

Office Channeling and Its Impact on the Growth of Indonesian Islamic Banking Industry

M. Nur Rianto Al Arif

Syarif Hidayatullah State Islamic University, Jakarta, Indonesia

The purpose of this paper is to analyze that the office channeling policy that based on Bank Indonesia's rule No. 8/3/PBI/2006 had an impact on the growth of Islamic banking industry in Indonesia. This research used ordinary least square regression to analyze the impact of office channeling policy on the growth of Indonesian Islamic banking industry. The variable used in this paper is office channeling which is used as a dummy variable, and margin deposit and non-performing financing (NPF) are also used as control variables. The indicators of the growth of Indonesian Islamic banking industry are asset and third-party funds. The result shows that office channeling does not have an impact on the growth of Islamic banking industry which is measured by asset growth and third-party funds growth. According to this result, Bank Indonesia should have an innovative policy to stimulate the Islamic banking industry growth in Indonesia.

Keywords: office channeling, asset, third-party funds, margin deposit, non-performing financing (NPF)

Introduction

The banking sector is the heart of the economic system of a country and is a tool in the implementation of the government's monetary policy. To determine whether a bank is in good shape or in a state of financial difficulties, there must be an assessment of the bank performance. To assess the performance of the bank, the bank's financial statements will be required, because the bank's financial ratios can be calculated based on the financial statements to assess the financial condition of the bank in the past, present, and more likely in the future.

The concept of Islamic banking and finance, which was originally just a theoretical discussion, has now become a reality that grows and develops as a fact. In fact, the current Islamic banking industry has transformed from simply an alternative bank with a bank sharia system that is able to play its role in the world economic arena. Islamic banking and financial institutions continue to experience a significant growth. According to the annual report of the Islamic Development Bank (IDB, 2009), the Islamic financial institution was expected to grow more than 15% per year, with the number of Islamic financial institutions being more than 300 spread over 75 countries with an estimated total asset of 500 billion dollars, or around Rp 4,600 trillion. In other words, the market has now reached only about 10%. From this IDB report, it can be concluded that the industry is still promising a remarkable development in the future.

Credence to Islamic banks after the economic crisis of 1997, the Indonesian government has established

the Law No. 10 of 1998 about banking. It is explicitly stated in the act that Indonesia has adopted the dual banking system in the national banking system with a recognized presence of banks with Islamic principles to operate either as an Islamic commercial bank or as an Islamic business unit of conventional banks. In 1999, Law No. 23 of 1999 about Bank Indonesia was established by the Indonesian government. In this law, Bank Indonesia was recommended to take monetary policies based on Islamic principles. Islamic monetary instruments issued by Bank Indonesia include, namely, Islamic Interbank Money Market (Pasar Uang Antar-Bank, PUA) and Wadiah Bank Indonesia Certificate (Sertifikat Wadiah Bank Indonesia, SWBI), and Islamic interbank loans are allowed using Interbank Mudaraba Investment Certificate (Sertifikat Investasi Mudharabah Antar-Bank, SIMA). In 2001, Bank Indonesia established a working unit bureau of Islamic banking which specializes in Islamic banking. Then in 2004, it had established the Law No. 3 of 2004 about Bank Indonesia which amends the Law No. 23 of 1999. In the same year, there was also a change in Bank Indonesia, i.e., before 2004, Islamic banking industry was managed by the Bureau of Islamic Banking and after 2004, Islamic banking industry was managed by the Department of Islamic Banking at Bank Indonesia.

In a blueprint issued by Bank Indonesia, it is said that the development of the Islamic banking business units of conventional banks or Islamic banking itself has been growing, both in terms of asset growth and the growth of number of Islamic banking units or networks. However, the growth of the Islamic banking business units of conventional banks or Islamic banking is not adequate when compared to the service needs of the community, which is one of the bottlenecks of office network.

Because of this office network problem, in Bank Indonesia Regulation (Peraturan Bank Indonesia, PBI) No. 8/3/PBI/2006, entitled *Conversion of Business of Conventional Commercial Banks to Commercial Banks Conducting Business Based on Sharia Principles and Establishment of Bank Offices Conducting Business Based on Sharia Principles by Conventional Commercial Banks*, conventional banks are allowed to have Islamic business units in order to serve the transaction based on the Islamic principles of conventional bank branches, known as the office channeling system. If prior to the birth of this regulation, customers who need Islamic transactions can only be served on sharia branches of conventional banks alone, then with the PBI, customers who need Islamic transactions can be served at conventional bank branches. It is hoped that after the publication of this regulation (No. 8/3/PBI/2006) about office channeling, the growth of Islamic banks can be more rapid in Indonesia.

