“Determinant factors of market share: evidence from the Indonesian Islamic banking industry”

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DETERMINANT FACTORS OF MARKET SHARE: EVIDENCE FROM THE INDONESIAN ISLAMIC BANKING INDUSTRY

Abstract

Market share is one of the performance indicators for the Islamic banking industry in Indonesia. Actually, the policy makers had set up the 5% market share to be achieved in 2008. Unfortunately, this target finally was met at the end of 2016. This study is going to examine the determinants of market share in the Indonesian Islamic banking industry. From the empirical result, we can see that some of the variables had an impact on market share. The variables impacting market share are the default rate, operational efficiency rate, the yield of profit sharing, and conventional bank's interest rate. The other variables such as profitability ratio and liquidity ratio don't have an impact on market share. The result implies that Islamic banks should strengthen the internal factors to accelerate their growth and performance.

Keywords market share, Islamic banking, acceleration strategy, multiple regression

JEL Classification C30, D40, G21

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INTRODUCTION

The Islamic banking industry in Indonesia has been started since 1992, but its development is very slow. The economic crisis that occurred in 1998 in the Asian region (including Indonesia) brings a blessing for Islamic banking industry. When many conventional banks were affected by the crisis, the only Islamic banks at the time (i.e. Bank of Muamalat Indonesia) could survive from it. After the crisis, the banking system in Indonesia began to embrace dual banking system. In 2008, a new Act about Islamic banking industry in Indonesia (i.e. The Act No. 21 of 2008) was adopted. After the enactment of this Act, Islamic banking industry in Indonesia was very rapid. Table 1 shows that until 2017, there were 13 Islamic full-fledged banks, 21 Islamic business units, and 165 Islamic rural banks.

Table 1. The number of Islamic banks in Indonesia

Year	Islamic full-fledged banks	Islamic business unit	Islamic rural banks
2007	3	26	114
2008	5	27	131
2009	6	25	138
2010	11	23	150
2011	11	24	154
2012	11	24	158
2013	11	23	163
2014	12	22	163
2015	12	22	163
2016	13	22	163
2017	13	21	165

Bank of Indonesia had established the blueprint for Islamic banking industry development in 2002 and the revised edition in 2006. This blueprint was aimed to accelerate the Islamic banking industry in Indonesia (Ismal, 2011). Bank of Indonesia and the stakeholders agreed to establish the acceleration program. The objective of this blueprint was to achieve the five percent asset market share in 2008. In fact, this target was not achieved in 2008. Then this objective was changed to 3.5% in 2009 and 4.75% in 2010 (Ismal, 2011). Finally, this 5% market share target was achieved at the end of 2016.

Market share is one indicator that was used to measure the Islamic banking industry growth in Indonesia. The higher market share will make more significant impact of Islamic banking industry on the Indonesian economy. Table 2 shows the market share development of Islamic banking industry in Indonesia. It took several additional years to achieve the 5% market share target in Indonesia. The target of 5% market share is finally achieved after the conversion of Bank of Aceh into Islamic full-fledged bank.

Table 2. The Islamic banking market share development

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017
Market share (%)	2.61	3.24	3.98	4.58	4.89	4.85	4.83	5.3	5.74

Sari et al. (2013), Rahman (2016) stated that the current market share of Islamic banks is too small compared the potential market share. Wouters (2009) in Sari et al. (2016) shows that the market share of Islamic banks in Indonesia is lower than in other countries such as Malaysia and Singapore. The highest Islamic banks' market share is in Iran with 100%, because Iran fully converts the banking industry to Islamic banks. There are several reasons that still make the market share low. These are lack of government support, the trust and public interest in Islamic banks tend to be low (Rusydiana, 2016).

One of the strategies pursued by policy makers in order to accelerate the market share growth of Islamic banking industry is spin-off policy. Spin-off is one of the main issues that Islamic banking Act (The Act No. 21 of 2008) contains. However, there are a lot of perspectives about the spin-off policy. Some of the researchers argue that spin-off policy can accelerate the growth of the Islamic banking industry (Hamid, 2015; Ramdani, 2015). But some of them suggest that the spin-off policy should be evaluated (Al Arif et al., 2017a), because they find that there is no difference in Islamic banks' performance between pre and post spin-off (Al Arif, 2015; Haribowo, 2017).

