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The merger of Islamic banks and their impact on the stability of the country's economy

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Abstract

Mergers are familiar in economic terms, one of which is in the banking sector. Indonesia's banking sector adopting a dual banking system, namely the operation of conventional and Islamic banks, has caused the Indonesian people to have the choice to entrust their finances to one of the two types of banks. Not long ago, the Indonesian government announced that the three Islamic banks, which are part of the three conventional banks, would merge and change their name to Bank Syariah Indonesia (BSI). Of course, this decision is not easy, but it is a decision taken after careful consideration from the banking and economic perspective. Based on data from OJK, the total assets in the second quarter of Islamic banking in 2021 after the merger was recorded to have increased by 16.4 percent compared to the previous year's period. This increase is in line with Bank Syariah Indonesia (BSI) financial report data in the first and second quarters, namely with second quarter total assets of 481 trillion rupiah and second quarter total liabilities of 435 trillion rupiahs. Based on these facts and data, this article aims to determine the impact of the merger of the three Islamic banks on the stability of the Indonesian economy by comparing data from before and after the merger of Islamic banks in Indonesia.

Keywords: Consolidation; banking; sharia; conventional; financial

1. Introduction

The decision of state-owned companies, namely banks, to merge is a decision that only happens with careful consideration of the impact of this merger on the economy's future in Indonesia. Perceptions about bank mergers and acquisitions can lead to better-performing banks with strong intuitive appeal but need more empirical support. In principle, companies can benefit from these mergers and acquisitions through transferring management of new technologies and best practices when the mergers occur, as well as from a broader market reach and greater market power and economies of scale after these mergers and acquisitions occur (Du & Sim, 2016).

With the growing implementation of Islamic law in organizations, financial business entities with Sharia principles are also developing in Indonesia, one of which is Islamic banks. Generally, the efficiency of these principled Sharia banks or Islamic banks has differences in their organizational boundaries and has a higher relative efficiency score distribution than conventional banks (Abdul-Majid et al., 2017). The merger's performance will also change in connection with the recent merger of Islamic

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banks in Indonesia. The changes will also impact the Indonesian economy in the future, coupled with the decision to merge the three Islamic banks. Of course, it will also affect the conventional bank's performance as rivals in the Islamic banks' financial sector.

In practice, Indonesia has adopted a dual banking system, namely the operation of conventional and Islamic banks (Trinugroho et al., 2021). Banking on an Islamic basis is based on key principles derived from Sharia, especially on the prohibition of usury and profit-sharing or equity-based financing (Abedifar et al., 2013). Islamic banks differ from conventional banks in prohibiting *gharar* (uncertainty or excessive risk), usury, and illegal or called *haram* activities (such as alcohol and drugs). The most common financing product in Islamic banks is *murabaha* (plus fee), in which the bank buys goods and sells them to customers with a profit limit agreed upon by both parties. Another financing concept is a partnership between the bank and the customer, where which can be in the form of *mudharabah* (profit sharing) or *musyarakah* (profit and loss sharing) (Abdul-Majid et al., 2017). Any progress and innovation in the banking sector, such as the emergence of Islamic banking, which leads to a dual banking system (both Islamic and conventional), will have implications for stability or vice versa in the banking sector. With the existence of a dual banking system, the consequences for economic growth will always be a concern (Rizvi et al., 2020).

The merger of three Islamic banks in Indonesia, which include Bank Syariah Mandiri, BRI Syariah, and BNI Syariah, which later merged and became Bank Syariah Indonesia (BSI), is expected to encourage the Indonesian economy to become more stable and resilient from crises. In this regard, during local crises, banks with Sharia principles have higher capitalization ratios than conventional banks, have better capitalization, and have fewer loan problems (Alqahtani et al., 2017). However, based on the type of bank, there is no substantial difference in cost savings between conventional and Islamic banks.