This regulation had a great impact on extending the networking of Islamic banking services. Through this regulation, conventional commercial banks that had a shariah unit can offer the Islamic banking product in conventional branch. Therefore, since 2006, there have been efforts made by conventional banks which have opened Islamic business units with offices or at the principal office of sharia (conventional banks). Al Arif (2010; 2012) said that after this regulation, the development of the Islamic banking industry is growing more rapidly.

Bank Indonesia, in the Islamic banking development report in 2006, stated that office channeling policy focuses on efforts to provide wiggle room for banks to provide financial products and services of Islamic banking, as well as to improve public access to the products and services of Islamic banking. The implementation of office channeling policy is expected to be more efficient for banks in expanding networks and services as well as to accelerate the growth of its business volume. And judging from the institutional side, the whole Islamic banking branch network had increased significantly in 2006. It is characterized by the operations of 456 branches of conventional banks to provide Islamic services (office channeling), especially

since the second half of 2006. The spread of Islamic banking office network now reaches people in more than 70 districts/cities in 31 provinces.

Rohaya (2008) also found that the office channeling policy has a positive influence on the growth and performance of banking such as: (1) After applying the office channeling policy, the total assets of Islamic banking in particular have increased significantly from year to year; and (2) The performance of Islamic banking funds has increased as reflected in the growth of the third-party funds.

Ade Chandra Kusuma (2007; as cited in Kartika, 2010) found that the office channeling policy has a positive impact, among others: (1) With this policy, the services of shariah banking unit can broadly expand the business without having to build a branch office or offices under its own branch offices that can make a high operational cost; and (2) Through the office channeling policy, greater collaboration between Islamic banks and conventional banks would be possible.

Based on the range of exposure, researchers are interested in conducting research related to the title of *Office Channeling and Its Effect on Growth of Islamic Banking in Indonesia*, in which an attempt to see the effect of the office channeling policy on the growth of Islamic banking in Indonesia was made. Because until 2012, the 5% market share of the national banking still cannot be achieved.

To focus on the discussion of this research, the issues to be examined are only limited aspects of growth and also the development of assets and third-party funds in Islamic banks. The purpose of this paper is to examine whether there is an effect of office channeling policy on the growth of Indonesian Islamic banking industry. This research focused on the growth of overall Indonesia Islamic banking industry which is based on Islamic banking report published by Bank Indonesia.

Methods

To achieve the goal of this research analyzing the influence of office channeling policy on the growth of asset of Indonesian Islamic banking, regression analysis is used. The mathematical equation proposed in this research is:

$$Y_t = \beta_0 + \beta_1 D_1 + \beta_2 X_{1t} + \beta_3 X_{2t} + \varepsilon$$

where:

Y_t = Asset of Islamic banking industry;

D_1 = Dummy variable for office channeling, which is zero before office channeling and one after office channeling;

X_{1t} = One-month margin deposit;

X_{2t} = Non-performing financing (NPF).

X_{1t} and X_{2t} are used as control variables in this model.

Otherwise, the mathematical equation to estimate the impact of office channeling policy on third-party funds is:

$$Y_t = \beta_0 + \beta_1 D_1 + \beta_2 X_{1t} + \beta_3 X_{2t} + \varepsilon$$

where:

Y_t = Third-party funds of Islamic banking industry;

D_1 = Dummy variable for office channeling, which is zero before office channeling and one after office channeling;

X_{1t} = One-month margin deposit;

X_{2t} = NPF.

After processing the regression analysis, to see whether the model is good or bad, we have to know the goodness of fit of the model. To see the goodness of fit of the model, we have to look at the t -statistics, F -statistics, the coefficient of determination (R^2), as well as to cover classical assumption test heteroscedasticity, autocorrelation, and multicollinearity.

Decision to accept or reject H_0 was made on the basis of the value of the test statistic obtained from the existing data. Under the normality assumption followed the statistical distribution of variable t with degrees of freedom $N - k$. A statistic is said to be statistically significant if the value of the test statistic is in the critical region. The aim of the statistical t -test is to see how big the effect of independent variables is on the dependent variable individually.

Testing the null hypothesis with F -statistics is necessary to test if $\beta_k = 0$. The calculation of F -statistics is performed by comparing the critical value F obtained from the F -distribution table at a certain significance level. If the null hypothesis is rejected, it means that the independent variables affect the dependent variable. In this case, the empirical treatment aims to look at the effect of independent variables on the dependent variable.

