

CHAPTER I

INTRODUCTION

1.1 Background of the Problem

Bank is one of the financial institutions that plays an important role in a country's economy. This is due to the function of the bank itself in which it functions as an institution that connects people who need the fund with those who have many funds. As stated in Act No. 10 of 1998 about the alteration of the Act No. 7 of 1992 regarding the banking, bank is defined as a corporation that accumulates fund from society in form of saving and then distributes it to the society in form of loan or something else to increase the standard of living of the whole society. Indonesian banks are divided into several types based on the interest payment or profit sharing, they are:

1. Conventional bank, a bank that runs conventionally;
2. An Islamic bank, a bank that is organized based on the Islamic law.

In terms of the Islamic bank, most of the Moslems in Indonesia and even in another part of the Moslem world have expected its existence for a long time. They expect that an economic system which is based on the values and principles of Islam (Islamic Economic System) can be implemented in every aspect of business life and human transaction. In addition, this desire is caused by awareness to apply the principles of Islam totally.

Islamic bank and conventional bank have similarity in some aspects, particularly in the technique of money receipt, the mechanism of transferring, the

computer technology that is adopted, the general requirements of acquiring such financings as identity card, the Principal Number of Tax Obligation (NPWP in Indonesian), proposal, financial statement, and so on. The main differences between these two banks are things concerning with the legal aspect, the structure of the organization, the work environment, and the business that is funded (Syafi'I Antonio, 2001).

Since 1992, the Islamic banking has developed rapidly until now. In the period of 1992 until 1998, there was only one Islamic Public Bank and 78 Society's Credit Banks based on Islamic law (BPRS in Indonesian). Being triggered by the Act No. 10 of 1998 that enables the banking to run dual banking system, then it makes the conventional banks, which dominate the market at that time, start opening and running the Islamic unit. The development of Islamic Public Bank and the conventional bank that also opens the Islamic branch is triggered by the survival of Islamic banks during the monetary crisis in 1998 in which it was the worst crisis for the national banking at that time.

The profit sharing system of Islamic banking, as what is applied in its products, makes the bank can relatively retain its productivity and the bank is not ruined because of the increasing level of interest, therefore, it makes the operational burden lower than what the conventional bank has. The pattern of this profit sharing enables its clients to supervise directly the productivity of Islamic bank via monitoring the amount of profit sharing the clients gain. The bigger profit that the bank makes, the bigger profit-sharing the clients will gain, and vice versa. The small amount of profit sharing in a long period indicates the decline of the bank

administration. This condition is an early warning that is transparent and easy for the clients to know. Unlike the conventional banking in which its clients cannot assess the productivity of the bank only from the indicator of interest that they gain (Novita Wulandari, 2004).

On dual banking system, the bank can run two activities at once, namely interest-based banking activity and Islamic banking activity. Those who convert their bank to Islamic banking, then the working mechanism of their bank will be managed in such a way, particularly things concern with the interactions between interest-based activity and interest-free activity, that both can be explicitly separated.

The socialization and education effort done by the practitioners of Islamic banking are also incessantly conducted, with a goal of converting the paradigm of thinking of the society which has been accustomed to the conventional bank for a long time. Many promotional ways are also done by the Islamic banking practitioners to introduce the Islamic banking system.

There is a certain measurement that is taken as a standard in measuring the productivity of a bank, namely an evaluation system appointed by the Bank of Indonesia. This evaluation system is decided through the Decree Letter of the Management of the Bank of Indonesia No. 30/227/KEP/DIR on March 19, 1998, in terms of the Manners of Assessing the Level of the Bank's Health. The method of assessing the level of the bank's health is then called as *Capital Asset Management Earning Liquidity* method (CAMEL). After conducting the calculation of the level of the bank's health, based on the CAMEL method, then it is continued with the

calculation of the level of the bank's obedience to several specific certainties. The method is then known as CAMEL Plus.

Based on the explanation above, therefore, the writer is interested in researching the impact of the difference of the banking system administration through the level of the bank's productivity, in which in this case, the writer relates it to one of the measuring tools of the bank's health level. The writer then presents the research in a thesis entitled **“A Comparative Analysis of the Liquidity, Earning, and Capital of the Islamic Bank and Conventional Bank”**.

