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The Comparison of Islamic and Conventional Banking in Ownership Structure and Interest Rates in Indonesia

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Abstract

Ownership structure and interest rates are important factors affecting a bank's performance. Previous studies have found the effect of ownership structure and interest rates on company performance, but no one has specifically examined differences in Banking performance in ownership structure and interest rates. This study aims to compare the performance of Islamic and conventional banking in ownership structure and interest rates. In this study, the author used quantitative methods that emphasize the analysis of numerical data processed using Stata 16. Based on the unstructured data panel, there are 13 Islamic banking and 107 conventional banking, the total banks used as objects are 120 banks with 1110 observations. The results are local ownership did not affect the performance of Islamic banks, compared to conventional banking on the contrary. Foreign ownership in Islamic banking affects Banking performance, while conventional banking has no effect. Furthermore, government ownership affects the performance of Islamic banks, but does not affect the performance of conventional banking. Based on the results of the study, it can be proven that government and foreign interference in the ownership of Islamic banking plays a role in improving the bank's performance. Whereas conventional banking has performed well under local ownership.

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Introduction

The financial crisis that occurred in Indonesia in the past has caused a loss of public confidence in the functioning of some conventional banking. Pat the same time increased attention to Islamic banking. Over time, the growth rate of banks, both banks and conventional banking experienced significant growth. This condition motivates investors, both local and foreign investors, to invest in the banking sector. The ownership structure in the bank is one of the important factors and influences the performance of the bank (Shawtari 2018). Based on its ownership structure, banks in Indonesia consist of banks with institutional ownership and managerial ownership. Institutional ownership consists of local ownership, foreign ownership, and government ownership. The existence of differences in ownership structure will result in differences in the policies taken which in turn will have an impact on different performance. Ownership to the ownership structure, and interest rates are also one of the factors that have an important role in company performance. The interest rate is a price that connects the present and the future, like any other price, the interest rate is determined by the interaction between demand and supply. The interest rate greatly affects the company's profit, because the higher the interest rate, the lower the profit earned by the company.

Several previous studies have raised the topic of the effect of ownership structure and interest rates on company performance. However, no one has specifically compared differences in banks' performance in ownership structure and interest rates. Robin, Salim & Bloch (2018) stated that there was a negative impact of government ownership on all measures of profitability, return on assets, and return on equity studies in Bangladesh in the period 1983 to 2012. While other studies show that there is a significant positive relationship between performance and government ownership (Shawtari, 2018). Several studies on the effect of interest rates on company performance are shown by research by (Kalengkongan 2013; Ngurah, Aditya, and Badjra 2018) which prove that interest rates affect company performance. Conversely, Wibowo (2015) in his research proved that interest rates do not affect company performance (ROA).

Literature Review

Banking Performance

Banking is a company engaged in a financial institution that has a license to accept deposits, provide loans, provide financial services, wealth management, currency exchange, and safes, which are regulated by the government and central banks or the Financial Services Authority as in Indonesia (Soedarso 2020). In this context, banks are also divided into two categories, namely conventional and sharia which have different values. Maximizing loan interest is the main value of conventional banking in obtaining profits, while sharia-based banks emphasize more on the values of Islamic law which expressly prohibits the use of interest in obtaining profits (Ali &; Naeem, 2019; Salman & Nawaz, 2018; Maradin et al., 2017). Salman & Nawaz, (2018) further said that the difference between Islamic and conventional banking can be seen through regulatory aspects such as higher minimum capital requirements to establish Islamic banks than conventional banking. Therefore, to maximize customer satisfaction and profit margins, conventional banking and Islamic banks must adopt different services and different strategies to provide choices for customers who choose and move from Islamic banks to conventional or vice versa (Lone et al., 2017).

The value of conventional banking companies focuses on serving the public by implementing an attractive system in their operational activities, generally operating by issuing products to absorb public funds, through savings, time deposits, current accounts, and further channeling available funds, including investment loans, working capital, and consumer loans (Wardhani, 2020; Sutikno, 2017) . While the value of Islamic banking focuses on providing products and services by sharia (Islamic Law) which strictly prohibits not only excessive riba (interest costs) such as additional costs from borrowing, but also prohibits unethical involvement such as speculation and gambling (Aisyah, 2018; Yanikkaya et al., 2018; Salman & Nawaz, 2018). Yanikkaya et al., (2018) further said that the value of Islamic banks lies in the prohibition of receiving and taking *interest on Riba*, *Maisir* gambling, excessive uncertainty *Gharar* with several principles of contractual obligations built on buying and selling *Murabahah*, Ijarah or partnership in *Musharakah/Mudharabah* in assets. Therefore, balancing conventional and islamic banking values can increase the determinants of economic efficiency in Indonesia (Baehaqy, 2019).

