Profitability Ratio to Distinguish between Islamic and Conventional Banks in Indonesia

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Abstract: The aim of this paper is to find out whether Islamic and conventional banks in Indonesia can be distinguished from each other based on profitability. In particular, we consider whether researchers or regulators can properly categorize Islamic or conventional banks by using profitability ratios. This research method is explanatory method. Data generated from 2008 - 2017 comes from 7 Islamic banks and 30 conventional banks in Indonesia. The results of this study are Islamic banks and conventional banks can be distinguished from each other based on profitability and Islamic banks more profitable than conventional banks, because the profitability ratios (ROA) obtained greater.

1 INTRODUCTION

Since the founding of Dubai Islamic Bank in 1975 as the world's first private interest-free bank, the growth of sharia banking worldwide has been phenomenal with its managed assets generally growing at an annual rate of 12% to 15% per annum. In Iran, Pakistan, and Sudan, the entire banking industry has become Islamic and many major international banks (eg, HSBC, BNP Paribus, Commerzbank, and Citicorp) have introduced Islamic divisions that offer different Islamic or Sharia products in the structure of the banking conventional. According to the Institute of Islamic Banking and Insurance (IIBI) there are 277 sharia banks and financial institutions operating in more than 70 countries in 2005. IIBI estimates that Islamic banks manage assets of $ 260 billion in 2004. Most of the early growth of Islamic banking took place in South Asia. However, only in the 1990s, Indonesia enlivened the Islamic banking industry with the establishment of Bank Muamalat by Majelis Ulama Indonesia in 1991 and officially began operating in 1992.

The principles in sharia banks differ significantly with conventional banks. Sharia banks are governed and operate on the basis of Islamic legal principles (sharia) that require the sharing of risks and prohibit the payment or receipt of interest (usury). In contrast, conventional banks are guided primarily by the principle of maximizing profits. If the difference between the two types of banks is not just semantic (as some Islamic finance critics say), sharia and conventional banks must be distinguished from each other based on financial information obtained from the company's balance sheet and income statement. However, since all banks operate in the same competitive environment and are regulated in the same way in most countries, it is possible that both Islamic and conventional banks show similar financial characteristics.

A substantial body of research examined the structure, operation, and management of Islamic banks (Turen, 1995; Murjan and Ruza, 2002; Islam, 2003; Essayyad and Madani, 2003), while other research explains the principles of finance Islam is common to non-Muslim readers (Siddiqui, 1981; Bashier, 1983; Khan, 1985). Unless Karim and Ali (1989) and Rosly and Abu Bakr (2003), Olson and Zoubi (2008) researchers have not examined the financial ratios of sharia banks. Karim and Ali (1989) argue that Islamic banks prefer to obtain funds from depositors rather than shareholders during the period of expansion in the economy. Rosly and Abu Bakar (2003) showed that profitability (based on return on assets and profit margin) was statistically higher for Islamic banks in Malaysia during the period 1996-1999 than the conventional banks. However, they point out that in recent years, Islamic banks have

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chosen to behave more like conventional banks than strictly follow the principles of Sharia. In summary, research to date has not been resolved the question of whether Islamic and conventional banks are operationally different and whether profitability ratios can be used to differentiate between two types of banks significantly.

The purpose of this paper is to find out whether Islamic and conventional banks in Indonesia can be distinguished from each other based on profitability. In particular, we consider whether researchers or regulators can properly categorize Islamic or conventional banks by using profitability ratios. Although many studies have documented the usefulness of accounting information in predicting bankruptcy and credit ratings, no research has been conducted on the potential value of accounting information data in distinguishing between sharia and conventional banks.

Examination of previous studies, such as Karim and Ali (1989) and Rosly and Abu Bakar (2003), suggest that Islamic banks may be more profitable than conventional banks. However, it is possible that shareholders in Islamic banks are willing to accept lower equity yields (Olson and Zoubi, 2008). Assuming that the possibility that Islamic banks are more profitable. Hence the hypothesis in this study is Islamic banks are more profitable than conventional banks.

2 DATA AND METHODOLOGY

2.1 Data

The data used are secondary data from 30 conventional banks and 7 Islamic banks since 2008 - 2017. The data used from the financial statements (balance sheet and profit and loss) taken from the stock exchange of Indonesia.