1.2 Identification of the Problem

This research is to identify the problems as follows:

1. The liquidity, earning, and capital of Islamic bank;
2. The liquidity, earning, and capital of conventional bank;
3. The comparison of the liquidity, earning, and capital of the Islamic bank and conventional one;

1.3 Limitation of the Problem

Limitation problem in this study are as follows:

- a. Islamic banks are selected in this research is that Islamic banks have been established for more than five years. Islamic banks in this case represented by the Bank Muamalat Indonesia (BMI) and Bank Syariah Mandiri (BSM). Conventional banks selected for comparison with Islamic banks are conventional banks with total assets comparable to the sharia banks. At the

time of this study BMI total assets of Rp. 12,596,715,000,000, and asset of BSM is Rp. 17,063,838,000,000. Conventional banks that have total assets equal to two banks Sharia is Bank Commonwealth (Rp. 12,495,087,000,000), Bank Ekonomi Raharja, Tbk (Rp. 18,201,135,000,000), ABN AMRO Bank (Rp. 17,033,309,000,000), Bank UOB Buana, Tbk. (Rp. 21,204,929,000,000).

- b. The information used to measure the performance of banks is based Publication Reports Finance Bank during the period 2005- 2008. The data are taken annually reports of each bank, published in the newspaper or the internet.
- c. Bank performance measures used in this study is the bank's financial ratios, including Capital Adequacy Ratio (representing the ratio of capital), Return on Assets and Return on Equity (representing the ratio of profitability), Operating Expenses divided Operating Income (representing the efficiency ratio), and Loan to Deposit Ratio (representing the ratio of liquidity).

1.4 Objective of the Research

This research is aimed at collecting the information about the liquidity, earning, and capital of the Islamic bank and conventional one as well as the comparison between the two banks.

In addition, based on the identification of the problem as mentioned before, this research is also conducted to know:

1. The liquidity, earning, and capital of Islamic bank;
2. The liquidity, earning, and capital of conventional bank;

3. The comparison of the liquidity, earning, and capital of the Islamic bank and conventional one;

1.5 Advantage of the Research

Based on the objectives of the research above, the writer expects that this research will be useful for those who have interest in it, namely:

1. Writer

To be able to compare the concept of the knowledge that has been learned and its implementation in reality which is related to the level of the bank's health.

2. Banking World

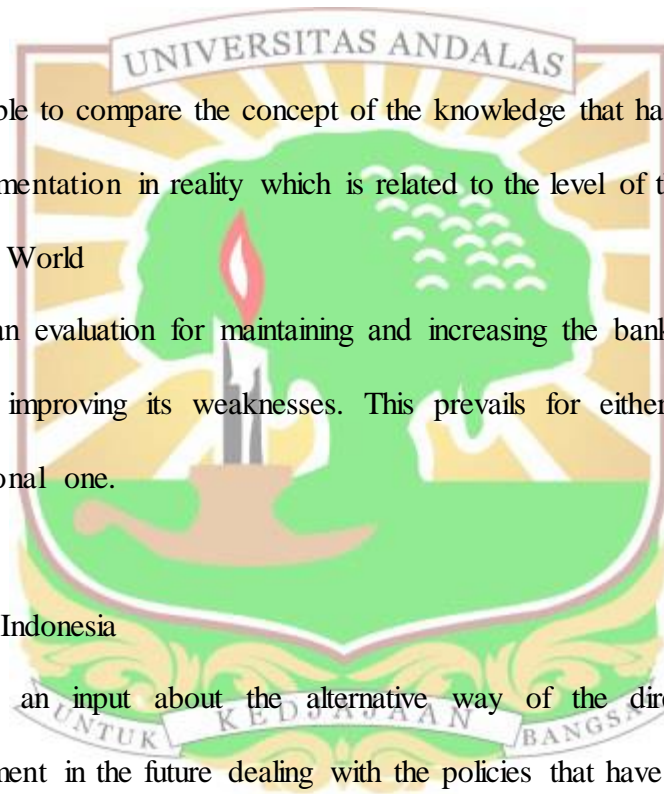
To be an evaluation for maintaining and increasing the bank's productivity as well as improving its weaknesses. This prevails for either Islamic bank or conventional one.

3. Bank of Indonesia

To give an input about the alternative way of the direction of banking development in the future dealing with the policies that have been taken.

4. Other Researchers

To give a contribution to other researchers who want to conduct a further research which is still related to this topic.



1.6 Theoretical Framework

Within the last seven years, since the Act No. 7 of 1992 about banking which also gives an opportunity to build the Islamic bank is decided, the development of Islamic bank from the amount of its office and activity is still not satisfying. Therefore, the government endeavors to promote the development of Islamic bank in Indonesia.

The effort to boost the development of Islamic bank in Indonesia is conducted by observing the reality that most Moslems in Indonesia today are waiting for an Islamic banking system which is healthy and reliable for accommodating their needs of banking service that fits the Islamic principles. The developing of Islamic banking is also aimed at improving the mobilization of society's fund which is not fulfilled yet all this time by the conventional banking system. Besides, along with the effort of restructuring the banking, the developing of Islamic bank is an alternative system of banking service with all of its strengths.

