

Does Islamic Banking have a Competitive Advantage over Conventional Banking in Indonesia?: A Study of Perspectives

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ABSTRACT

This research aims to highlight, from the perspective of competitive advantage, the difference between Islamic and conventional banking. The competitive advantage is based on capital's preference. The sample of this study was 120 commercial banks but only 49 banks, accounting for 52% of banks in Indonesia, completed and returned the questionnaire (response rate 39%). The research focused on the top management team and data was collected using questionnaires. The questionnaire was based on a variable construct, taking into consideration the bank's competitive advantage and innovation performance among others. The results show that capital is the only factor of advantage for Islamic banks.

Keywords: Competitive advantage, innovation performance, absorption capacity, organisational culture, conventional and Islamic banking

INTRODUCTION

The banking and financial industry in Indonesia is experiencing a dynamic change. Law Number: 21, 2008 started Islamic banking in Indonesia. Islamic banking is different from conventional banking whereby the latter offers savings, deposits and current accounts while the former offers *Murabaha*, *Isthisna'*, *Ijara*, and *Mudaraba* among others. A bank's performance is largely determined by its competitive advantage. Competitive advantage measures how a company faces

competition. to see whether Does Islamic banking have a competitive advantage over conventional banking? The competitive advantage of a bank is determined by the amount of capital it holds. This is exemplified by the Bank

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Indonesia's effort as the Central Bank to boost its capital reserves (Indonesian Banking Architecture, Bank Indonesia, 2004). Its policies to achieve that include single present policy, having minimum capital of IDR100 billion, and mergers between banks to boost capital. Islamic banks need to improve their competitive advantage in order to compete with conventional banks.

In the strategic management context, culture is seen as a competitive advantage (Barney, 1986; Fiol, 1991). Fiol (1991) proposed Identity-Based View as a sustainable competitive advantage. Culture is considered important by practitioners and a central factor in the McKinsey 7S and as one of the factors in Balanced Scored Card (Kaplan, 2005). There are many definitions of organisational culture. The present study, adopts the definition of Pettigrew (1979) and Van den Berg and Wilderom (2004) whereby organisational culture is a system of accepted meaning, approved and accepted or perception shared, manifested in work habits, and owned collectively by certain groups at certain times.

This study examines the difference between Islamic banks and conventional banks from the perspective of competitive advantage in Indonesia. The study analyses aspects of the capital, innovation,

absorptive capacity and organisational culture. This study concludes that capital can improve the competitive advantage of both Islamic and conventional banks. Innovation, absorption capacity and organisational culture can improve the competitive advantage of banks, both Islamic and conventional.

METHODS

This study examined 120 commercial banks in Indonesia. The study sample to included public banks which are state-owned, private, foreign banks, private-public banks, Islamic Bank, Regional Development Banks, Exchange Banks-Non-Foreign Exchange Bank, and the medium and small banks. Respondents belonged to top management team (CEO or BOD), represented by directors and senior officers under the Board of Directors. Items that are not valid will be test repaired using Structural Equation Modeling /SEM-based variant, via the Smart PLS application 3.0.

RESULTS AND DISCUSSION

It is necessary to test the validity and reliability, dimensions and indicators are in line with the constructs. Validity and reliability of test results can be seen in the table below:

Table 1
Validity and Reliability Testing

	First Item	Used Item	Validity	Reliability	Inform
Competitive Advantage	14	14	0,596-0,947	0,847	Valid and reliable
Product Innovation	5	5	0,571-0,933	0,935	Valid and reliable
Process Innovation	4	4	0,748-0,828	0,910	Valid and reliable
Acquire	7	6	0,635-0,748	0,876	Valid and reliable
Assimilation	9	7	0,645-0,812	0,895	Valid and reliable
Transformation	9	8	0,606-0,851	0,931	Valid and reliable
Exploitation	5	5	0,964-0,892	0,912	Valid and reliable
Developed	5	5	0,589-0,808	0,850	Valid and reliable
Group	5	2	0,608	0,751	Valid and reliable
Rationale	5	5	0,545-0,815	0,873	Valid and reliable
Hierarchy	5	4	0,595-0,687	0,804	Valid and reliable

Table 1 shows that all variables used in this study have adequate validity and reliability. Of the total 73 items, 65 items unused measurements have adequate validity (0545-.947). The entire variable also has adequate reliability (Cronbach alpha 0751-0935). Research participants must have a minimum capital of IDR100 billion (as at 31 December 2011). A total of 120 banks met these criteria and adequately represented the banking industry as a whole. The sample included big banks (in terms of capital), followed by medium-sized banks and small banks. The small banks accounted for the largest number in the sample. The size of the bank is important for the ANOVA test and to determine the mean score of variables. Only commercial and

Islamic banks participated in this study whereby the latter outnumbered the former.. Islamic bank respondents who participated in this study encouraged other Islamic banks to participate as well which accounted for their overrepresentation in the sample.