Ownership Structure

Ownership structure is an important factor in determining the management, operations, and performance of a banking company (Shawtari, 2018). In this context, bank ownership structures are divided into five types, namely (1) state banks; (2) Indonesian private banks; (3) foreign private banks; (4) regional development banks; and (5) mixed banks (Dianitasari &; Hersugondo, 2020). This is in line with Robin et al. (2018) that the ownership structure of banks affects all profitability, assets, profits and losses, performance and policy determination of banking companies. As shown by Agustin et al. (2020), banks controlled by local or domestic ownership usually have large shares in non-financial companies but assets, profits, and losses in transactions have high risk while Islamic commercial banks that are influenced by bank ownership structures by the government and private have high profitability due to financing principles based on principles Islam. This is in line with Ramlan & Adnan (2016) that the profitability and assets of banks are more profitable than the profitability of conventional banking . This is because of the principle of an islamic banking such as *mudharabah* which provides welfare in asset ownership and transactions to its users.

In the context of islamic banking, bank ownership is structured into several parts. As Ben Slama Zouari &; Boulila Taktak (2014) show, the ownership of islamic banking is structured as follows: (1) government; (2) foreign investors; (3) shareholders, both individual investors and families. For banking ownership, most investors come from within the country, while for conventional banking, ownership is mostly managed by foreign investors. In this context, differences in ownership structure have a significant effect on control in regulating the principles, performance, and governance of a banking company (Bokpin, 2013; Lin et al., 2016).(Lin, Doan, and Doong 2016) As Muawanah (2014) writes, differences in ownership structures in banking affect differences in culture, legal systems, regulations, and company characteristics. As in the case study written by

Lassoued et al., (2018) where the transaction system and profit sharing in conventional banking are regulated by shareholders while in islamic banking profit management is regulated and distributed equally to investors and customers.

Interest Rate/Profit Sharing (Conventional banking and Islamic Banking)

Banking companies have grown rapidly in the last three decades (Bilgin et al., 2021) which generally consist of two types of banking, namely conventional banking that charge customers with deposit interest, while Islamic banks do not burden customers with deposit interest (Barry & Njie, 2020 Aisyah, 2018)(Aisyah 2018). Based on its operations, fund distribution products at conventional banking are called loans, while fund distribution products at Islamic banks are called financing (Bitar &; Tarazi, 2019; Majid &; Ulina, 2020; Qian &; Velayutham, 2017) which the form of service is the same, but what distinguishes it lies in the contracts in Islamic banks, namely *hawalah*, *kafalah*, *wakalah*, *rahn*, and *sharf* (Suparmin 2019). However, when viewed in the conception of guarantees and collateral, conventional and Islamic banks have different rationales (Apriyanti, 2018; Indra, 2019) guarantees and collateral in conventional banking arise due to the relationship between creditors and debtors, while Islamic banks see the concept of guarantees and collaterals from the concepts of *Rahn* and *Kafalah*, although in reality the practice of guarantees and collaterals in Islamic banks also uses legal norms of guarantees (Fitriani 2017).

Conventional and islamic banking have many differences, especially in the principle of regulating interest and transactions in the system (Sanosra et al., 2017). For example, the interest-based transaction system in conventional banking is replaced by a *profit loss sharing* transaction system in islamic banking, where profits, losses, and risks are shared between creditors and borrowers so that transactions do not involve interest rates and profits in their investment activities. This is because the principles of islamic banking are based on the principles of Islamic law which refer to the rules contained in the Qur'an and Hadith (Khediri et al., 2015). As written by Basri, Siti Nabiha, & Majid (2016) that the characteristic of islamic banking is to operate using the principle of profit sharing (*mudharabah*) and no interest (*usury*) because *riba* is haram in Islamic law. This is in line with the opinion of Ernayani, Robiyanto, & Sudjinan (2017) that islamic banking arises because Islam prohibits people from withdrawing or paying interest as is done in the transaction system at conventional banking . While in conventional banking the interest system is based on the percentage of funds deposited or lent and is set at the beginning of the transaction so that the amount can be ascertained regardless of profit and loss (Wafa 2017). Such as the interest system applied by Bank Mandiri and the profit sharing system at Bank Mandiri Syariah (Arinta 2016).