This paper aims to determine the impact of the merger of Islamic banks in strengthening and stabilizing the economy by taking the case of Indonesia, which recently merged its three Islamic banks. The writing of this paper itself uses secondary data, which are analyzed using quantitative techniques in the form of tables and graphs. The author focuses on comparing data from the three Islamic banks before the merger and after the banks merged, as well as analyzing what financial impact is obtained from the merger of these Islamic banks on the Indonesian economy. By knowing the impact of the merger of Islamic banks in strengthening and stabilizing the economy, this paper provides answers to questions about the effectiveness or not of the merger decision that has been made in Indonesia and what kind of impact this merger decision has on the economy, whether it is positive or even negative for the Indonesian economy. In addition, by writing this paper, it will be known what kind of contribution has been made by Islamic banks to the Indonesian economy and banking sector.

In connection with this, the authors found that the merger carried out by the three Islamic banks positively impacted the stability of the Indonesian economy, especially the Indonesian banking business. This finding is based on data obtained by the author from the Financial Services Authority (OJK) and the three state-owned banks that have merged. Bank Syariah Indonesia (BSI), as a bank resulting from the merger, has succeeded in proving its financial stability, as evidenced by the stable increase in total assets and liabilities in the first and second quarters of 2021, right after the merger in early 2021.

2. Literature review

Merger of banks in Indonesia

Perceptions about bank mergers and acquisitions can lead banks to better performance with a strong intuitive appeal but lack empirical support (Du & Sim, 2016). This bank merger affects bank borrowers' incentives to disclose information publicly by influencing banks' monitoring and financing services (Chen & Vashishtha, 2017). Banks carry out mergers usually due to various underlying reasons such as to save banks that are about to collapse or experience a crisis, the lack of development of banks, wanting to increase market reach, improve performance, and improve administration. The effect of mergers and acquisitions on bank efficiency is not statistically significant when both targets and acquirers are considered equal. However, when a distinction is made between them, the target, which is not the average acquirer, is more efficient after the merger (Du & Sim, 2016).

Bank mergers in Indonesia can only be carried out if they comply with applicable legal regulations. In addition, some rules must be adhered to by banks wishing to carry out this merger to avoid problems in the future. The impact of this merger decision can determine the fate of a bank in the future, whether it can survive or not. The merger results and the efficiency obtained will be decisive for the company or, in this case, the banking sector in implementing the merger. The result can be improved bank performance, increased market reach, and less competition due to this merger. Mergers of banks tend to occur in waves, with relatively low merger activity followed by periods of relatively high activity. During the economic crisis, companies tend to merge to keep their production chains operating. Meanwhile, on the other hand, as long as there is progress or improvement in the economy, the decision of shareholders to postpone or accelerate their company standards can delay or speed up the decision to merge (Tarsaleska, 2015).

Various banks have carried out merger practices in Indonesia, and in its development, some banks still survive today. These surviving banks can prove the merger's success as a way out of various previous bank problems. In this regard, a merger requires approval from both parties, and the result of this merger is a combination or amalgamation of banks that have interests and have taken a joint decision to merge. As previously mentioned, mergers are carried out based on the agreement of companies (in this case, banks) that merge into one and remain as an entity with a legal basis, while others will stop their activities or even disband/bankrupt.

Sharia vs. conventional banking

Indonesia, as a country with a majority Muslim population, is certainly no stranger to Islamic banking, which practices the same as conventional banks, namely as a financial provider but has different principles, where Islamic banks use principles that follow Islamic law, while conventional banks no. In addition, the main difference between Islamic and conventional banks is funding. In comparison, these Islamic banks have a smaller scope for companies to invest because these banks screen out businesses that are not following Islamic rules, which includes the screening of companies operating in types of business that are prohibited in Islamic law and screening companies that cannot meet specific financial criteria (Abedifar et al., 2015).

Conventional banks are generally more diversified than Islamic banks in that the diversification's marginal costs are likely to outweigh the marginal benefits. Diversification typically negatively affects conventional banks' performance, while Islamic banks have a more minimal effect. However, considering the size of the bank, diversification positively impacts the profitability of large banks, and this positive effect is more pronounced among Islamic banks (Chen et al., 2018). The presence of Islamic banks benefits consumers because these banks charge lower switching costs, which can be a strategy for these financial institutions to make Islamic banking services available to customers who care about prices regardless of their beliefs (Miah et al., 2020).

