# ANALYSIS OF THE EFFECT SPIN-OFF INCREASING SHARIAH COMPLIANCE IN INDONESIAN ISLAMIC BANK

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**Abstract**

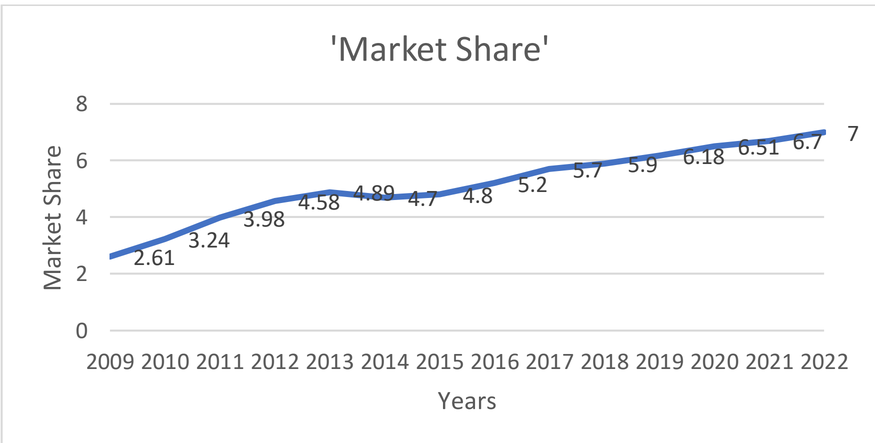
*Sharia-compliant banks demonstrate a dedication to expanding their presence within the asset and sharia market, while simultaneously striving for comprehensive adherence to sharia principles in all aspects of their operations. One approach that has been employed is the strategy of spin-off, however, it has shown to be ineffective in terms of increasing the market share of Sharia products in Indonesia. The efficiency of Sharia-compliant banks does not exhibit significant growth, and the revenues generated from spin-off activities are rather low. The objective of this study is to examine the effects of bank spin-offs on the adherence to Sharia principles in Islamic banking institutions. This study employs a causal qualitative methodology that relies on qualitative data to examine the cause-and-effect relationship of a policy. To enhance the robustness of the findings, the researchers employed a methodology involving in-depth structured open interviews with a diverse range of participants, including policymakers from the banking industry (BI), academics, and individuals associated with Islamic bank spin-offs. The findings indicate that the implementation of Spin-off is deemed essential in accordance with the provisions of Law No. 21 of 2008, primarily due to its significant role in advancing the objectives of halal Islamic banks. The impact of spin-off banks on sharia compliance is observed to be greater compared to UUS, albeit with a very modest growth rate and suboptimal operational efficiency.*

**Keywords**: Impact, Spin-off, Sharia bank, Compliance.

## Introduction

The fourth phase (2013-2015) in the development of Indonesian Sharia banks has been completed with major share achievements, including the construction of the integration of the Sharia financial sector. This period lasted from 2013 to 2015. The percentage of the banking market that is dominated by Islamic finance in Indonesia continues to periodically undergo significant expansion. In a similar vein, the rise in assets held by Islamic banks is significant. Despite the fact that both types of banks are expanding, nominally speaking, Islamic banks are still a long way behind conventional banks.

Figure 1. Market share of Indonesian Sharia banks




Source: Publication of Bank Indonesia Sharia Financial Progress Report (Bank Indonesia, 2019)

In Indonesian banking statistics as of December 2019, there were no less than 14 Sharia Commercial Banks and Sharia People's Financing Banks (BPRS) with 164 banks and 617 offices (Ojk, 2019). Apart from that, the total assets of Sharia commercial banks reached 272,343 (in billion rupiah). This amount is still relatively small compared to the national banking assets in general, reaching 5,615,150 (in billion rupiah) (OJK, 2023). This means that the Sharia banking market share is still tiny, only 6.3%, even though the Sharia banking market share target is 15% by the end of 2025. The percentage increase is significant but still tiny in nominal terms. Suppose the growth of Sharia banks continues like this. In that case, the effect will be that the development will be slow because it will not be proportional to the number of the Indonesian population who are Muslim. This encourages Sharia banking practitioners to immediately look for a more massive sharia development strategy (Syukron, 2013).