Table 1: Number of Banks in the Sample.

	Total Observations
Conventional	30
Islamic	7
Total	37

2.2 Methods

The analytical method used is descriptive analysis. By using 3 measure of bank profitability ratio, that is Return on Assets, Return on Equity and Profit Margin.

Table 2: Definitions of 3 financial ratios.

Bank Profitability Ratios	Measurement
ROA	net income / average total assets
ROE	net income / average stockholders' equity
PM	net income / operating income

3 RESULTS AND DISCUSSION

To begin an analysis of whether Islamic banks and conventional banks can be distinguished from each other based on their profitability characteristics, Table 3 presents descriptive statistics for both types of banks.

Table 3: Descriptive statistics for the 3 profitability ratios.

Variable	N		Mean		St. dev		t-test for equality of means	
	CB	*IB*	*CB*	*IB*	*CB*	*IB*	*t-value*	*p-value*
ROA	30	7	0.004	0.008	0.077	0.009	-0.067	0.004
ROE	30	7	0.104	0.057	0.348	0.073	-0.275	0.047
PM	30	7	0.077	0.066	0.335	0.457	0.121	0.104

The t-test for equality of means is based on the mean for Islamic banks minus that of conventional banks for each ratio. The test is calculated assuming unequal sample variances.

The last column of the table shows the t-test results for the similarities between Islamic and conventional bank groups for each ratio. Test statistics and degrees of freedom are calculated assuming unequal population variance, and are not equal, since the variance of about one-third of the financial ratios is more than twice as large for one bank group than any other group. The average values for ROA and ROE differ significantly at the 1% and 5% levels between the two types of banks, while the mean of both ratios

(ROA and ROE) also differ significantly at the 1% and 5% levels.

The results of the above analysis is the ROA of sharia banks higher than conventional banks. These results answer the hypothesis above bahwasannya Islamic banks more profitable than conventional banks when viewed from the ROA. In line with previous studies which reported higher ROA for sharia banks [Rosly and Abu Bakar (2003)]. In this study, an ROA of 0.8% for sharia banks while conventional bank ROA was only 0.4% larger at a significant 1% level.

However, for the results of ROE analysis can not answer the above hypothesis, because the results of Islamic bank ROE is not greater than conventional banks. Average ROE per year of conventional banks is 10.4%, while Islamic banks are only 5.7%, with significant differences at the 5% level. The reason for this analysis is that Islamic banks prefer to raise capital from investment deposits rather than equity capital in funding their investment which is a high strategic choice according to Islamic banks (Karim and Ali (1989) .While the Islamic financial boom in recent years finally, it makes sense for sharia banks to rely more on deposits than on equities (Olson and Zoubi, 2008), but in Indonesia conventional banks operate longer and have more customers than Islamic banks and have a market share of only 5% of conventional banks. which resulted in the results of this study not in accordance with previous research (Olson and Zoubi, 2008) and obtaining the results of Islamic bank ROE is smaller than conventional banks While profit margin has no significant significance in the results of analysis in this study.And in line with previous research that PM has no significance (Olson and Zoubi, 2008).

The above results show the reliability of Islamic banks compared to conventional banks. With a relatively smaller amount of assets than conventional banks, Islamic banks can still optimize their profitability and generate higher return on assets than conventional banks. It can be deduced that Islamic banks are indeed more profitable than conventional banks. This is in line with previous researchers [olson, karim, rosli] who produced similar findings. Thus can be said accounting information in the form of profitability can be made differentiation between Islamic banks and conventional banks, Islamic banks are more profitable than conventional banks.

4 CONCLUSION

The result of the above analysis gives the conclusion that Islamic banking especially in Indonesia is more profitable than conventional bank. This is because profits derived from assets are higher than conventional banks. This illustrates that although the assets of Islamic banks in Indonesia are small, and the market share is low, Islamic banks can still optimize the profits of their assets compared to conventional banks. The results of this study can provide information to customers to be able to prefer Islamic banks to save funds because Islamic banks do not use the system of interest that became a ban on Islamic religion, as well as more profitable than conventional banks. Although with a small capital Islamic banks can still be optimal in generating profits. Limitations in this study were to use only three profitability ratios to see the difference between the two banks. For further research is expected to increase the ratio of profitability in order to increase the accuracy that the two banks can be distinguished by looking at profitability.

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