Conventional banks in the past few decades faced challenges from the new generations' financial innovations that resulted in low funding costs. These banks then started to engage in off-balance sheet income activities, such as creating instruments to generate profits and securing cost advantages. Meanwhile, Islamic banks provide services for borrowing and lending that comply with Sharia law and stick to the core philosophy of Islam. Islamic banking has the key principle that money doesn't have an intrinsic value and should only be considered a unit of account rather than a commodity.

Islamic law also prohibits *riba* (interest) on loans or deposits (i.e., investment deposits). In addition, Islamic banks share their net profits or losses with depositors and comply with Islamic law (Chen et al., 2018).

Islamic banking products, such as loans, are unlike conventional banking products in the sense that these conventional banking products are loans with interest. In contrast, Islamic banking products do not have an interest. In addition, the products of Islamic banking can be classified into partnership-based and sales-based products. Unlike conventional banks, on average, even though the risk is higher than conventional banks, Islamic banks, in practice, use derivative finance in a limited way, for example, namely Salam and Istisna'a. The rationale behind the prohibition of derivatives in contemporary forms of Islamic banking is motivated by the negative consequences of the potential speculative strategies that may occur. According to the three monotheistic religions, not only Islam, money may not return to produce money, which means usury is forbidden. As a result, the high-risk level of Islamic banks is driven more by the risk-sharing features of their contracts. In contrast, the risk of conventional banks can be caused by lending, investment, and speculative activities (Grira & Labidi, 2021).

Risks in Islamic banking

In most economical systems, conventional banks and Islamic banks compete with each other. Also, many conventional banks even install the ‘windows’ of Islamic banking to intensify the competition between the two. The competition also arises from conventional domestic and foreign banks, which adopt this strategy from Islamic banking. On the positive side, this Islamic bank will bring more innovative Islamic financial products to the market. However, on the downside, this excessive competition could have a detrimental effect on the long-term sustainability of these two types of banks (Ariss, 2010; Kabir & Worthington, 2017). Based on studies from Ariss (2010), Islamic banks allocate a much more significant portion of their assets for financing or loans than conventional banks, implying a greater exposure to credit risk. However, on the other hand, Islamic bank balance higher portfolio risk with much lower financial risk through higher capitalization rates. However, again, there is no significant difference in the level of profitability between conventional and Islamic banks.

Furthermore, based on studies from Abedifar et al. (2013), Islamic banks have a lower credit risk than conventional banks, especially for banks with small amounts of debt or operating in countries where more than 90% of the population is Muslim. In terms of bankruptcy risk, small Islamic banks have more stable conditions than conventional banks of the same size because they have more capital. In this regard, however, there is no significant difference between large Islamic and conventional banks. The lending quality, interest income (implicit), and expenses from costs of Islamic banks are less sensitive to domestic interest rates than conventional banks. However, the sensitivity of Islamic banks to interest rates is similar to that of conventional banks. In addition, in its development, according to a follow-up study from Abedifar et al. (2015), Islamic banks (especially smaller banks) have at least the same level of efficiency and also have a lower risk of default or bankruptcy as conventional banks. Islamic banks usually focus more on higher-margin small business borrowers who are less likely to default or be unable to repay their debts. Evidence on the issue of market power itself is mixed, although there is some evidence that these Islamic banks can be more competitive than other conventional banks.

3. Method

The author uses secondary data from a certain period obtained from various sources. These data sources come from the Financial Services Authority (OJK), financial report data from three state-owned banks (BRI Syariah, Mandiri Syariah, and BNI Syariah), as well as data from Bank Syariah Indonesia (BSI). Thus, this paper is a quantitative research using descriptive methods and using a secondary data analysis approach by comparing data obtained from related agencies to obtain actual results following the objectives of this study, namely to determine the impact of the merger of three Islamic banks with the stability of the country's economy.