Sharia banks have been around for a long time, but the market share of Sharia banks is still small, around 6.3% in 2019. The birth of Indonesian Sharia banks has been around since Bank Muamalat was founded in 1991, meaning that it is now 28 years old. Development is considered stagnant; there is no significant increase. It considered the comparison with the large population of Muslims in Indonesia, which is 85% of the total 273 million people or 232 million people as a potential market. So, an in-depth and comprehensive evaluation study is needed as to why this happened from the development of sharia bank still low.

Based on this problem, Islamic banks are trying to ensure a more significant increase in market share, assets, and profits. From the background of this problem, some effort is required to create solutions and alternatives. Many methods and strategies have been implemented both by the government, Islamic bank management, and the community. Of the many businesses, this is through Sharia bank spin-offs. The initial aim of the spin-off was to increase growth in Islamic banks (Farouk & Umam, 2018). So that in the future, the business activities that can be carried out by BUS are broader than those of UUS from conventional banks. For example, GE revealed that its healthcare division, GE HealthCare Technologies, which is a world leader in precision care, had been split off. This was part of a plan that was announced in 2021 to split GE into three separate businesses, one each for energy, health, and flight. The spin-off on this company is successed and independent company and start a new chapter advancing our position as a global leader in precision care.

By separating itself, it is hoped that Islamic banks can manage their company management, so the expected final result is asset and profit growth. However, an interview conducted with one BI official (Dr Rifqi Ismal) stated that the spin-off did not have a solid academic basis. Many Sharia banks spin-off with the initial aim of advancing Sharia and independent banking (Rianto & Arif, 2014). So in 2008-2014 nine BUSs were born due to separation from UUS, and there were also BUS taken from acquisition and conversion. BUS was born into Law No. 21 of 2008 in the initial regulations. According to the contents of the law, there is a requirement that UUS are required to be separated from those that have reached 50% of their assets from their main bank or are 15 years old. So it could be said that the spin-off of Islamic banks is premature or too forced.

Looking at the various things above, the policy of separating Islamic banks, which was implemented in 2008, apparently has not yet significantly influenced the development of the Islamic banking industry in general. This can be seen based on data on the growth of third-party funds, assets, and the number of Sharia bank fund distributions, which have decreased starting in 2012 compared to previous years. It can still not achieve the market share target of 7% of national banking assets. In terms of financial ratios, several indicators are not good, such as the decreasing ROA and ROE ratios, increasing problematic financing as indicated by an increase in NPF, and increasing BOPO ratios, which suggest that in terms of operational costs, there is a decrease in efficiency in the sharia banking industry. (Rianto & Arif, 2014).

Because of this, this research seeks to analyze the impact of separating Sharia business units into Sharia commercial banks on Sharia compliance. Sharia commercial banks resulting from the separation should be able to optimize some human resources (Siswantoro, 2014). As is known, human resources for Sharia banks are still minimal in terms of Sharia knowledge because many public universities graduates work in Sharia banks. The impact is that human resources will be less able to adapt after the spin-off and are required to have expertise in the field of Sharia because HR will later affect Sharia banks in their compliance with Sharia compliance.

Spin-offs have several goals. One of the main goals is to separate halal and haram transactions. It is not permitted to mix halal and haram goods simultaneously. Items that are haram will have a haram effect on things that are still halal. Mixing of goods is possible because if Sharia and conventional banks are still one, then the mix of business capital will always be mixed. Capital is haram because the interest results will be combined with other assets such as cash, financing, assets, equipment, etc. If a spin-off occurs, there will be a separation of assets between conventional banks and Islamic banks. So that in the future, sharia banks will be more sharia and pure in running their business (Umam, 2010).

This study is a new term on Islamic banking particularly in Indonesia. Several spin-off in the world occurred in company except Islamic banking. Moreover, the research concern on conventional company, very rare on Islamic company. Then, the research focusing on sharia compliance is very limited. So, this research is significant to elaborate more wide in certain the Islamic research.