By putting the Act No. 10 of 1998 about the banking into effect, and the Act No. 23 of 1999 about the Indonesian bank, so it opens widely the opportunity for the society to build the bank which enforces the activity based on Islamic principle, including the opportunity to the public banks to open their branch offices which are specialized in activity based on the Islamic principle. This is known as dual banking system which enables the bank to enforce the two systems of banking, namely conventional and Islamic, contiguously. Therefore, the bank will have two operational systems at once.

The bank which runs conventionally gains its main income from the interest which is calculated based on certain percentage of the loan. The conventional bank is also obliged to pay some percentage of its clients' savings. Meanwhile, the Islamic bank gains its income based on the profit sharing which is counted proportionally from the loan given by the bank and the whole capital of the entrepreneur. The result then is divided based on the agreement that is made when the financing contract is agreed and it is put into the form of 'nisbah'. If there is a loss which generally becomes a business risk, then the loss will be born together in accordance with the agreement which has been made.

The bank which is operated based on Islamic principle must also give a reward to its clients. The reward is given in the form of profit sharing after being proportionally calculated over the total amount of each saving. Besides of the 'nisbah' that has been decided, each saving will get a value based on the length of the fund has been deposited. The reward given by the bank is the comparative result between the savings and the total amount of savings, then, it is multiplied with 'nisbah', the value of the bank's profit sharing then is divided.

Unlike the conventional bank, the Islamic bank does not explicitly differentiate between the monetary sector and real sector. Therefore, in its activity, the bank can make transactions in the real sectors, such as trade or business of renting things out. The Islamic bank can also run the activity to gain the reward from other banking services which are not opposite to the Islamic principles.

To measure the productivity of a bank, there is a measurement that is commonly employed as a standard, namely an evaluation system which has been

appointed by the Bank of Indonesia. This evaluation system is decided through the Decree Letter of the Management of the Bank of Indonesia No. 30/277/KEP/DIR on March 19, 1998, about the Manners of Assessing the Level of the Bank's Health. In the letter, it is stated that the health of a bank is the importance of everyone who gets involved in it, either owner or manager of the bank, society as the service user, or Bank of Indonesia as the bank supervisor.

The certainty of the bank's health level is supposed to be used as:

1. The measurement for the bank management to assess whether the bank has run in accordance with the banking principles which are healthy and meet the prevailing certainties;
2. The measurement to determine the direction of the establishment and development of the bank as individual banking or a whole.

The research that is done is related to the point 1, namely using the measurement of the bank's health level to assess whether the bank administration has been conducted in accordance with the banking principles which are healthy and based on the prevailing certainties. In this case, the writer would like to know the impact of the application of the Islamic and conventional principles applied by a bank toward the bank's health level and the prevailing certainties.

The aspects which are considered as the determiner of the level of the bank's health comprise the capital aspect, the quality of the productive asset, the management of learning, and the liquidity. Each aspect is interrelated and influences each other.

The meaning of capital in a bank is the fund that is invested by the owner to build a business which is intended to finance the activity of the business and to fulfill the regulation which has been decided as well. Earning is the company's ability to gain profit compared with the capital that has been expanded and it is explained in percentage. Liquidity indicates the company's ability to fulfill its financial obligation which should be fulfilled. In other words, it is the ability to fulfill the financial obligation when it is required.

The comparison between conventional bank and Islamic bank is presented in the table below:

ISLAMIC BANK	CONVENTIONAL BANK
Doing the legal investment only.	Doing the legal and illegal investment.
Based on the principle of profit sharing, trading, and renting.	Using interest.
Profit and 'falah' oriented	Profit oriented.
Keeping the relationship with its client in the form of partnership.	Keeping the relationship with its client in the form of debtor-creditor.
The accumulation and distribution of the fund must be based on the instruction of Islamic Supervisory Council.	There is no such council.

1.7 Hypothesis of the Research

Based on the previous framework of thought, then the writer formulates the hypothesis as follows:

Ho1 : $\mu_1 = \mu_2$ there is no significant difference in the financing/credit toward the fund accepted by the third party (FDR/LDR) between the Islamic bank and conventional one.

Ha1 : $\mu_1 \neq \mu_2$ there is a significant difference in the financing/credit toward the fund accepted by the third party (FDR/LDR) between the Islamic bank and conventional one.

Ho2 : $\mu_1 = \mu_2$ there is no significant difference on the profit before imposing the tax on the total of the asset (ROA) between the Islamic bank and conventional one.