4. Results and discussion

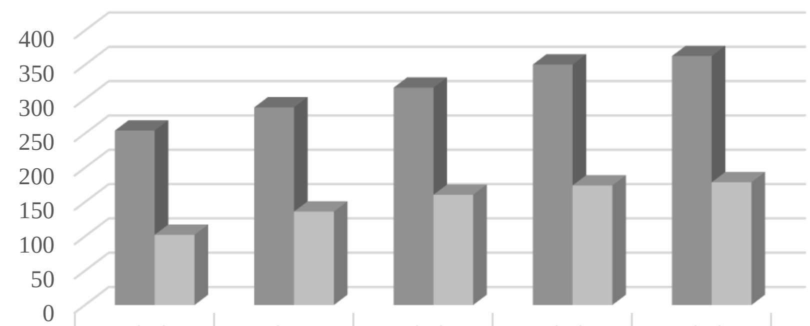
Performance of Islamic banks in Indonesia

There are three types of Islamic banks, namely Islamic banks operating in countries with strong and active support from the government, then Islamic banks operating in the private sector, which also compete with conventional banks, and finally, conventional banks that provide Islamic banking system through Islamic banking products or services offered by conventional banks (Abedifar et al., 2015; Trinugroho et al., 2021). Previously, Islamic banks in Indonesia were included in the latest classification, namely banks that are part of the conventional banks that provide Islamic banking services. These conventional banks are state-owned or public banks operated by the government, consisting of Bank Rakyat Indonesia (BRI), Bank Mandiri, and Bank Negara Indonesia (BNI).

The Islamic banking system was introduced in Indonesia in the 90s and is still developing today. This is based on the composition of the Indonesian people, whose majority adheres to Islam. This Islamic bank is an appropriate and suitable place for Muslim society because its principles align with Islamic religious rules. Islamic banks in Indonesia have significantly contributed to the banking system, particularly by increasing loans and deposits (Rizvi et al., 2020; Trinugroho et al., 2021). Indonesia, the fourth most populous country in the world and with the highest Muslim population, has a dual banking system. Indonesian banking law No.7/1992 is the basis of this dual banking system, in which Sharia and conventional-based banks can provide banking services together. Based on this law, these Islamic banking companies can be Islamic Commercial Banks (Bank Umum Syariah–BUS), Islamic Rural Banks (Bank Pembiayaan Rakyat Syariah–BPRS), and Islamic Business Units (Unit Usaha Syariah–UUS) (Trinugroho et al., 2021).

In this regard, the Islamic banking sector is proven to have increased every year. This can be seen in Figure 1, where there has been a continuous increase in the total assets of Islamic Commercial Banks (BUS) and Islamic Business Units (UUS) from 2016 to 2020. This increase indicates that more and more people are entrusting their finances to Islamic banks and using the services of these Islamic banks for their benefit.

Figure 1. Total assets of Islamic Commercial Banks and Sharia Business Units in 2016-2020 (in billion rupiahs)



	2016	2017	2018	2019	2020
BUS	254.184	288.027	316.691	350.364	362.692
UUS	102.32	136.154	160.636	174.2	178.905

Notes: BUS is Bank Unit Syariah, UUS is Unit Usaha Syariah. Source: OJK, Sharia Banking Statistics, December 2020

This annual increase in total assets proves that Islamic banks positively contribute to the growth of assets in the Indonesian banking sector. This also demonstrates that Islamic banks positively impact the stability of the Indonesian economy, especially the Indonesian banking business. In line with this statement, it can be concluded that the presence of Islamic banks in the Indonesian banking industry increases the stability of the Indonesian banking system. However, it does not have an impact on its profitability (Rizvi et al., 2020). For Islamic banks with higher capitalization, higher loan growth can exacerbate credit risk one year ahead. This suggests that higher capitalization can exacerbate moral risk in Islamic banks to take higher risks (Sobarsyah et al., 2020).

