

# CHAPTER I

## INTRODUCTION

### 1.1 Background

The existence of banking as financial intermediate institution, take the roles as part in the economic growth. The Indonesian economic growth in the regional level influenced so much by the role of Regional Development Bank which called as Bank Pembangunan Daerah (BPD). Therefore, the BPD performance will also influence the local economic development. BPD is banking with fifty percent of the shares are belongs to the local government (province), which is assist the local potential economic resource development through equity financing. The BPD working scope is only limited to the financing order in the province, district and sub-district level. Only certain BPD has challenged to open their branch beyond the border.

Now, BPD is acting as Commercial Banks (BUS Company or parent company) and BPD sharia is as its Banking Units (UUS or Islamic Banking Windows). In UUS the organizational structure is somewhat different. Though itself chaired by the head of UUS who leads operational activities such as treasury activities and business operations, but the central management of risk is still in the risk management department in the parent company. This dual banking system let the bank customer choose either going to the conventional or Islamic one.

Islamic bank accelerate-grows significantly since the Central Bank issued the dual banking system.<sup>1</sup> In this rules, banking units may issue and offer their own Islamic banking products those are different with the conventional with separate infrastructures, staffs and their own branch offices. Based on OJK data-August 2015, there were 12 BUS, 22 UUS and 136 BPRS in Indonesia. Among 22 UUS, the 68% or 15 UUS are belonging to BPD.

Since the issuance of Central Bank Regulation<sup>2</sup>, a new phenomenon was born follow on dual banking system, i.e. spin-off now or not to spin-off? Several expertise said that too costly for the newly-bees to compete with the established BUS.<sup>3</sup> Therefore, need prolong time for UUS become BUS or at least UUS have to apply leveraging model or office channeling where the infrastructures are still attach to the parent company. Some said, since middle capital prone to the riskiest, therefore it can be consolidated the UUS banks like BPD Sharia Jabar and BPD Sharia Banten did,<sup>4</sup> or make a new collaboration such BPD Celebes Sharia or BPD Borneo Sharia,<sup>5</sup> because the merger or accusation is alternatively solution

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<sup>1</sup> Undang-Undang No. 10/1998, source [www.bi.go.id](http://www.bi.go.id)

<sup>2</sup> Undang-Undang No.21/2008 and Undang-Undang No. 11/2009, pasal 40 ayat 1 says that “Conventional Banks (BUS/Parent Company) those who has Islamic Banking Unit (UUS), have to release it become independent BUS when UUS asset reach 50% of Parent Company’s asset before 2023.” source [www.bi.go.id](http://www.bi.go.id) retrieved on November 1, 2015, 19:40:03WIB

<sup>3</sup> Sri Sugiarti on her interview report with Herwin Bustaman (Head of Sharia Banking Maybank Indonesia) 19/10/2015 for Keuangan Syariah Magazine, “Spin Off Beresiko Bagi Bank Syariah”, <http://keuangansyariah.mysharing.co/spin-off-beresiko-bagi-bank-syariah/>, retrieved on October 20, 2015, 20:15:00WIB

<sup>4</sup> UUS BPD Syariah Jabar and UUS BPD Syariah Banten merged become BUS under name BJB Syariah

<sup>5</sup> Farodillah Muqoddam on his interview report with Mulya E. Siregar (Commissioner Deputy of Banking Inspector OJK) 07/10/2015 for Syariah Bisnis Magazine, “Tak Semua Unit Usaha Syariah Bisa Spin Off, Mengapa?”, <http://syariahbisnis.com/read/20141007/232/263053/ojk-tak-semua-unit-usaha-syariah-bisa-spin-off-mengapa>, retrieved on October 20, 2015, 20:18:00WIB.

to increase the capital and to reduce the banks number.<sup>6</sup> Other economists also said, that when UUS managing separately from its BUS, they have to consider the economics of scale condition. Because if the scale were still likely low, Islamic bank will not efficient enough to compete with the established bank in accumulating funds, handling high cost of funds (due to competition in collecting deposits) and in giving competitive financing rate.<sup>7</sup>

Efficiency is an important indicator of entire company activities measurement. Efficiency often means by how company produce at lower cost. Efficiency is also means by the relationship between outputs and input i.e. how to allocate the optimum production factors in order to get maximum output. A company will be said has a high efficiency if the total input produce more or in a certain total output it can used less input. The efficiency of a bank or a banking industry is an important overall aspect that often seemed to be absorbed in generates a healthy and sustainable financial performance (Berger and Mester, 1997).<sup>8</sup>