Ha2 : $\mu_1 \neq \mu_2$ there is a significant difference on the profit before imposing the tax on the total of the asset (ROA) between the Islamic bank and conventional one.

Ho3 : $\mu_1 = \mu_2$ there is no significant difference in the operational burden toward the operational income (BOPO) between the Islamic bank and conventional one.

Ha3 : $\mu_1 \neq \mu_2$ there is a significant difference on the operational burden toward the operational income (BOPO) between the Islamic bank and conventional one.

Ho4 : $\mu_1 = \mu_2$ there is no significant difference in the capital toward the weighted asset on the average (CAR) between the Islamic bank and conventional one.

Ho4 : $\mu_1 \neq \mu_2$ there is a significant difference in the capital toward the weighted asset on the average (CAR) between the Islamic bank and conventional one.

Ho5 : $\mu_1 = \mu_2$ there is no significant difference on the level of the bank's health between the Islamic bank and conventional one.

Ho5 : $\mu_1 \neq \mu_2$ there is a significant difference on the level of the bank's health between the Islamic bank and conventional one.

1.8 Research Method

In conducting the research, the writer employs descriptive and comparative method in his research. Descriptive method is a method used to investigate the status of a human group, an object, a condition, a system of thought, or even today's thought (Mohd. Nazir, Ph.D.). The aim of the descriptive research is to make a description systematically which is factual and accurate about the facts, characteristics, and the relationship between the phenomena being investigated. In the descriptive method, the researcher is allowed to compare certain phenomena so that it then becomes a comparative study.

Meanwhile, the comparative research is a kind of descriptive research which is aimed at searching for the underlying answer about the cause and effect by analyzing the factors causing the emergence of a phenomenon.

The method of comparative research is ex-post facto. It means that the data are collected after the events completely happen. The researcher can see the effect of a phenomenon and verify the cause-effect relationship from the data that are available. The research that will be conducted comprises the assessment toward financial productivity of a bank that is observed from the level of the bank's health like the aspect of liquidity, earning, and capital during the period of the observation.

1.9 Systematics of Writing

Bab I : Introduction

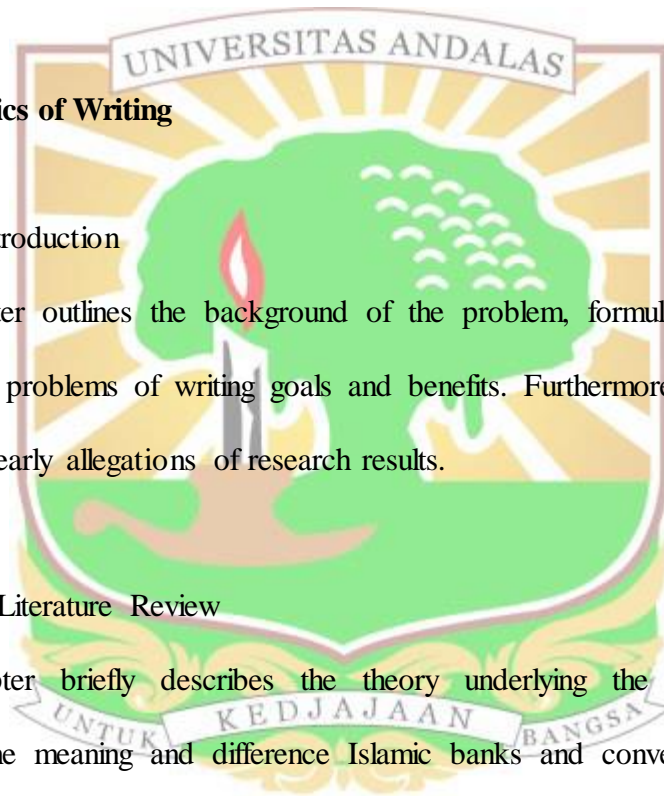
This chapter outlines the background of the problem, formulation of problems, constraints, and problems of writing goals and benefits. Furthermore also presented a hypothesis that early allegations of research results.

Bab II : Literature Review

This chapter briefly describes the theory underlying the research, including discussion of the meaning and difference Islamic banks and conventional banks. The next discussion is about the bank's performance measurement theory emphasizes the calculation of the bank's financial ratios

Bab III : Research Method

This chapter describes in detail the research methods used. The explanation begins with the data collection method, followed by data analysis methods.



Bab IV : Result of The Research And Discussion

This chapter contains the analysis of problems based on data that have been processed in the previous chapter

Chapter V: Conclusions and Suggestions

This chapter contains a summary or conclusion of the study. Based on the author's conclusions will provide advice to the parties involved in the effort to improve the performance of a bank.