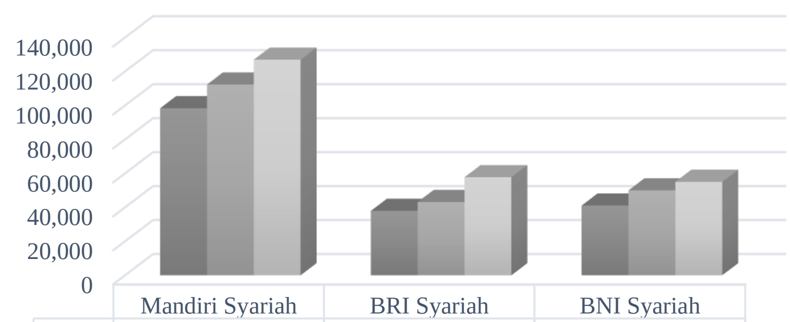
Sharia banks within Indonesian conventional banks

Before merging the three Islamic banks in Indonesia and changing their name to Bank Syariah Indonesia, they were part of the conventional banking system managed by the government (BUMN). These banks provide Islamic banking services or products while still being under the auspices of conventional banks or still being part of the conventional banking system. In its development, these Islamic banks experienced an increase in the aspect of their performance, which later became one of the reasons for the merger of the three Islamic banks, namely Bank Rakyat Indonesia Syariah (BRI Syariah), Bank Mandiri Syariah, and Bank Negara Indonesia Syariah (BNI Syariah).

Indonesia has a stable banking industry. This statement aims to show that the growth of assets and liabilities of Islamic banking in Indonesia is steady and contributes positively to strengthening the financial system in Indonesia (Rizvi et al., 2020). Islamic banks that apply Islamic law, such as prohibiting usury (often referred to as interest), contracts from Islamic banks must be clear or have a lot of uncertainty (gharar), and not allow doing business that is prohibited by Islamic law (known as haram). Its development, even though it has different rules from conventional banks, does not prevent Islamic banks from continuing to increase yearly, proving that Islamic banks contribute to the Indonesian banking sector.

This is evident in the increasing total assets of the three Islamic banks, namely BRI Syariah, BNI Syariah, and Bank Mandiri Syariah, from 2018 to 2020, which can be seen in Figure 2. As can be seen in the table, there was an increase in the total assets of the three banks continuously every year before the merger of the three banks.

Figure 2. Total Assets of Three Islamic Banks from 2018 to 2020 (in billion rupiahs)



	Mandiri Syariah	BRI Syariah	BNI Syariah
2018	98,341	37,915	41,049
2019	112,291	43,123	49,980
2020	126,907	57,715	55,009

Source: Annual reports of BRI Syariah, BNI Syariah, and Mandiri Syariah

Apart from experiencing an increase in assets, these three Islamic banks also experienced an increase in liabilities and equity per year in the same period, namely from 2018 to 2020. It can be seen in Table 1 that before the merger, these three banks experienced a stable and continuous increase.

Table 1. Total Liabilities and Equity of Three Islamic Banks in 2018 to 2020 (in billion rupiahs)

Bank	Liability			Equity		
	2018	2019	2020	2018	2019	2020
Mandiri Syariah	14,477	19,052	31,359	8039	9,245	10,839
BRI Syariah	10,894	11,880	17,475	5026	5,088	5,444
BNI Syariah	9,787	13,072	17,253	4,242	4,735	5,459

Source: Annual reports of BRI Syariah, BNI Syariah and Mandiri Syariah

Based on these data, the increase in the total assets of the three Islamic banks was also accompanied by an increase in the liabilities and equity of the three banks. This goes along with the statement (Rizvi et al., 2020) that states that Indonesia has a stable banking industry is demonstrated by the steady growth of sharia banking assets and liabilities, and its development has contributed positively to the strengthening of the financial system in Indonesia. In this regard, it can be concluded that this Islamic bank has a positive impact on strengthening the financial system and stability of the Indonesian economy.