The efficiency of banking industry can be viewed from the micro and macro perspective. From the micro perspective, A bank has to be efficient in its operation if were capable to sustain and develop in the tight competitive banking market. An inefficient bank would be exit from the market due to incapability in

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<sup>6</sup> Nuraini on her interview report with Achmad K Permana (Director of Permata Bank Syariah) 10/09/2015 for Republika Newspaper, "Spin-Off UUS BPD Dinilai Tidak Efisien", <http://www.republika.co.id/berita/koran/financial/15/09/10/nug60a23-spinoff-uus-bpd-dinilai-tak-efisien>, retrieved on October 20, 2015 20:30:00WIB

<sup>7</sup> Paulus Yoga on his interview report with Maryono (Director of BTN Tbk) 19/10/15 for Info Bank News, "Menghitung Deadline Spin-Off UUS", <http://infobanknews.com/menghitung-deadline-spin-off-uus/>, retrieved on October 20, 2015, 20:20:00WIB

<sup>8</sup> Berger, A.N. and Mester, L.J. (1997). Inside the black box: what explains differences in the efficiencies of financial institutions, *Journal of Banking and Finance* **21**, page: 895-947.

the competition, either in pricing, or quality of product, or services. Inefficient banks would face difficulties in maintaining client loyalty and also not attractive by potential customers in order to increase its customer-base.

While in macro perspective, an efficient banking industry would influence the intermediation cost and financial system stability. It is because of strategic role of banking industry is as an intermediary and as a producer of financial services. With a high efficiency level, bank would be better in allocating financial resources and by the end, would increase the investment activities and economic growth (Weill 2003).<sup>9</sup>

Wheelock and Wilson (2015) noted that efficiency is an important banking operational condition and one of banking individually success indicator after comparing it with whole banking industry Efficiency study also important to measure a potential impact from a central bank policy toward a revision policy.

Sharia regional development bank or Bank Pembangunan Daerah Sharia (BPDS) is a part of national banking system that also have to show an optimum efficiency of its performance in order supporting the financing of local development. At the same time, BPDS have to ready competing with the aggressive parent company and other banks. Therefore, BPDS have to strengthen the function as an intermediary institution as well as to improve the efficiency performance of its operation activities.

Inefficiency will become a stumbling block in the head to head competition between BUS and UUS. To win this competition, or at least, to improve its

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<sup>9</sup> L. Weill (2003), "Banking efficiency in transition economies: The role of foreign ownership," *Economics of Transition* 11, page 569 –592.

performance, UUS have to had a clearly understand their own strengths and weaknesses. Therefore, efficiency study is an important analysis that UUS have to do regularly to maintain the strength its function as an intermediary institution and to support its readiness for spin-off execution in 2023. Hence, this study will **Analyze the Efficiency of Sharia Regional Development Bank (BPDS) in Indonesia, those are listed as an banking units sharia (UUS) in Bank Indonesia.**

### **1.2 Research Limitation**

The constraint of this study is strongly objected to restrict to the particular point of:

- a. This research aimed to the BPDS as a banking unit sharia (UUS) of BPD, those provide financial report data and facing the dilemma of spin off 2023.
- b. The financial report data used is the available quarterly data in Bank Indonesia since the launch of BPDS until September 2015.
- c. Despite the availability of the data, this research suggests and restricts only to aspect of earning or income and cost, since the capital and asset of UUS still attaching to the parent company.

### **1.3 Research Question**

Based on the elaboration in the study background, the researcher decides to arrange all the details of problems as follows:

- a. Does all of Islamic Business Unit of BPD in Indonesia efficient?

- b. Does all of Islamic Business Unit of BPD ready for spin-off in 2023?

#### **1.4 Research Objectives**

Based on the research questions above, the researcher resolves to set specific aims as follows:

- a. To provide a latest empirical evidences for the efficiency of BPDS
- b. To analyze the data for knowing of readiness the BPDS facing the spin-off 2023

#### **1.5 Research Benefits**

- a. This research optimistically hope provides benefit for the stakeholders of BPDS especially, and for the regulator (Bank Indonesia) in order to formulate the suitable policy to improve the synergy between BPD and BPDS in facilitating intermediary process to the real sectors.
- b. This research study would also benefit for bankers in BPD and BPDS in describing their position in the banking system.
- c. The bankers of BPD and BPDS would realize potential strengths and weaknesses and propose an alternative answer for solving the problems.