

# Readiness of Conventional Commercial Banks in Indonesia to Face Spin Off

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## **ABSTRACT**

Research was conducted to investigate readiness of the Conventional Commercial Bank in Indonesia that open Islamic banking units to face spin off. The variables used in the research are Government Regulations, Information Technology, Diversification Strategy and Spin Off Readiness. Research method is a census with unit analysis of all conventional commercial banks that open Islamic banking units. Collected data is processed using software SmartPLS 3.0. Conventional commercial banks that manage Islamic business units are not ready to spin-offs. It is found that Diversification Strategy does not affect to Spin Off Readiness.

**Keywords** - Government Regulations, Information Technology, Diversification Strategy, Spin Off Readiness

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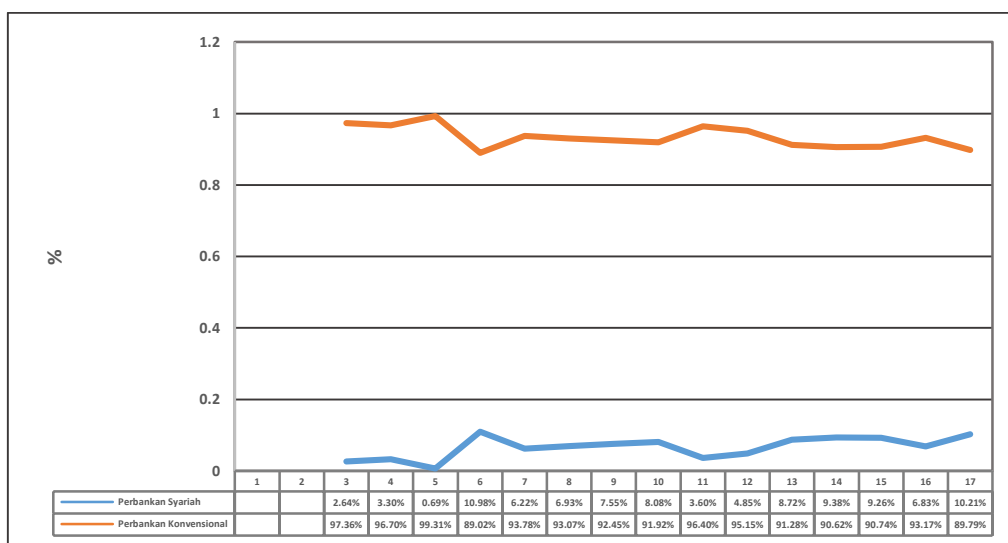
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## **INTRODUCTION**

Since the enactment of law number 7 of 1992 which was amended by law number 10 of 1998 and lastly with the enactment of law number 21 of 2008, conventional commercial banks are allowed to manage sharia business units. There are 20 conventional banks that manage sharia business units must spin off no later than July 2023. Conventional Commercial Banks that have Islamic Business Units are a business diversification strategy in order to increase market share in the targeted business, bank efficiency and increase banking profits. Russo (1992) suggest that there is a regulatory effect on diversification and backward integration and supports the theory of transaction costs. Islamic banking operations are more productive than conventional banking schemes since 1997 due to the migration of generated funds (Batchelor, 2005). Alam (2012) states that the average cost efficiency score for the conventional banking industry is higher than the Islamic banking sector, while the profit efficiency score for Islamic banks outperforms conventional bank. Implementation of information technology Microsoft Digital Nervous System (DNS) which is expected to operate an effective and efficient communication and information sharing system throughout the organization so as to enable it to respond and react quickly to customer feedback (Fontain, 2013). Information technology helps support the acquisition and assimilation of external knowledge, in the form of absorption capacity to support information technology that can be used to activate absorption capacity in relation to organizational learning such as knowledge alliances and networks (Dong & Yang, 2015).

Delta of the market share of Islamic banking compared to conventional banking can be seen in Figure 1.2. The market share of Islamic banking in 2020 was the largest since 2005 due, among other things, to the conversion of Aceh's conventional banks to Aceh's Sharia Commercial Banks in 2016. It was added that there was a regulation, Aceh Qanun Number 11 of 2018 concerning Islamic financial institutions which stipulates that Islamic banking institutions Conventional finance that is already operating in Aceh must open a Sharia Business Unit.