Spin-off allows sharia banks to apply sharia principles totally. It's different when a sharia bank becomes a sharia business unit in its main bank. Sharia banks always obey and comply with conventional banks as their mains. Sharia banks' compliance with sharia principles can be more fully implemented. However, it turns out that several Sharia banks have not implemented sharia principles as a whole. It turns out that several Islamic banks have not been able to completely separate from their main banks, such as in terms of capital. Sharia banks resulting from spin-offs are not yet independent in terms of capital. At one time, Islamic banks, due to their small capital and significant operational costs, still needed capital from their main banks. As a result, Islamic banks cannot fully comply with sharia principles as a whole. Spinning off from the sharia side is an effort to make sharia banks purer and separate from conventional banks. Comply with the regulation of prudence and follow sharia principles (Tohirin, 2003).

**Spin-Off Relationship with the Development of Sharia Banks**

Spin-off is a pro-rata distribution of main shares to a subsidiary without any cash transactions. The main stock has shares in both companies after the Spin-off (Veld & Veld-merkoulova, 2002). Spin-off is an additional representation/derivative product from the results of a previous business. It can take various forms, such as technology transfer and ownership of property rights (Nasuha, 2012). This separation generally requires significant efforts toward control, risk and profit distribution. Spin-off is a business/transfer of company assets into an independent company. Power remains with the leading company and ownership of subsidiary shares (Rizqullah, 2013).

Meanwhile, according to Law No. 40 of 2007, spin-off is a legal action carried out by a company to separate its business which results in all of the company's assets and liabilities being transferred by law to two or more companies or some of the company's assets and liabilities being transferred by law to one company. or more. Furthermore, these regulations were clarified by PBI No 11/10/PBI/2009 spin-off, namely the separation of business from one BUK (Conventional Commercial Bank) into two or more business entities following the provisions of the applicable laws and regulations. Bank Indonesia. 2009. Bank Indonesia Regulation No. 11/10/PBI/2009 concerning Sharia Business Units. Jakarta (ID). And the Republic of Indonesia. 2007. Law no. 40 of 2007 concerning Limited Liability Companies. Jakarta (ID).

Meanwhile, when UUS becomes BUS, its business activities will become broader. BUS will independently manage its business sector fully. These business activities include guaranteeing securities, trusteeship, safeguarding other people's interests, capital participation, being an issuer, bidder and trader of sharia long-term securities and being a founder and administrator of a pension fund. (Farouk & Umam, 2018).

The type of spin-off separation can be from the main company due to reasons of not being able to exploit opportunities or being unable to do so. Meanwhile, the second type is a subsidiary company that is different from its main company. This type is often used and is the type used by Islamic banks (Al Arif, 2015). Regarding strategy in the field, there are several alternatives in continuing the Spin-off. The sequence begins by using an existing company. Next Spin-off based on certain types of elements. The formation of a new company is based on communication programs, culture, customer response, competitor response, delivery channels, and taxation. You can also spin-off with an existing company, this is influenced by: reporting system, employee status, IT system, regulator response, IT and due diligence. These two Spin-offs were motivated by the priority of the problem as the reason for the Spin-off (Rizqullah, 2013).

**Shariah Compliance**

Sharia compliance refers to an Islamic bank's conformity with sharia principles. Islamic banks are financial institutions that carry out their operations following Islamic principles, which means that the bank follows the provisions of Islamic sharia, especially in terms of how to conduct business transactions in an Islamic manner. The main principle of Islamic banking is reflected in its products which do not involve interest and adopt the principle of profit sharing (Antonio, 2001).

Sharia bank compliance is based on the main factor of the prohibition of usury. In the Qur'an, Surah Ali Imron 130, it is forbidden to consume usury in multiple ways and if it is violated, it will result in hell fire reserved for the disbelievers. (Hisyam & Septiarini, 2016).