Indonesian Sharia bank

In early 2021, the Indonesian government announced that the three Islamic banks, which are part of the three conventional banks, would merge and change their name to Bank Syariah Indonesia (BSI). Bank Syariah Indonesia (BSI), which was formed due to this merger, was later crowned the most prominent Islamic bank in Indonesia and the seventh largest bank in Indonesia. The government's decision to carry out this merger was not a decision that was only made in a short period of time but was made carefully to improve the Indonesian economy. As previously mentioned, Indonesia, which has a majority Muslim population, is a very compatible market for the expansion and centralization of the Islamic banking system in Indonesia.

Mergers are not uncommon in business, including in the banking sector. Mergers in the banking sector are common, considering the banking sector is a crucial sector in the country's economy. However, a merger can only be done by complying with every applicable law. In addition, a merger cannot occur without an agreement, so it is necessary to enter into a joint agreement between the three related banks to comply with the rules prior to the merger. In this regard, the merger carried out by the three Islamic banks, namely BRI Syariah, BNI Syariah, and Bank Mandiri Syariah to become Bank Syariah Indonesia (BSI) is expected to become a growth locomotive in Islamic banking.

Besides that, Bank Syariah Indonesia (BSI), as a product of the merger of these three Islamic banks, is expected to develop and be able to contribute more to improving the Indonesian economy in the future. In its development, this hope was later proven by an increase based on data from the OJK. The total assets of Islamic banking in the second quarter recorded an increase of 16.4 percent compared to the same period in the previous year. It can be seen in Table 2 that there has been an increase in the total assets and total liabilities of Bank Syariah Indonesia in 2021 per quarter, namely in the first and second quarters of 2021.

Table 2. Total Assets and Liabilities of BSI in the First and Second Quarters of 2021 (in millions of rupiah)

	Total Assets	Total Liabilities
Q1 (First Quarter)	234,427,001	211,929,191
Q2 (Second Quarter)	247,299,611	223,957,694
TOTAL	**481,726,612**	**435,886,885**

Source: Bank Syariah Indonesia (BSI)

Based on the table above, it can be seen that there was an increase in total assets and liabilities in the first and second quarters, with total assets in the second quarter of 481 trillion rupiahs and total liabilities in the second quarter of 435 trillion rupiahs. This increase in the first and second quarters gave positive results to the Indonesian banking system, estimated for the following quarters and even the next years will experience continuous improvement. The shareholder composition (PSP) of Bank Syariah Indonesia in the second quarter of 2021 consists of 50.83% owned by PT Bank Mandiri (Persero) Tbk, 24.85% owned by PT Bank Negara Indonesia (Persero) Tbk, and 17.25% owned by PT Bank Rakyat Indonesia (Persero) Tbk. The composition of these shareholders changes every quarter. For the second quarter of 2021, the highest shareholder of Bank Syariah Indonesia is owned by PT Bank Mandiri (Persero) Tbk with a number of shares are 20,905,219,379 with a nominal value of up to 10 trillion rupiahs.

5. Conclusion

The merger of three Islamic banks, now named Bank Syariah Indonesia (BSI), is a good and positive decision to improve the country's economy. As a result of the merger, Bank Syariah Indonesia (BSI) later became the most prominent Islamic bank and is the seventh largest bank in Indonesia. In this regard, the merger of Islamic banks amid a pandemic is considered the right step to maintain the country's economic stability. This is evidenced by the positive impacts Bank Syariah Indonesia (BSI) provided on the Indonesian economy.

In implementation and practice, the merger carried out by these three Islamic banks provides a more varied service, a market that has a broader reach, and better capital capacity. In addition, the annual increase in total assets in Islamic banks proves that Islamic banks make a positive contribution to the growth of assets in the Indonesian banking sector. This also demonstrates that Islamic banks positively impact the stability of the Indonesian economy, especially the Indonesian banking business. Besides that, with an increasingly strong market capitalization, Bank Syariah Indonesia is targeted to enter the top 10 as the world's largest Islamic bank within five years of the merger.

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