Graph 1 : Delta Market Share of Islamic Banking and Conventional Banking for the Period of 2005 to 2020

## RESEARCH CONTEXT

Separation of company divisions into an independent company through a spin off process increases the value of the company in order to mitigate information asymmetry. Companies that do spin off generally have a higher level of information asymmetry than the industry and experience a significant decline after the spin off. Companies with higher growth and requiring external capital show a higher tendency to spin off (Krisnaswami et al, 1990). Main difficulties faced by spin-off companies are raising capital, managing growth and penetrating new markets, business problems rather than technological problems (Smilor et al, 1990). Some small to medium-sized companies that grew and developed from their initial status as small-scale spin-off companies, encountered obstacles to growth in finance, competition between companies and organizational integration (Feldman et al, 1999).

Government regulations on the restructuring of Sharia Business Units require that conventional banks that open Islamic banking units must increase their business capital to a minimum of IDR 500 billion become a Islamic Commercial Bank from the previous minimum requirement to open a Islamic Banking Unit, which is IDR 100 billion (Bank Indonesia Regulation number 11/2009).

Research conducted by Davis (1993) developed a technology use model (TAM) that the use of an application is influenced by the ease of use of the application and the benefits obtained by consumers to facilitate daily transactions through the online/digital technology application. Venkatesh (2003) combines several theories/models in the use of these technologies for company activities such as training, marketing and other company activities.

Digital banking transactions can be an example of technology applications used by digital bank customers, which currently have 7 establishments in Indonesia Stock Exchange. The convenience and benefits of using digital bank applications can be one of the advantages in the competition between banks and non-bank financial institutions such as multi-finance institutions, pawnshops and others. The Financial Services Authority has issued a regulation regarding digital banks Number 12/POJK.03/2021 concerning Commercial Banks. The transformation of advanced digital banking into a program from the Financial Services Authority made in the Road Map for Indonesian Banking Development 2020-2025. Santhanam (2013) suggests that companies with superior information technology capabilities show better and sustainable company performance compared to the average industry performance. According to OJK, one of the challenges faced by Islamic banks in the field of information technology is the low quality and quantity of information technology, which hinders the development of services and products due to the limitations of banks to develop IT independently. Digital transformation of Islamic Banks including Sharia Business Units is a necessity because of the demands for changes in digital behavior (digital behavior) of the community. Information technology is a priority for Islamic banking to improve its performance.

Companies involved in the spin off have a higher level of information asymmetry compared to the industry and it decreases significantly after the spin off (Krishnaswami, 1999). Separation of company divisions through spin offs can increase value because it will reduce information asymmetry about the company

The establishment of new companies based on technology as a result of spin-offs is common in the United States due to employees separating themselves from companies in the same industry, encouragement from external factors, entrepreneurship factors and the product life cycle (Garvin, 1983). In contrast to banking spin-offs in Indonesia, more are driven by external factors, namely the existence of government regulations through Law Number 21 of 2008 concerning Islamic Banking.

## HYPOTHESES DEVELOPMENT

Regulation is the main prerequisite for effective public policies for sustainability and corporate social responsibility (Steurer, 2013). Sharia Business Units that run banking services with sharia principles in addition to *tijarah* (commercial) orientation also have social obligations and responsibilities through *tabarru* (social) contracts such as *zakat*, *infaq*, *shodaqoh*, *waqf* and other instruments. The provision of financing with *tijarah* contracts such as *murabahah*, *mudharabah*, *musyarakah*, *ijarah*, *salam*, *istishna* and other contracts is also intended to be able to move the community's economy in order to achieve economic justice and distribution of income and reduce poverty.

Government regulations bind all relevant parties and the executive and judiciary are the institutions tasked with enforcing regulatory compliance (Shaffer, 1995). If the regulations are not complied with by the Sharia Commercial Bank that manages the UUS, it will be subject to sanctions ranging from light/moderate (money fines, written warnings, lowering the soundness level of the Sharia Business Unit) to severe levels such as prohibition from participating in clearing activities, freezing of business activities. both for certain branch offices and the Sharia Business Unit as a whole and dismissal of the management of Conventional Commercial Banks.

