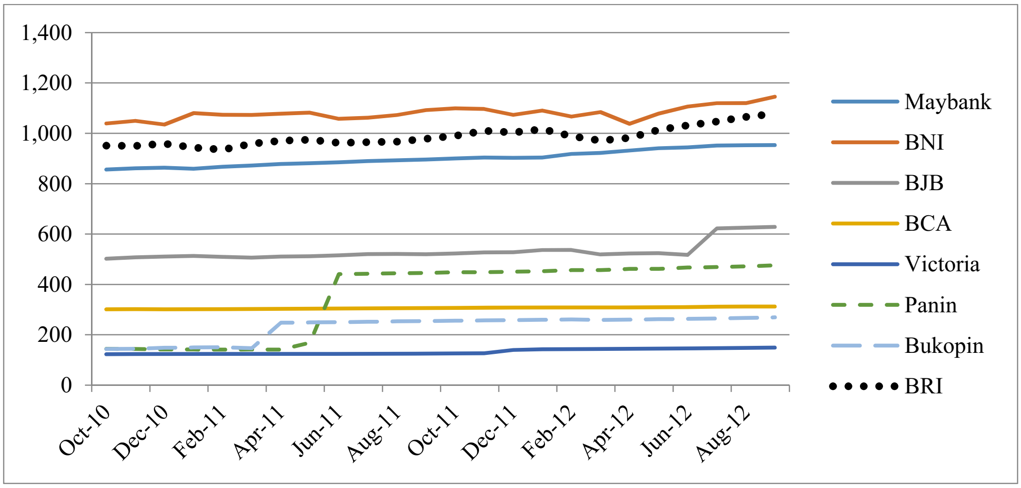

Fig. 4. Equity Growth (after September 2010) (in Rp bn)

Among four Islamic banks with the biggest savings accounts, only Bank Jabar Banten (BJB) had a decreasing ratio of *murabahah*/funding after spin-off. *Murabahah* is a sales transaction with a fixed margin. Their funding consists of *mudharabah* (profit sharing) and *musharakah* (profit sharing, but joint project shareholder) but *murabahah* is safer from an Islamic bank perspective because it has fixed margin income, while *mudharabah* and *musharakah* are based on the bank's net income. BCA and Paninback started with the lowest ratio; it then increased but later tended to decrease. Maybank and Bank Victoria were excluded because Maybank did not have funding since November 2011 (14th month), and the ratio was around 41-fold since September 2011 and averaged 2.7 between October 2010 and August 2011. Banks with biggest unrestricted investment funds have the highest ratio, such as BNI and BRI (see Fig.3). This may be because *murabahah* is easier to disburse and safer (which means it does not need complicated analysis and has smaller risk).

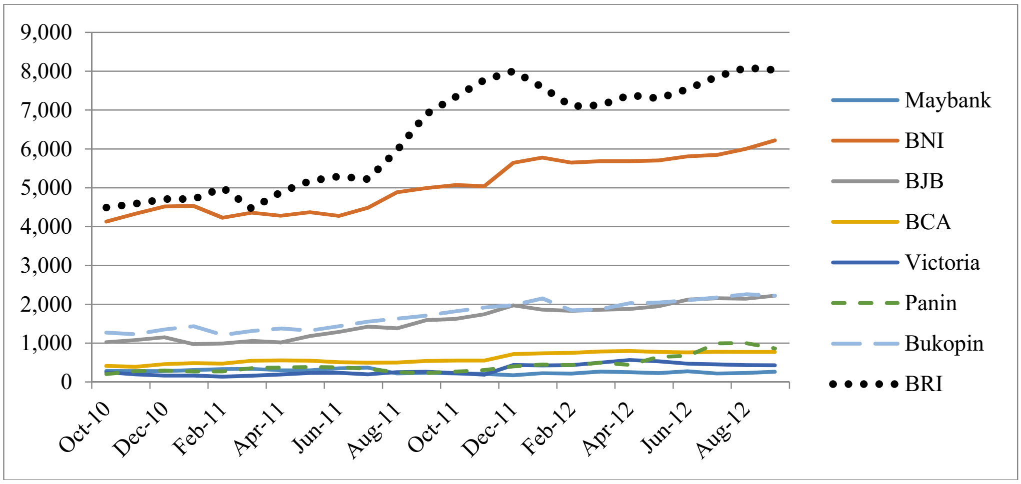

Fig. 5. Unrestricted Temporary Fund Growth (after September 2010) (in Rp bn)