Hypothesis

This study reexamines the effect of ownership structure (local ownership, foreign ownership, government ownership) and interest rates on company performance. The focus of this study is different from previous studies because this study tries to compare the performance between two banks, namely islamic banking and conventional banking from the content of ownership structure and interest rate/profit sharing which is still rarely studied. In line with this, this study tries to answer the hypotheses proposed, namely:

H1ib : Local ownership affects the performance of islamic banking
H1cb : Local ownership affects the performance of conventional banking
H2ib : Foreign ownership affects the performance of islamic banking
H2cb : Foreign ownership affects the performance of conventional banking.
H3ib : Government ownership affects the performance of islamic banking
H3cb : Government ownership affects the performance of conventional banking.
H4ib : Profit Sharing Rate affects the Performance of islamic banking
H4cb : Interest Rates affect the Performance of conventional banking

Research Methods

Research Method

This study aims to analyze and see the difference in the influence of ownership structure (local ownership, foreign ownership, and government ownership) and interest rates on the performance of foreign and conventional in Indonesia. In this study, the author used quantitative methods, namely methods that emphasize the analysis of numerical data processed using the Stata 16 application. Based on the *unstructured* data panel, there are 13 Islamic banks and 107 conventional banking so that the total companies that are the object of this study are 120 banks with a total of 1110 observations during the period 2007-2020.

Data Collection Techniques

This research is causal associative research with a quantitative approach. The source of data used is secondary data obtained from the official website of the Financial Services Authority (OJK), namely www.ojk.co.id. Here is the definition of variables from this study:

Table 1. Variable Operational Definition

Variable	Formula	Scale
Profitability (ROE)	$\frac{Net\ Profit}{Shareholder'sEquity}$x100%	Ratio
Local Ownership (Domestic)	$\frac{total\ shares\ owned\ by\ local}{total\ outstanding\ shares}$	Ratio
Foreign Ownership	$\frac{total\ shares\ owned\ by\ foreigners}{total\ outstanding\ shares}$	Ratio
Government Ownership	$\frac{total\ shares\ owned\ by\ the\ government}{total\ outstanding\ shares}$	Ratio
Interest Rate	$Interest$	Ratio

Source: Collected from various sources by researchers, 2021

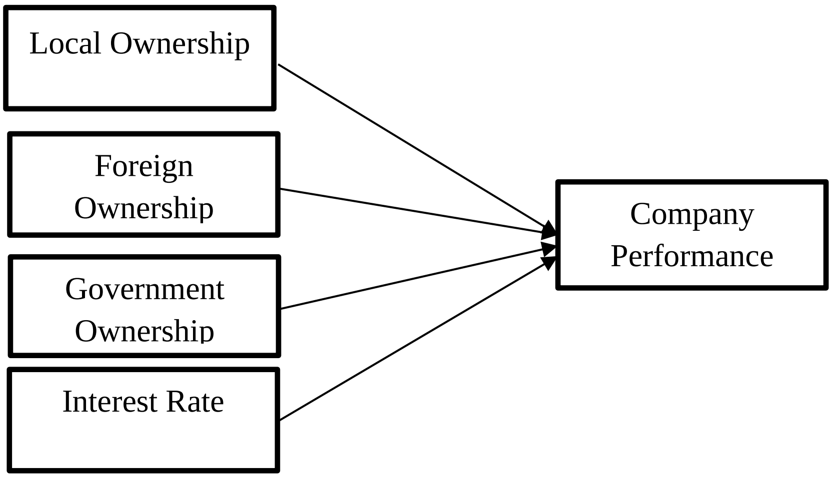
Data Analysis

This study used statistical measuring tools, namely STATA 16 to determine descriptive statistics, correlation tests, classical assumption tests, and multiple regression tests. The steps in this study are as follows:

Step I

Determine the path diagram based on the variable relationship paradigm below. Here is the framework of this study:

Graph 1. Research Structure



Source: Processed by Researcher, 2023

Step II

Determine the stuructural equation as follows:

$$Y\ (ROEib) = \alpha + \beta\ (X1ib) + \beta\ (X2ib) + \beta\ (X3ib) + \beta\ (X4ib) + e1$$
$$Y\ (ROEcb) = \alpha + \beta\ (X1cb) + \beta\ (X2cb) + \beta\ (X3cb) + \beta\ (X4cb) + e1$$

Description:

ROEib : Performance of Islamic banking companies
X1ib : Local Ownership of Bank Syariah
X2ib : Foreign Ownership of Sharia Banks
X3ib : Government Ownership of Sharia Banks
X4ib : Islamic banking Profit Sharing Rate
ROEcb: Performance of conventional banking companies
X1cb : Local Ownership of Conventional banking
X2cb : Foreign Ownership of Conventional banking
X3cb : Government Ownership of Conventional banking
X4cb : Conventional Bank Interest Rate

Step III

Analyze using 4 steps, namely analysis for substructural 1, substructural 2, substructural 3, and substructural 4.