This study is going to examine the factors that affect the Islamic banks' market share in Indonesia. This research is different from the study by Al Arif (2017b). The previous study focused on the effect of spin-off policy on the market share. This study focuses on the factors affecting the market share of Islamic banks in Indonesia. The result of this study is expected to be a consideration for the policy-makers. Thus, the policy-makers can develop appropriate policy to accelerate the growth of Islamic banking industry. This study findings will be recommended to the policy-makers in determining the appropriate strategies to stimulate the market share of Islamic banking industry. This recommendation gives a significant novelty for the enrichment of Islamic banking studies.

1. LITERATURE REVIEW

Islamic banks have different characteristics with the conventional banks. In Indonesia, the Islamic banking industry only has five percent market share in overall banking industries. One of the ways to accelerate the Islamic banking industry is the policy-makers establishment of the new regulations focusing on Islamic banking industry. There are three legislations concerning Islamic banking industry in Indonesia. The first one is The Act No. 7 of 1992 concerning the banking industry. In this Act the existence of Islamic banks has not been officially recognized. The Islamic banks are recognized as banks based on the principle of profit sharing only. The presence of Islamic banks is not supported by adequate regulations. The lack of regulation makes the number of Islamic banks do not increase.

In mid 1997, there was an economic crisis in Asia (including Indonesia). This economic crisis has proven that Islamic banks can survive, while the conventional banks have liquidity difficulties. This economic crisis became later the basis for the issuance of a new banking law, i.e. The Act No. 10 of 1998. After the adopting of this Act, the banking system in Indonesia officially embraces dual banking system: the conventional banking system and the Islamic banking system. According to the Act, the Islamic bank has been mentioned as a bank that operates by Sharia principles. There are two types of Islamic banks in Indonesia: first, Islamic full-fledged banks and second, the Islamic business units of the conventional banks. There is a rapid growth of the Islamic banking industry in Indonesia after the enactment. From 1998 till 2007, there were three Islamic full-fledged banks and 26 Islamic business units. However, the presence of the Act No. 10 of 1998, gave still paltry support for accelerating the growth of Islamic banking industry. This problem became the basis for the issuance of Islamic banking Law (i.e. The Act No. 21 of 2008). One of the objectives of this Act was to accelerate the Islamic banking industry growth in Indonesia.

Some factors determine the market share of Islamic banks, such as internal factors and external factors. Syafrida and Abror (2011), Saputra (2014), and Purboastuti et al. (2015) conclude that some internal factors affect the market share, such as profitability ratio (ROA), default rate (NPF), and the liquidity ratio (FDR). Rahman (2016) also found that the default rate, operational efficiency ratio, and the capital requirement had an impact on Islamic banks' market share.

Market share will become one of the factors determining the Islamic banks performance. Mirzaei (2010) states that the market share will affect the profitability of Islamic banks. In general, an increase in market share of Islamic banks will increase the contribution of Islamic banking to the economy.

2. RESEARCH METHOD

This study uses a quantitative approach. The method used in this study is a multiple regression analysis. Multiple regressions are used to analyze the factors that had an impact on Islamic banks' market share in Indonesia. The equation applied in this study to determine the factors that influenced Islamic banks' market share, is as follows:

$$MS_t = \alpha + \beta_1 ROA_t + \beta_2 NPF_t + \beta_3 FDR_t + \\ + \beta_4 EFF_t + \beta_5 Margin_t + \beta_6 Int_t + \varepsilon_t, \qquad (1)$$

where MS is market share of assets from Islamic banking industry, ROA is profitability ratio, measured by return on asset, NPF is default rate, measured by non-performing financing, FDR is liquidity ratio, measured by financing to deposit ratio, EFF is operational efficiency ratio, measured by ratio of operational efficiency, $Margin$ is profit sharing margin of deposit fund, Int is interest rate of conventional banking.