In terms of geographical distribution, the banks were well represented. They were located in North Sumatra, Bandung, Jakarta, Surabaya, Maluku, Sulawesi and Papua. It is important to understand the characteristics of the bank executives as respondents. On average, each bank is represented by 1.7 respondents. Thus, it is expected subjectivity is minimised. Data related to respondents are captured in Table 3.2 (non-parametric data) and Table 3.3 (parametric data) below:

Table 2
Respondent Characteristics-Non Parametric Data

No	Respondent Characteristics	Sum	Proportion
1	Education Level		
	Doctor/PhD	3	4%
	Master	41	49%
	Bachelor	39	46%
	Diploma	0	0
	High School	1	1%
2	Gender		
	Female	10	12%
	Male	74	88%
3	Position		
	CEO or Vice CEO	3	4%
	Director	17	20%
	Vice Director	64	76%
4	Work Unit		
	CEO or Vice CEO	3	4%
	Operation and IT	21	25%
	Marketing	10	12%
	Risk Management, HR, Audit, Corporate Affair and Support System Unit	50	60%
Total		84 Respondents	

The respondents were educated executives. Most of them (49%) hold a Master’s degree and 4% of them had a doctorate. There were more male respondents than females. This could be due the fact the banking sector in Indonesia has more male executives than female

executives. Most of the respondents worked in the HR, Finance, Risk Management, Corporate affairs and Audit divisions. In addition to demographic non-parametric data, this study also included parametric data. Table 3.3. below provides an analysis of this data:

Table 3
Respondent Characteristics-Parametric Data

No	Respondent Characteristics	Mean	Modus	Median	Minimum	Maximum
1	Age ^{*)}	47	43	47	32	72
2	Work period in bank ^{*)}	19	24	19	1	50
3	Work period on position ^{*)}	4	7	6	1	12

Most of the respondents were executives aged between 43 and 47. From the perspective of developmental psychology, all the participants in this study were mature and between the ages of 40 and 60. Mature executives are expected to carry out their duties intelligently (Wink & Scott, 2005). Most of the respondents had between 18 and 24 years of work experience in the banking industry. This long service means they have a deep understanding of the banking industry. The respondents of this study are considered very capable with an ability to understand the variables used in this study. The respondents have been working in the banks under study between 4 and 6 years. This indicates that respondents

are well versed in their duties and functions as well as possessing a good understanding of the banks they work in and the position of their bank compared with other banks in Indonesia and in the region. The respondents were considered responsible in carrying out their duties evident from their answers in the questionnaire. For data on the size of the banks, in this case the bank's capital as at 31 December 2013, it does not test the validity and the reliability for official use of secondary data sourced from the regulator. Primary data was collected in 2013. A two-way analysis of variant test was conducted to determine the variance of each variable. The results can be seen in the table below:

Table 4
Two Way Analysis of Variant Testing

	F test	Significance	Summary
Capital	10,290	0,000	Significant
Conventional-Islamic	-0,121	0,729	Non-significant
Conventional-Islamic	1,497	0,228	Non-significant

From the data it appears that a positive score of F test with a score of 0.000 is significant. This indicates that the bigger a bank is, the stronger its competitive advantage. This is consistent with results of previous studies, as well as from the fact regulators often encourage banks to strengthen their capital base. The indicator used is the ratio of the price compared with cost, product quality, product delivery, product innovation and the speed with which the products are released to the market. Chen and Huang (2009) state that the company's internal conditions

and the position of the company against its competitors are important. Chen et al. (2009) reported on the importance of Absorptive Capacity (ACAP). In statistics, measuring instruments must have good reliability and validity. The "diamond" (Porter, 1980) framework points to the level of competition as one of the dimensions that affect competitive advantage. In the context of this research, there are three groups of banks with different levels of competition (Mulyaningsih & Daly, 2001). The banks compete directly with a group of banks. Due to different levels of competition,

the competitive advantage of a company depends on if they are competing with a group of banks or individual banks. This study focuses on the competitive advantage of a banking group as well the competitive advantage of banks which are not part of a group. A banking group has a competitive advantage against its rivals as its competitors can't replicate the success of its strategy, and thus, the company can achieve a sustainable advantage (Di-Baggio & Powel, 1983; Chen et al., 2009): IDR.100 M \leq capital <IDR.1 T; IDR.1 T \leq capital <IDR.50T; IDR.50T \leq capital (www.bi.go.id; Mulyaningnsih & Daly, 2011). A bank does not have superior position against competitors if it is not part of a group with sound capital, where competitors can't replicate the success of the strategy of the company, so the company can make a steady profit (Di Baggio & Powel, 1983; Chen et al., 2009). Bank group with capital: IDR.100 M \leq capital <IDR.1 T; IDR.1 T \leq capital <IDR.50T; IDR.50T \leq capital (www.bi.go.id; Mulyaningnsih & Daly, 2011).