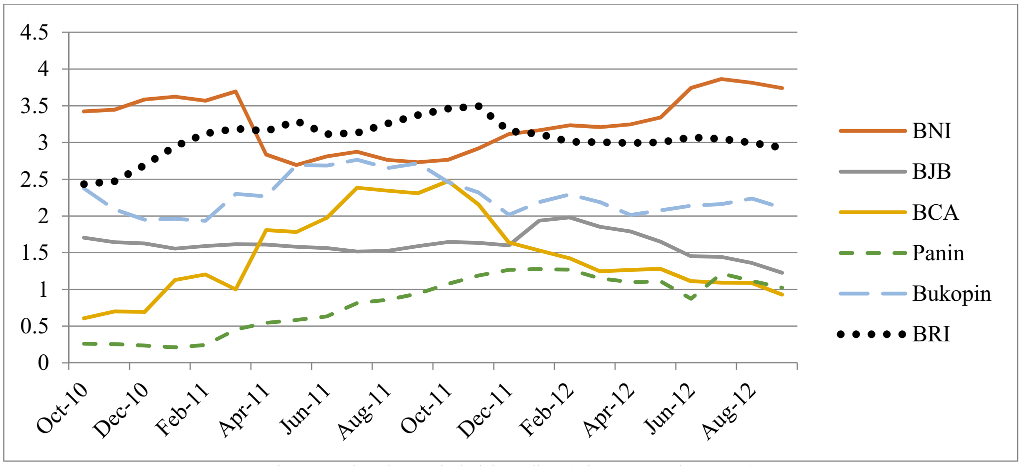

Fig. 6. Ratio of Murabahah/Funding (after September 2010)

Equity showed no difference between the first and second analyses (Figs. 1 and 4) from October 2011 until September 2012. Capital injection is needed to support the development and growth of Islamic banks in Indonesia. In this case, Bank Victoria was at the lowest position among Islamic banks (see Fig.4). To meet economies of scale, Islamic bank should add capital to support their operational expense and strategy.

Unlike in the first analysis, from October 2010 to September 2012, BRI had the biggest savings account. It was followed by BNI. After the capital injection, BRI could manage and expand its strategy effectively. This can be seen in the sharp increase in the savings account. While Bukopin was slightly above BJB at the first analysis, it was below BJB in the second (see Fig.5).

5. Conclusion

Capital injection in Islamic banks after spin-offs from parent companies can accelerate their growth. However, it must be supported by effective management. This phenomenon is shown by BRI and Bukopin. For Paninbank, it seemed that the capital injection did not affect its growth. This was also the case with BJB and may be due to the timing of the capital injection. To be effective, capital injection should be conducted quickly after spin-offs. However, Islamic banks can utilize other funding such as (a) issuing *sukuk* (bond), (b) initial public offering (IPO), and (c) direct investment. So far, only bond issuance is used for this issue.

While the ratio of *murabahah*/funding may be caused by the position of unrestricted investment fund (savings account), Islamic banks with the biggest unrestricted investment fund or savings account also have the highest ratio, and vice versa regarding the smaller banks. This may be because the *murabahah* scheme is easier to manage and disburse than the profit sharing funding scheme (*mudharabah* and *musharakah*).

Further research in this area should determine (a) the effect of spin-offs to parent's share price, (b) other effective funding after spin-offs, and (c) the effect of spin-offs on an acquired bank that is converted to an Islamic bank. Islamic banks have potential growth and development in Indonesia, but these must be based on effective strategy in management and financial analysis.

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