3. RESULT AND DISCUSSION

The result shows the intercept significance at ten percent confidence interval. Besides that, the result shows that the variables that had an impact on Islamic banks' market share are default rate, operational efficiency ratio, the yield of profit sharing, and conventional banks' interest rate. The other variables such as profitability ratio and liquidity ratio do not have an impact on Islamic banks' market share.

Table 3. Estimation result

Model	Coefficients	t	Sig
Constant	4.518	1.746	.084*
Return on asset (ROA)	–.014	–.046	.963
Non-performing financing (NPF)	–.389	–3.898	.000***
Financing to deposit ratio (FDR)	.005	.280	.780
Ratio of operational efficiency (EFF)	.087	4.275	.000***
Margin	.263	3.577	.001***
Interest rate	–.871	–4.145	.000***

Note: * 10%, ** 5%, *** 1%.

From Table 3, we can write the estimation as follows:

$$MS_t = 4.518 - .014\,ROA - .389\,NPF + \\ +.005\,FDR + .087\,EFF - \\ -.263\,Margin - .871\,Int \qquad (2)$$

$R^2 = .588$, F-stat = 18.758, Adj $R^2 = .529$

The coefficient determination had a value of approximately 0.529. This value means that all of these variables can explain the model about 52.9%; the rest is explained by other variables outside the model such as macroeconomic variables. The F-test result shows that all of the independent variables simultaneously had an impact on determining the Islamic banks' market share in Indonesia.

The coefficient of default rate (NPF) had a negative sign; it means that if the default rate declines it will cause the increase in market share. The value of –0.389 means that one percent decrease in market share will create 0.38% increase in market share. This result is consistent with Saputra (2014), Purboastuti et al. (2015), and Rahman (2015), who also found that the non-performing financing affects the market shares. In fact, Rahman (2016) found that the default rate (NPF) is the dominant factor in the long run.

For the operational efficiency ratio, variable had a positive sign. The positive sign indicates that higher cost allocated by Islamic banks will be able to increase the market share. If there is one percent rising in operational efficiency ratio, this will cause the 0.087% rising in market share. This result is consistent with that by Saputra (2014) and Rahman (2016) who found that the efficiency had an impact on the market share. In fact, Rahman (2016) found that the operational efficiency ratio is a dominant factor that determined the market share in the short run.

The margin of profit sharing also had a significant impact on Islamic banks' market share in Indonesia. These results indicate that the higher the margin, the higher the market share of Islamic banks will be. The higher margin will make it possible to attract more customers to save. The increasing numbers of customers and deposit funds will be able to increase the market share. The coefficient value of 0.263 means that a one percent increase in the margin will cause the market share increase by about 0.26%.

The conventional banks' interest rate also had an impact on the market share of Islamic banks. The negative sign means that higher interest rate will decrease the market share of Islamic banks. Because the higher interest rate will attract more Islamic bank customers to switch their funds to conventional banks. The movement of deposit funds will cause a decline in the market share of Islamic banks. The coefficient value of –0.871 means that a one percent increase in interest rate will cause the decline in the market share by about 0.87%.

The other variables such as profitability ratio (measured by ROA) and liquidity ratio (measured by FDR) do not impact Islamic banks' market share. Saputra (2014), and Purboastuti et al. (2015) found a different result. They found that profitability ratio had an impact on Islamic banks' market share. The differences in the results may be due to the differences in data used. This research is using monthly data from January 2009 until December 2016. Profitability ratio is one of the financial indicators to explain the Islamic banks growth. The higher the profitability ratio, the more profitable is the Islamic banking industry.

For the liquidity ratio (measured by FDR), this result is consistent with Purboastuti et al. (2015). The liquidity ratio didn't have an impact on Islamic banks' market share. However this result is different from Saputra (2014) who found the incidence of liquidity ratio in determining the Islamic banks' market share. The result differences may be due to data differences. This research is using the monthly data of Islamic banks' industrial statistics.