**Sharia compliance Variable**

Measuring sharia compliance in Islamic banking is crucial in ensuring Islamic financial institutions operate following sharia principles. There are several essential variables used to measure the level of sharia compliance in Islamic banking.

a. Financial Ratios: One of the main ways to measure sharia compliance is through financial ratios. Ratios such as the Financing to Assets Ratio, the Financing to Third Party Funds Ratio, and the Own Capital Ratio are essential indicators. Research by Zulkhibri (2017) reveals the importance of these ratios in measuring the stability of Islamic banks in Indonesia (Zulkhibri & Sukmana, 2017).
b. Product and Transaction Structure: The conformity of products and transactions with sharia principles is essential in measuring sharia compliance. For example, products that use the principle of profit sharing and avoid elements of usury are positive indicators (Budiono, 2017).

c. Governance: Governance structure is also a relevant variable. This includes the composition of the board of directors, sharia committee, and decision-making procedures following sharia principles. The study by Hasan et al. (2019) compares Islamic banking governance in Bangladesh and Malaysia.
d. d. Disclosure and Reporting: Islamic financial institutions' level of transparency and quality of information disclosure are essential variables. This can be seen from annual reports and sharia disclosures.
e. Assessment by Third Parties: This assessment from sharia auditors or independent audit institutions is crucial. This assessment provides confidence that Islamic financial institutions operate following sharia principles.

In conclusion, measuring Sharia compliance in Islamic banking involves variables including financial ratios, product structure, governance, disclosure, and external assessment. Islamic banks and financial institutions must pay attention to these variables to understand and monitor the level of Sharia compliance. This is important to ensure that Islamic finance remains compliant with Sharia principles and can meet the expectations of shareholders and the general public.

From the background mentioned above, looking at the symptoms and phenomena in the field, the researcher concludes that the spin-off of Islamic banks is still limited to the separation of assets and transactions but not the complete halal separation from conventional banks to Islamic banks.

**Research Method**

This research is qualitative in nature by exploring the fundamental problems of implementing Spin-offs in Islamic banking. This type of research is more causative qualitative, looking at the cause-and-effect relationship of a spin-off policy that has been implemented. Next, analyze the impact of the policy results on its effects on.This research comes from primary data directly from linear and new journals. This research tries to find data that is directly related and tangential to problems in the field precisely. Meanwhile, the data collection method was taken from observation data and structured open interviews. So the function of the data results is to be more measurable, focused and not stretched. Interviews were conducted with pure academics, Bank Indonesia policymakers and the Sharia supervisory board

The research methodology applied in this research will focus on qualitative data analysis with two main stages, namely tabulating and editing which will be used to analyze the collected data. This research will also apply a triangulation approach, combining three data collection methods: library research, interviews, and observation. A triangulation approach will provide a strong foundation for deeply understanding this research topic by involving diverse viewpoints and data sources. Thus, this research will combine the advantages of qualitative data analysis, various data collection methods, and triangulation to produce comprehensive and valid findings to answer the research questions asked. The informant of interview came from Head of Dirjen Indonesian Islamic bank, Prof Raditya Sukmana and Prof Des Nafik as expert of Investment and academician Islamic banking in Unair, Dr Yasni from DSN MUI as expert of sharia compliance and Prof Tjipta as expert of financial report on Islamic banking Unair.

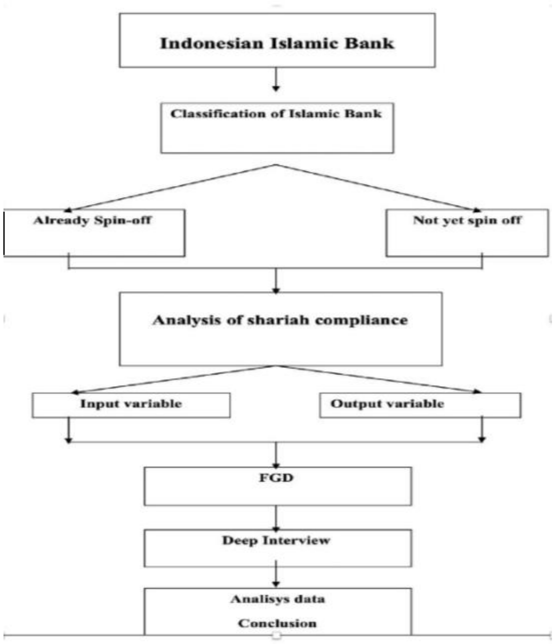



Figure 2. Flow chart of research methods

Source: Processed by researchers

After data analysis, conclusions are drawn through an inductive process, namely from general to specific by generalizing from various post-spin-off economic events. If Islamic economics is positive, it is more appropriate to the inductive method (Janwari, 2014). The results of these economic activities are linked to verses from the Koran and hadith.