H1 There is an effect of government regulation on diversification strategy

Innovations made by financial technology (fintech) have an impact on conventional banking services in providing financial/social safety nets. So that banks initiate digital banking services, among others, by acquiring several fintech companies by banks. (Lumpkin, 2020). With the rapid development of financial technology that emerged in Indonesia in 2006, to date there have been 140 registered fintech companies (OJK) in line with the rapid growth of startup companies. These fintech startup companies disrupt banking services because they are similar to bank businesses (shadow banking). Banking responds competition with these fintech companies by launching digital bank services that have been registered with the OJK as many as 7. The emergence of digital banks is a strategy to diversify the banking business in order to increase bank market share and profits.

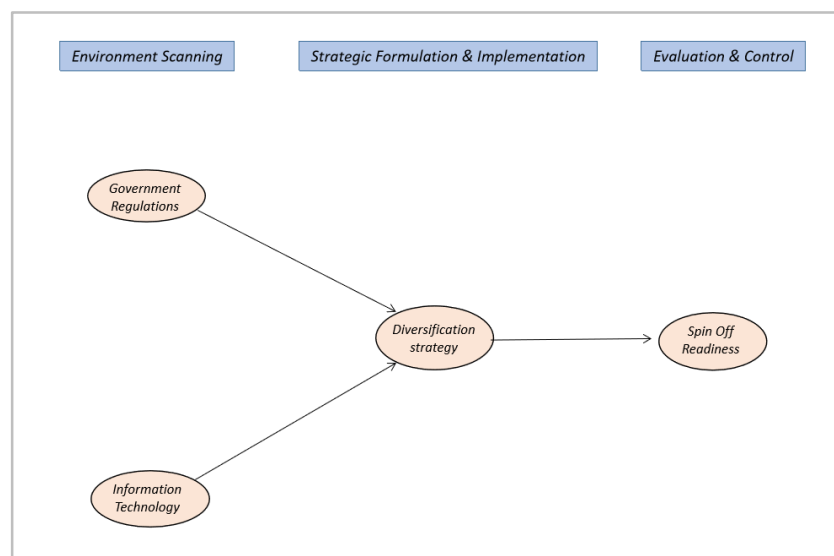
H2 There is influence of information technology on diversification strategy

The spin off of companies in America is more common in companies in the high-tech industry (Garvin, 1983). Research on technology-based companies in Sweden was also conducted by Dahlstrand (1997) on spin-off companies compared to non-spin off companies. It was found that after a ten year period, spinoff companies grew significantly faster than non spinoff companies

H3 There is an effect of diversification strategy on spin off corporate readiness

Al Arif (2015c) found that there was a decrease in efficiency after the spin-off policy caused in the initial period of separation there were additional operational costs that had been borne by the parent bank. The results of the study confirm that the business model of the Sharia Business Unit, namely the dual banking strategy, is proven to be more efficient and effective than Sharia Commercial Banks.

Based on the framework and research context above, research paradigm can be described in Figure 1.



Source : Data processing results, 2021

Figure 1. Research Framework (own data processing,2021)

## METHODOLOGY

### Sample & data collection

Author has sent questionnaire to 20 Conventional Commercial Bank in Indonesia which are all members of population which is a saturated sample (Sugiyono, 2013). Alternative answers from respondents using a semantic differential scale. There are 20 questionnaire statement indicators consisting of 7 dimensions. Islamic Banking Unit consist of 7 banks are under coordination of Asbisindo and 13 banks are under cordination of Asbanda. In early July 2021 questionnaire has been sent through asbanda and asbisindo by email. Questionnaires have been received since July 9, 2021 and finally all questioner completely received on September 8, 2021. Data that has been collected is calculated and analyzed using the Partial Least Square Structural Equation Model application to determine correlation between indicators and variables and correlation between variables.

### Variabel measurement

- Dependent variable (endogenous) of these research object is Spin Off ( $Y_1$ ). Meanwhile,
- independent variables (exogenous) are Government Regulation ( $X_1$ ), Information Technology ( $X_2$ ), Diversification Strategy ( $X_3$ ).