In order to increase the market share, the Islamic banks should improve their performance. Hosen and Rahmawati (2016) found that there is a relationship between efficiency and profitability in the Indonesian Islamic banking industry. Besides that, the Islamic banks should re-engineer the business process to increase funding (Widigdo et al., 2016). Usman (2015) and Soma et al. (2017) found that religiosity is still one of the determinants in choosing Islamic banking product. So, the Islamic banking management should increase the adherence to Islamic principles to enhance customer loyalty. Some people still resist Islamic banks. In their opinion, there is no difference between Islamic banks and conventional banks (Dayyan, 2016). Sahut et al. (2015) conclude that the Islamic banks are more competitive rather than the conventional banks. The Islamic banks express a higher degree of market power, but this does not guarantee higher profitability for Islamic banks.

Besides that, the Islamic banking should also increase the service quality. Suryani and Hendraydi (2015), Cahyani (2016), and Khan (2016) suggest that Islamic banks should improve the service quality to increase the customer loyalty. The quality service improvement will increase the loyalty of existing customers and attract new customers. Increase in loyalty can cause the rising in Islamic banks' market share. Sometimes, customers compare the service quality between the Islamic banks and the conventional banks.

There are some of strategies that should be done by policy-makers. First, spin-off policy can be one of the strategies to accelerate the performance and the market share of Islamic banking industry (Hamid, 2015; Ramdani, 2015; Al Arif, 2017b). The second strategy is the full conversion of conventional banks into the Islamic full-fledged banks. This strategy was developed by Bank of Aceh, and this conversion became the reason why the five percent market share finally could be achieved. The third strategy is a merger of either some Islamic full-fledged banks or some Islamic business units into one Islamic full-fledged bank (Miftah & Wibowo, 2017). The merger will cause the industry become highly concentrated; this will make a performance increase in the Islamic banking industry.

There are still many problems that the Islamic banking industry faces on the way toward increasing the market share. Rusydiana (2016) suggests several strategies to solve the Islamic banking industry problems. First, strengthening the capital and economy of scale. Second, increasing the quality and quantity of human resources. Third, increasing the cost of fund and harmonization of the regulation. Hamzah (2008) said that the Islamic banks should increase the socialization of their products. So, it will improve the customer loyalty of Islamic banks on the way towards increasing the market share. One of the strategies to strengthen the Islamic banks' capital is through go-public policy. Santoso (2016) found that go-public policy had an impact on profitability. The go-public strategies have been developed by Bank of Panin Sharia.

Policy-makers can formulate several strategies. First, the socialization of Islamic banking product should improve. Second, the Islamic business units should strengthen the capital to perform better if they are going to do the spin-off. Third, harmonization of the Islamic banking industry regulation.

Besides that, there are also several strategies that can be formulated by the Islamic banks and conventional banks. First, the conventional banks should support the development of their Islamic business units. Second, the Islamic banks should increase the funding from current accounts and savings accounts. So, it will decline the cost of fund and make the margin became competitive. Third, Islamic banks should improve the service quality to attract more customers. Fourth, Islamic banks should create innovative products. Sometimes, the Islamic banks fail to fulfill the customers' needs these things move customers to conventional banks.

CONCLUSION

The result of this research shows that the variables such as default rate (measured by NPF), operational efficiency ratio (measured by REO), profit sharing margin, and conventional banks' interest rate had an impact on determining the Islamic banks' market share. The other variables such as profitability ratio (measured by ROA) and liquidity ratio (measured by FDR) don't have an impact on the market share of Islamic banks. This result means that the Islamic banking industry should improve the performance. Performance improvement will make it possible to increase the market share of Islamic banks.

The policy-makers should create a regulation that can support the Islamic banks' market share. Sometimes, there are contradictions with the aim to grow the Islamic banking industry. Besides that, the Islamic banks should improve the product quality and service quality to attract more customers. The increase in number of consumers will increase the market share of Islamic banks.

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