In the two-way analysis of variant testing, it appears that the bank size and its operating principles do not necessarily offer it a competitive advantage. It can be seen from this study that Islamic banking principle does not offer the bank a competitive advantage. Islamic banks need to look at other sources of competitive advantage. A source of competitive advantage can come from external factors, such as special support from the Islamic bank regulator and public awareness of the shar'i principles among others. Islamic banks must also focus on internal factors as a source of competitive advantage as they can be controlled and managed in-house. Among the internal factors which are important is innovation, the ability to absorb and utilise external knowledge (absorptive capability) and a strong organisational culture. However, are Islamic banks and conventional banks different in these three aspects? Results of the study can be seen in the table below.

Table 5
Statistics Testing

	Mean for Conventional Banking	Mean for Islamic Banking	T test	Significance	Summary
Product-Innovation	4.53	4.29	0.67	0.52	Non-significant
Process-Innovation	4.89	4.63	0.91	0.38	Non-significant
Acquire	4.97	4.97	-0.01	0.99	Non-significant
Assimilation	5.18	5.21	-0.11	0.91	Non-significant
Transformation	4.97	4.97	0.02	0.99	Non-significant
Exploitation	4.9	4.8	0.03	0.76	Non-significant
Developed	4.67	4.56	0.45	0.66	Non-significant
Group	4.95	4.8	0.56	0.59	Non-significant
Rational	5.18	5.01	0.76	0.46	Non-significant
Hierarchy	4.67	4.47	1.01	0.33	Non-significant

The test results using independent samples T-test, using $\alpha = 5\%$, show no significant difference.

Result from the test repaired done using Structural Equation Modeling /

SEM-based variant, via the Smart PLS application 3.0. described as Validation test item shows loading minimal 0.7. Less than 0.7 is discarded and illustrated as below,

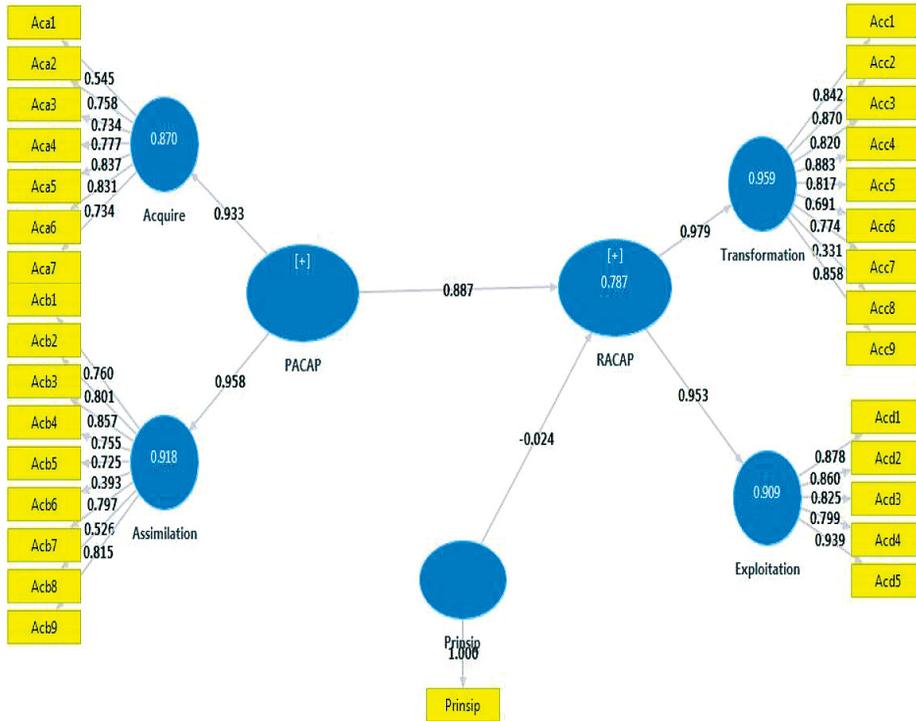


Figure 1. Result Model

Table 6
Reliability Test

	Average Variant Extracted/AVE Min 0,5	Composite Reliability/CR Min 0,7	Cronbach's Alpha/CA Min 0,7
Acquire	0.62	0.91	0.88
Assimilation	0.63	0.92	0.90
Transform	0.72	0.95	0.93
Exploitation	0.74	0.94	0.91
Principle	1.00	1.00	1.00