Results

Descriptive Statistics Analysis

Descriptive statistical analysis is used to determine the data picture of the variables used in a study by looking at the average value (*mean*), maximum value (*maximum*), minimum value (minimum), and the number of observations (*observations*). Based on descriptive statistical analysis using the STATA 16 statistical measurement tool, the following data picture is obtained:

Table 2. Descriptive Statistics of Islamic Banking Research Variables

	ROE	Foreign Ownership	Local Ownership	Government Ownership	Interest
Mean	24.96831	5.378155	14.11886	68.01863	5.297806
Maximum	92.12500	94.10000	100.0000	100.0000	10.04612
Minimum	-6.826667	0.000000	0.000000	0.000000	-3.852245
Observations	148	148	148	148	148

Source: Data processed by researchers, 2021

Based on Table 2 Descriptive Statistics of Islamic Banking Research Variables shows that the number of Islamic bank data used in this study was 148 Islamic bank data in Indonesia during the 2007-2020 observation period. The descriptive table illustrates the variables studied, including independent variables which include foreign ownership, local ownership, government ownership, and interest rates, as well as dependent variables, namely Banking performance as measured by ROE. From the Descriptive Statistics Table, foreign ownership shows an average value of 5.38%. This means that the average foreign ownership of banks in Indonesia is 5.38% of all existing ownership structures in Indonesia. The minimum foreign ownership value is 0% and the maximum value is 100%. This means that in the data the lowest value of foreign ownership of banks is 0% and the highest is 100%. The local ownership variable showed an average value of 14.12%. This shows that the average ownership of local (domestic) institutions of banks in Indonesia is 14.12% of the entire bank ownership structure. Local ownership shows a minimum value of 0% and a maximum value of 100%, which means that there are banks that have a minimum value of local ownership of 0% and there are banks that have a maximum value of local ownership by 100%. For variable government ownership shows an average value of 68.02%. This indicates that the average government ownership of banks in Indonesia is 68.02% of the entire bank ownership structure in Indonesia. The minimum government ownership value shows a figure of 0% and a maximum value of 100%. This figure shows that there are islamic banking that have a minimum value of government ownership of 0% and there are islamic banking that have a maximum value of government ownership of 100%.

Variable interest rates show an average value of 5.30%. This means that the average interest rate in Indonesia is 5.30%. The minimum interest rate value is -3.85% and the maximum value is 10.00% which means that during the observation period, the lowest interest rate in Indonesia was -3.85% and the highest interest rate was 10.00%. Furthermore, the performance variable of Islamic banks showed an average value of 25%. This means that the average performance of banks in Indonesia is 25%. The minimum

Islamic Banking performance value of -6.8 3% and the maximum value of 92.13% means that there is a syariah bank that has a minimum Islamic Banking performance value of -6.83% and there is Islamic banking which has a maximum value of 92.13%.

Tabel 3. Descriptive Statistics of Conventional Banking Research Variables

	ROE	Foreign Ownership	Local Ownership	Government Ownership	Interest
Mean	12.79613	29.87598	51.58075	17.46746	5.372829
Maximum	95.83500	100.0000	100.0000	100.0000	10.04612
Minimum	-97.25000	0.000000	0.000000	0.000000	-3.852245
Observations	962	962	962	962	962