**Discussion**

**Development of Islamic bank spin-offs**

The development of the spin-off phenomenon in the Islamic banking industry had become a significant topic in recent years. Before spin-offs, Islamic banks often operated as affiliated entities with existing conventional banks. This is because Islamic banks are still mixed into one organization under conventional bank management. In terms of organization, institutions, financial responsibility reports, etc., these are still under the control of conventional banks. All sharia bank regulations must not conflict with the rules decided by conventional banks.

However, with the increasing demand for financial services based on sharia principles, some sharia banks have decided to spin-off, separating themselves from conventional banks. This separation is to differentiate the rules that apply to both. In real terms, Islamic banks will use sharia principles as a whole, and conventional banks will also implement conventional banking principles independently. These two types of banks are very different in principle.

Examples of banks that have carried out spin-offs include Bank Muamalat Indonesia, Bank Syariah Mandiri, and others. This change in status allows Islamic banks to focus exclusively on developing products and services that comply with sharia principles. So, sharia compliance for sharia banks will be stronger if it is carried out independently and independently, apart from the shadow of conventional banks.

In the context of a comparison between Islamic banks that have undergone a spin-off and those that have not, it can be seen that banks that have undergone a spin-off have an advantage in maintaining and increasing their level of Sharia compliance. Because their main focus is sharia-based services, they can more easily manage and optimize their operations under sharia principles without any conflict with the interests of conventional banks. This can be reflected in higher sharia-based financing ratios, investment portfolios that are more in line with sharia principles, and stronger levels of sharia compliance overall. Although banks that have not yet undertaken spin-offs are committed to complying with sharia principles. However, challenges may arise in managing conflicts of interest between sharia-based and conventional operations. In this case, spin-offs have become an effective strategy in strengthening the position of sharia banks in maintaining sharia compliance.

**Obstacles in spin-offs**

The obstacles faced in the Islamic bank spin-off process are complex and need to be considered carefully. First, not all Islamic banks are ready or willing to undergo the spin-off process. This may be related to factors such as capital structure, management readiness and market situation. Second, an in-depth business feasibility study must be carried out before taking the spin-off step. This decision must be supported by thoughtful analysis to understand the potential benefits and associated risks. Third, several Islamic banks are still very dependent on their mains in terms of technological infrastructure and operational support. Leaving behind conventional frameworks can be a significant challenge. Fourth, there are concerns that Islamic banks may view spin-offs as a move that is not certain to be financially profitable, especially if there is still uncertainty in the market and regulations relating to Islamic banking. Therefore, overcoming these obstacles with wise strategies and careful planning in the Islamic bank spin-off process is essential.

**Sharia compliance after Sharia bank spin off**

The spin-off process in the sharia banking industry changes the bank's paradigm from being previously dependent on its main to becoming an entity with legal independence. Independent banks after spin-off can manage their organizations independently, including financial and organizational management. Independently, sharia banks will be separated according to the laws used as a benchmark for operations. Sharia banks that have undergone a spin-off must comply with the rules set by various regulatory institutions, such as the National Sharia Council (DSN), Sharia Supervisory Board (DPS), Bank Indonesia (BI), and the Financial Services Authority (OJK). They must also comply with fatwas from DSN, regulations from BI and OJK, as well as Financial Sharia Accounting Principles (PSAK) set by professional associations. In this regard, Islamic banks follow the legal regulations directly with their own legal entities, without following from banks in general.