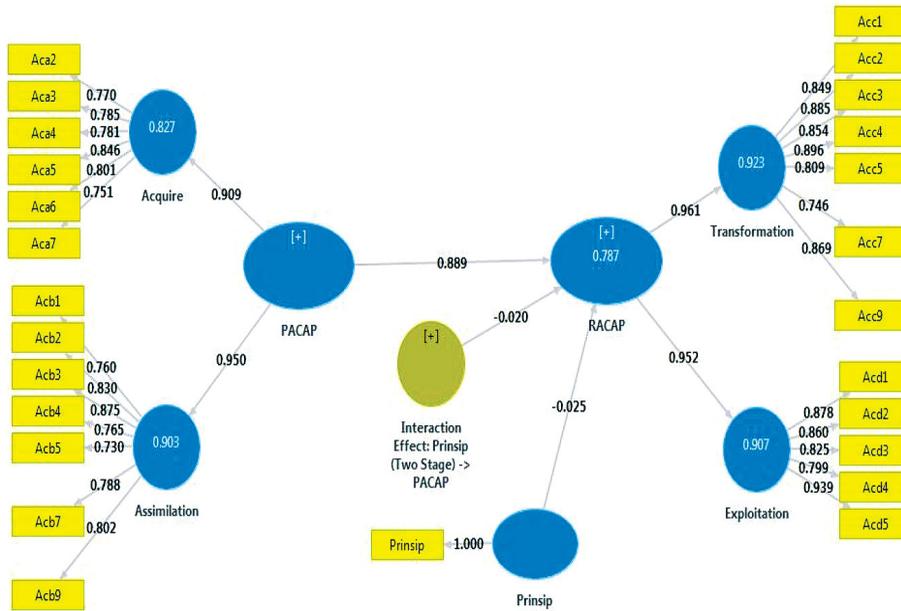


Figure 2. Model Testing for Valid item

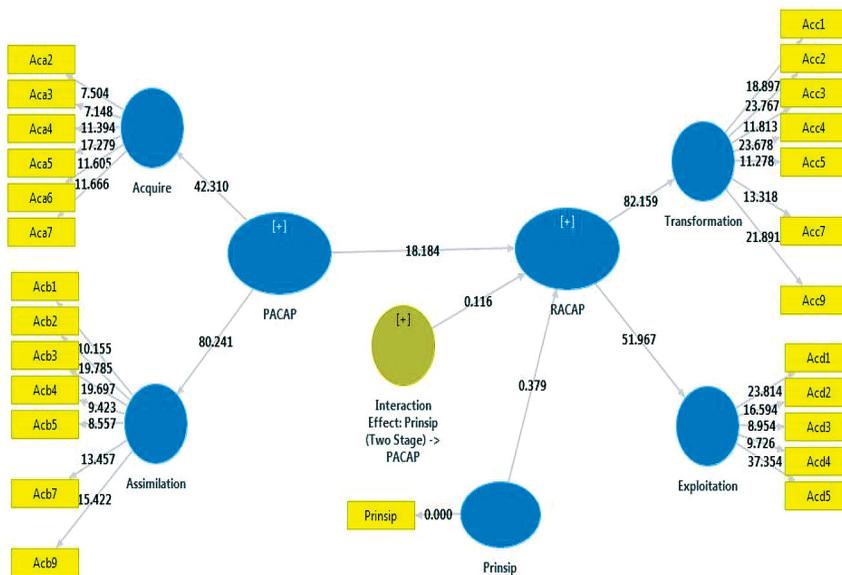


Figure 3. Model with Tests of significance $\alpha = 5\%$

CONCLUSION

From the present study, it can be concluded that:

1. Capital is a competitive advantage for Islamic banks.
2. Performance innovation, absorptive capacity and organisational culture are not competitive advantages for Islamic banks.

Therefore, in order to achieve competitive advantage, Islamic banks need to do the following:

- Having other competitive advantages in addition to the performance of innovation, absorptive capacity and organisational culture.
 - Conduct education for the community through the programme titled “Shar’i goes to School and Campus”
 - Gauging the public’s understanding of Islamic banking.
3. Establishment of DSD (Regional Islamic Council) at provincial/district / city level in Indonesia.

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