In order to calculate the relationship between each indicator and variable done by convergent validity (loading factor) with a value limit greater than  $> 0.7$  and to determine validity of each indicator variables calculating Average Variance Extracted (AVE) with value above 0.5. Meanwhile, to find out whether the construct has an adequate discriminant it's done by calculating discriminant validity. In order to determine level of reliability of outer model, it is done by calculating the Cronbach Alpha and Composite Reliability with values above  $> 0.7$  (Wold, 1985)

## EMPIRICAL RESULTS

Results of data collection on 20 Conventional Commercial Bank who manage Islamic Banking Units are as follows: First, Government Regulations generally provide opportunities for Islamic Banking Unit. Islamic Banking Units are generally 71,25% not ready to face spin off government regulations. Second, Information Technology got an average score 83.25%. Third, Diversification Strategy shows value 86.3% and is highly considered in the Islamic banking industry. Fourth, Spin Off Readiness is a lowest scores are 43% because of Islamic Banking Unit want spin-off obligation to be submitted to the corporate actions of each bank and Sharia Business Unit not determined by government regulations through Law Number 21 of 2008.

Reliability Measurement using Cronbach Alpha and Composite Reliability can be seen in the Table 1.

Table 1. Reliability Measurement Results

	Cronbach's Alpha	Rho_A	Composite Reliability	Average Variance Extracted (AVE)
$X_1$	0,799	0,912	0,905	0,826
$X_2$	0,683	0,837	0,854	0,747
$X_3$	0,881	0,892	0,918	0,738
$Y_1$	0,846	0,873	0,905	0,761

Source : own data processing,2021

Accepted hypothesis after passing the Validity Test (Convergent Validity, Average Variance Extracted) and Reliability Test using Cronbach's Alpha Test, Discrimant Validity and Composite Reliability can be seen in Table 2.

Table 2 Reliability and Validity Test

	Original Sample	Sample Mean	Standar deviation	T Statistics	P Values
$X_2 \rightarrow X_3$	0,575	0,596	0,116	4,947	0,000
$X_3 \rightarrow Y_1$	0,418	0,388	0,211	1,982	0,048

Source: Results of PLS SEM data processing, 2021

Spin Off Corporate Readiness obtained the lowest average score of 43% which was caused by majority of Islamic Banking Unit respondents that is 55% to 90% not ready with obligation to separate Islamic Banking Unit into Islamic Banking . Islamic Banking Unit generally wanted that policy of separation from parent given to policies and corporate actions each bank.

Islamic Banking Unit business model (Difersification Strategy) produces more efficient and effective Islamic bank financial performance as results of research from Ghalba & Wandebori (2013) that dual banking provides space for Islamic banks to run their business efficiently, using the office channeling scheme as practiced by CIMB Niaga with Dual Banking Leverage Model (DBLM) strategy. In terms of asset management, dual banking should compliance with sharia principles and communicated to public (Rahmatika, 2014).

Based on the results of study, it was found that relationship between Government Regulation, Information Technology, Diversification and Corporate Readiness Spin Off Conventional Commercial Bank who manage Islamic Banking Units in Indonesian. Information Technology directly affect with Diversification Strategy but does not affect to the Spin Off Readiness.

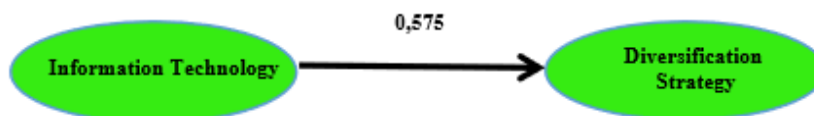
## DISCUSSION

The aim of this study was to investigate preparation of Bank Commercial Conventional dealing with obligation to separate of 20 Islamic Banking Unit into Islamic commercial bank in July 2023 if there is no change in Indonesia banking regulations. This research is expected to contribute in increasing Islamic banking financial transactions to customer and provide efficient and effective banking services and greater profits compared with Islamic commercial banks.

The results clearly indicated that Bank Commercial Conventional who manage Islamic Banking Unit providing a higher net profit than Islamic commercial banks by implementing Diversification strategy by maximizing sale of all sharia products (sharia first) in all of office channeling and setting pricing products as same as conventional bank products. Bank business performance is the result of work that has a strong relationship with the organization's strategic goals, customer satisfaction and contributes to the economy (Nasuha, 2012). Measurement of business performance is broadly based on criteria and resulting information can be divided into two, measurement of financial and non-financial performance (Horngren & Datar, 2009).