Spin-off is a necessity because Islamic banks want to make themselves the main destination for comprehensive halal (kaffah) in their operations said Prof Tjipta as informant. The best way to become a halal Islamic bank, one of which is to use a spin-off solution. With the Spin-off, sharia rules have a broader and more binding application in sharia banks. Previously sharia banks followed the laws of the main bank, which did not use sharia rules. Because Islamic banks initially adhered to the prohibition against usury from interest, the interest system previously used in BUS using interest will be replaced entirely with a profit-sharing system.

To comply with sharia principles prohibiting usury, the interest system previously used in BUS was replaced entirely with a profit-sharing system. By becoming an independent legal entity, Islamic banks that have experienced spin-offs tend to comply more with sharia principles. This fact is direct and as if BUS is forced to follow Sharia rules directly. Sharia compliance is recommended and has become an obligation that must be implemented.

The implication is increased compliance with sharia principles, resulting from the transformation into an independent legal entity. The significance of this Spin-off is a tendency to improve compliance with sharia principles. This is a result of the establishment of an independent legal entity (separate legal entity) (Umam, 2010)

Even though there are still shortcomings and challenges in this process, what is essential is that the journey towards halal sharia banking in a comprehensive manner continues to be fought for and improved without denouncing existing shortcomings. The halalness of all transactions in sharia banks is very important because sharia banks have made a clear separation from conventional banks. With this separation, Islamic banks are expected to be able to operate fully by Islamic sharia principles, especially those relating to the avoidance of usury or interest. In this context, the separation between Islamic and conventional banks is crucial to ensure that they can follow ethical principles and Islamic law in every aspect of their operations. Thus, efforts to achieve halalness in Sharia bank transactions become more possible and convincing.

## Conclusion

In this conclusion, it is essential to acknowledge that spin-off or separation between Islamic banks and conventional banks is an essential step in realizing halal Islamic banks. This separation gives Islamic banks the freedom and autonomy to regulate their operations by Islamic sharia principles, especially in the avoidance of usury or interest. Furthermore, banks that have carried out spin-offs tend to comply more with sharia principles than conventional banks that are still incorporated into one entity. Even though there are still challenges and obstacles in achieving optimal sharia compliance in the field, this is considered a process towards purer and kaffah compliance said Prof Tjipta. It should be remembered that not all sharia banks can immediately adopt the sharia business model entirely, but this change often takes place gradually.

Thus, the spin-off is not only an administrative step, but also a journey towards improving sharia compliance in the sharia banking industry. It is hoped that banks that have undergone spin-off will continue to be committed to strengthening their compliance with sharia principles to make a more significant contribution to developing and implementing banking practices based on Islamic ethics and law.

This research has several shortcomings that need to be noted. First, the respondents used in this research do not represent all stakeholders in Islamic banks. This can affect the level of representation of research results to the wider population. Second, because this type of research is qualitative, there is an element of subjectivity on the part of the researcher which can influence the interpretation of data and research findings. Therefore, it is necessary to be careful in generalizing the results of this study. Third, this research has not provided a numerically measurable impact because it focuses on qualitative analysis. Measurable impacts in the form of statistical data can give a stronger understanding of the effects of spin-offs on sharia compliance.

Nevertheless, this research provides valuable insights into the importance of spin-offs in improving sharia compliance in Islamic banks. In the future, further research with a diverse approach and involving more stakeholders could be a step to overcome some of these shortcomings and gain a more comprehensive understanding of the impact of spin-offs in the context of sharia compliance.

The suggestion for this journal is that apart from going through a spin-off process, massive awareness and outreach efforts are needed to the public and political solid support from the government for Islamic banks. This effort can help create awareness among the public about the importance of sharia banking products and services and incentivize people to switch to sharia banks.

In addition, greater emphasis should be placed on developing human resources (HR) in the Islamic banking sector. This includes a better understanding of sharia regulations and procedures and the need to emphasize moral hazard and morals in banking practices. Emphasizing morality and business ethics can help create a more robust and more profound Sharia banking culture among HR, thereby increasing compliance with Sharia principles. Thus, the combination of spin-offs, massive socialization efforts, and political support, along with an emphasis on moral hazard and morals in human resource development, can help create an environment that is more conducive to the growth and compliance of Islamic banks in complying with sharia principles in full.

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