Source: Data processed by researchers, 2021

Table 3 Descriptive Statistics of Conventional Banking Research Variables shows descriptive statistical data of conventional banking research variables. The number of conventional banking data in Indonesia used in this study was 962 banks for the period 2007-2020. From the descriptive statistical table, foreign ownership shows an average value of 29.86%. This means that the average foreign ownership of conventional banking in Indonesia is 29.86% of the entire ownership structure in Indonesia. The minimum foreign ownership value is 0% and the maximum value is 100%. This means that in conventional banking data owned by foreign institutions, the lowest value is 0% and the highest value is 100%. The local ownership variable showed an average value of 51.58%. This shows that the average ownership of local institutions of conventional banking in Indonesia is 51.58% of the entire bank ownership structure. Local ownership shows a minimum value of 0% and a maximum value of 100%, which means that there is conventional banking that have a minimum value of local ownership of 0% and there is conventional banking that have a maximum value of ownership The locality is 100%. For variable government ownership shows an average value of 17.47%. This indicates that the average government ownership of conventional banking in Indonesia is 17.47% of the entire bank ownership structure in Indonesia. The minimum government ownership value shows a figure of 0% and a maximum value of 100%. This figure shows that there is conventional banking that has a minimum value of government ownership of 0% and there is conventional banking that has a maximum value of government ownership of 100%.

Variable interest rates show an average value of 5.30%. This means that the average interest rate in Indonesia is 5.30%. The minimum interest rate value is -3.85% and the maximum value is 10.00% which means that during the observation period, the lowest interest rate in Indonesia was -3.85% and the highest interest rate was 10.00%. Furthermore, the performance variable of conventional banking showed an average value of 12.80%. This means that the average performance of conventional banking in Indonesia during the observation period was 12.80%. The minimum conventional banking performance value is -97.25% and the maximum value is 95.84%. This illustrates that there is conventional banking that has a minimum Banking performance value of -97.25% and there is conventional banking that has a maximum value of 95.84%.

Data Analysis Results

This section explains the results of statistical data analysis on the performance of banks and conventional banking in the ownership structure and interest rates in Indonesia. The results of inferential analysis obtained during the observation period 2007-2020 are as follows:

Table 4. Multiple Regression Analysis

	All Observation with ROE as Dependent		
VARIABLES	**fe**	**Islamic Banking (ROE)**	**Conventional Banking (ROE)**
Local Ownership	0.047**	0.087	0.047**
	(0.020)	(0.090)	(0.020)
Foreign Ownership	0.053**	0.354***	0.035
	(0.025)	(0.127)	(0.025)
Government Ownership	0.038	0.132**	0.007
	(0.028)	(0.052)	(0.037)
Interest	-1.074***	-1.546***	-0.990***
	(0.114)	(0.327)	(0.120)
Constant	18.089***	24.009***	16.998***
	(2.014)	(5.811)	(2.150)
Observations	1,110	148	962
R-squared	0.315	0.603	0.280
Number of id	120	13	107

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Source: Data processed by researchers, 2023

The Multiple Regression Analysis Table above shows the results of multiple linear analysis that measures the performance of Islamic banks and conventional banking in ownership structure and interest rates with the following description:

Regression Test of Islamic Banking Performance in Ownership Structure and Interest Rate

The following is a form of regression equation for Islamic Banking performance in ownership structure and interest rates in Indonesia:

$$\mathbf{Y\ (ROEib) = 24.009 + 0.087 + 0.354 + 0.132 + (-1.546) + e}$$

The regression equation (i) above shows the value of coefficient of regression of local ownership of 0.087. This value means that if the local ownership of Islamic banks increases or decreases by 1%, the performance of Islamic banks will increase or decrease by 0.087 or 8.7%. The value of the foreign ownership regression coefficient of 0.354 indicates that if foreign ownership increases or decreases by 1%, the performance of Islamic banks will increase or decrease by 0.354 or 35.4%.

Furthermore, the value of the regression coefficient of government ownership of 0.132 indicates that if government ownership increases or decreases by 1%, the performance of Islamic banks will increase or decrease by 0.132 or 13.2%. The interest rate regression coefficient of -1,546 illustrates that if government ownership increases or decreases by 1%, the performance of Islamic banks will decrease by -1,546 or -152%.

Statistical Test of Regression of Conventional Banking Performance in Ownership Structure and Interest Rate

The following is a form of regression equation for conventional banking performance in ownership structure and interest rates in Indonesia:

$$\mathbf{Y\ (ROEcb) = 16.998 + 0.047 + 0.035 + 0.007 + (-0.990) + e}$$

The regression equation (ii) above shows the k value of the regression coefficient of local ownership of 0.047. This means that if local ownership increases or decreases by 1%, then the performance of conventional banking will increase or decrease by 0.047 or 4.7%. The regression coefficient of foreign ownership of 0.035 indicates that if foreign ownership increases or decreases by 1%, the performance of conventional banking will increase or decrease by 0.354 or 35.4%. The regression coefficient of government ownership of 0.007 illustrates that if government ownership increases or decreases by 1%, the performance of conventional banking will increase or decrease by 0.007 or 0.7%. Furthermore, the interest rate regression coefficient of -0.990 indicates that if the interest rate increases or decreases by 1%, the performance of conventional banking will decrease by -0.990 or -99%.