Findings of the model generated in this study are as follows :

Finding of model is a diversification strategy as shown Figure 2. There is evidence that diversification strategy is dominantly influenced by information technology. Information technology, digitization of banking services, is the main factor influencing dual banking, which is 57.5%. Important indicators of diversification are digital transformation of banking as a result of industrial revolution 4.0 on banking industry, existence of advanced technologies such as internet of things, artificial intelligence, human machine interfaces, machine learnings and advantages of digital banks can directly acquire new customers. Financial technology is disrupting conventional banking services and will impact the banking landscape through integration, consumer centricity, service personalization, automation, virtual services, use of electronic money and cybercrime security. Digital banking transformation will make bank center of daily consumer transaction activities. In the 2020-2025 Indonesian banking development road map in the field of information technology, OJK has setting direction of banking development, strengthening information technology governance and risk management and encouraging implementation of advanced digital banking such as nano technology, 5G, quantum computing, human augmentation and brain computer interfaces.



Source : Data processing results, 2021

Figure 2 : Finding Model 1

Based on the findings above, this research produces a novelty, a model for improving business performance of Islamic banking units based on information technology through dual banking strategies and value creation programs as shown Figure 3.

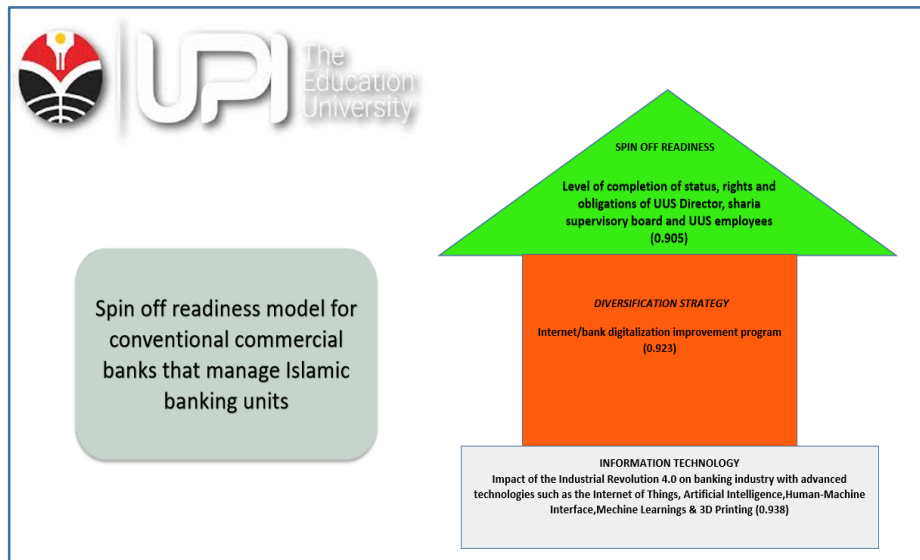


Figure 3 : Spin off readiness

Source : Data processing results, 2021

## CONCLUSION

Information technology is internet-based and internet of thinks, use of cloud servers, big data processing, use of artificial intelligence to assist consumer financial and non-financial activities. Response from sharia business units to information technology has an impact on the banking industry. According to OJK, one of the challenges faced by Islamic banks in the field of information technology is low quality and quantity of information technology, which hinders the development of services and products due to the limitations of banks to develop IT independently. Digital transformation of Islamic banks, including sharia business units, is a necessity because of the demands for changes in digital behavior (digital behavior) of the community. Dimension of financial inclusion is divided into 2 indicators are advantages of digital banks that can directly acquire new customers and money transfer and financing facilities without using a bank. Financial inclusion in this case is inclusion field of information technology as set out blueprint digital banking transformation that has been set by the Financial Services Authority.

Diversification is a strategy carried out by banks based on sharia principles carried out by their parent, conventional commercial banks. The aim is to increase financial service transactions by using all the resources owned by the parent bank so that they can be more efficient and effective in facing competition. Efficiency dimension of dual banking variable obtained the highest score, followed by the resource optimization dimension. Dual banking strategy is highly considered banking industry, especially for Islamic banks that have status of a sharia business unit.

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