Discussion

The Effect of Local Ownership on the Banking Performance

This study rejects hypothesis 1a because local ownership in Islamic banks does not affect Banking performance. Whereas conventional banking shows the opposite result that there is an influence of local ownership on Banking performance, meaning that hypothesis 1b is accepted. The results of this study are in line with several previous studies (Lone et al. 2017; Widodo and Haekal 2019; Yanikkaya, Gümüş, and Pabuçcu 2018).

The results of research studies in Indonesia itself show that conventional banking have a wider market share than Islamic banks. Based on the publication of "*Islamic banking* Snapshot June 2019" published by the Financial Services Authority (OJK), it is proven that the *market share* of Islamic banking is only 5.95%, while conventional banking is the rest, amounting to 94.05%. This result shows a very long comparison between the performance of conventional banking and Islamic banks. In line with the Big Research (2016) which explains that conventional banking has better performance than Islamic banks. Yanikkaya, Gumus & Pabuccu (2018) also gave results that the average ROA and NIM of conventional banking have higher values than Islamic banks in research at *the Organization of Islamic Cooperation countries and the United Kingdom.*

However, the results of this study contradict (Shawtari 2018) research conducted in Yemen. The results of the study have conditions that contrast with conditions in

Indonesia. Other studies that show conflicting results are (Ariss 2010; Ghaffar and Khan 2014; Ramlan and Adnan 2016). In the study, it was explained that Islamic banks are relatively better in terms of profitability, efficiency, risk, and liquidity management (Khan and Haleem 2016).

The Effect of Foreign Ownership on Banking Performance

The findings of this study prove that foreign ownership in Islamic banks has a significant effect on Banking performance, while in conventional banking there is no influence of foreign ownership on Banking performance. This means that hypothesis 2a is accepted and hypothesis 2b is rejected. This finding further proves that Islamic banks managed by foreigners can make a positive contribution to the development of Islamic banks compared to conventional banking.

The Effect of Government Ownership on Banking Performance

The results of this study show that government ownership in Islamic banking has a significant effect on Banking performance, while in conventional banking there is no influence on Banking performance. The results of this study accept hypothesis 3a and reject hypothesis 3b. This research can prove that state-owned Islamic banks in Indonesia can influence Banking performance. Thus, it can be concluded that the government as the owner of Islamic banks can have a positive influence on the management of Islamic banking compared to conventional banking, so that agency conflicts between management and the government can be minimized (Sabrina &; Muharam, 2015). Furthermore, (Ben Slama Zouari and Boulila Taktak 2014) also stated that banks tend to perform better if their largest ownership is the government or family.

However, the results of this study contradict several other studies including (Cornett et al. 2012; Lin and Zhang 2009; Rahman, Nurwahidin, and Adnan 2021; Robin, Salim, and Bloch 2018b; Robin et al. 2018b) stated that the structure of bank ownership by the government has a significant negative effect on the profitability ratio. While (Cornett et al. 2012) provides results that state banks have lower profitability, less core capital and have greater credit risk.

The Effect of Interest Rates on Banking Performance

From the results of this study, it appears that interest rates have a significant effect on Banking performance in Islamic banking and conventional banking (hypothesis 4a and hypothesis 4b are accepted). The results of this study are in line with the theory developed by Gregory Mankiw (2007). In his theory, (Mankiw 2007) states ROE is influenced by a country's macroeconomic activities. Bank Indonesia Interest Rate which is part of Bank Indonesia's monetary instrument and as a measure of capital costs that must be incurred by business actors or a company to use funds from investors, rising interest rates can attract investors' attention to keep their money in the bank, interest rates that are exceeded high will affect the company's cash flow, so that existing investment opportunities will no longer be attractive (Mankiw, 2007).

Conclusion and Suggestion

This research answers some of the questions and doubts of the public about the performance of Islamic banking and conventional banking based on ownership structure and interest rates. From the results of the study, it appears that Islamic banking with foreign ownership and government ownership can have a significant influence in managing the performance of its banks compared to conventional banking. While conventional banking owned by national institutions play a more important role in bank management than Islamic banks. Likewise, interest rates affect the performance of both types of banks. The results of this study can provide a new concept regarding the performance of Islamic banking in the leadership structure and interest rates that have always been undervalued after conventional banking.

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