The coefficient of determination or R^2 is a measure of goodness of fit which explained whether the linear regression is in line with the observational data. Kennedy (2008) used the coefficient of determination, R^2 , to represent the proportion of the variation in the dependent variable explained by variation in the independent variables. If $R^2 = 1$, it means a perfect relationship between independent variable and dependent variable, otherwise $R^2 = 0$ means no relationship between independent variable and dependent variable.

Discussion

According to data processing based on Islamic banking statistics, we get the equation from this model as follows:

$$\text{Asset} = 298.6544 + 287.6434 * D_OC - 264.8973 * NPF + 79.6375 * \text{Margin}$$

(0.22872) (0.561221) (-1.493702) (0.486783)

where:

$$R^2 = 0.998709;$$

$$\text{Adj. } R^2 = 0.998652;$$

$$F\text{-statistic} = 17,406.15.$$

From the results obtained above, it is seen that the coefficient of the constant value is 298.6544, meaning that when all other variables are assumed to be zero; the assets will still increase every month. However, as the t -test showed no significant result, the coefficient for the constant value does not mean anything in this study.

Then, the office channeling dummy coefficient, which is zero if before the enforcement of office channeling policy and one if after the enforcement of office channeling policy, has a positive sign. It means that there is a positive relationship between the office channeling policy and the increase of Islamic banking assets. However, because the value of the t -test showed no significant result, it means that office channeling policy does not have an effect on the growth of Islamic banking industry assets.

The first control variable is the ratio of NPF in Islamic banks which gives a negative sign, indicating that there is a relationship between the NPF and the amount of assets held by Islamic banks. The higher the value of the NPF held by Islamic banks, the assets held by Islamic banks will decline. T -test results that provide a

significant value do not indicate that there is no relationship between the NPF values and the amount of assets held by Islamic banks.

The second control variable is the amount of margin deposits in the form of one month in the Islamic banks which provides a positive sign, indicating that there is a positive relationship between the value of margin deposits and the amount of assets held by Islamic banks. Value of the t -test showed no significant result, showing that there is no relationship between the value of margin deposits in the first month and an increase in assets of Islamic banks in Islamic banking.

To see how much this model is influenced by the existing variable, we can use the coefficient of determination. The value of Adj. R^2 is 0.998652, indicating that the proportion of the variation in the dependent variable explained by variation in the independent variables was 99.8%; the rest is explained by other variables outside of the existing models. Next, to see the simultaneous effect of all independent variables on dependent variable, the F -statistics test is used. Based on the empirical result, it is shown that the F -test value is 17,406.15, meaning that the existing variables have an influence on the amount of assets contained in Islamic banking.

According to data processing based on Islamic banking statistics, we get the equation from the third-party funds model as follows:

$$\text{Third-party funds} = -2,048.271559 + 339.2624077 * D_OC - 497.55989 * NPF + 478.272449 * \text{Margin}$$

$$\begin{matrix} (-1.578812) & (0.675950) & (-2.853834) & (2.934671) \end{matrix}$$

where:

$$R^2 = 0.998088;$$

$$\text{Adj. } R^2 = 0.998003;$$

$$F\text{-statistic} = 11,746.72.$$

From the results obtained above, it is seen that the coefficient of the constant value is -2,048.271559. This means that when all other variables are assumed to be zero, the assets will still increase every month. However, as the t -test showed no significant result, the coefficient for the constant value does not mean anything in this study.

Then, the office channeling dummy coefficient, which is zero if before the enforcement of office channeling policy and one if after the enforcement of office channeling policy, has a positive sign. It means that there is a positive relationship between the office channeling policy and the increase of Islamic banking third-party funds. However, because the value of the t -test showed no significant result, meaning that office channeling policy does not have an effect on the growth of Islamic banking industry third-party funds.

The first control variable is the ratio of NPF in Islamic banks which gives a negative sign, indicating that there is a relationship between the NPF and the amount of the third-party funds held by Islamic banks. The higher the value of the NPF, the third-party funds held by Islamic banks will decline. T -test results that provide significant value indicate that there is a relationship between the NPF values and the amount of the third-party funds held by Islamic banks.

The second control variable is the amount of margin deposits in the form of one month in Islamic banks, which provides a positive sign, indicating that there is a positive relationship between the value of margin deposit and the amount of third-party funds held by Islamic banks. The value of t -test showed a significant result, meaning that there is a relationship between the value of margin deposit in the first month and an increase in third-party funds of Indonesian Islamic banking industry.

To see how much this model is influenced by the existing variable, we can use the coefficient of determination. The value of Adj. R^2 is 0.998003, indicating that the proportion of the variation in the dependent variable explained by variation in the independent variables was 99.80%; the rest is explained by other variables outside of the existing models. To see the simultaneous effect of all independent variables on dependent variable, the F -statistics test is used. Based on the empirical result, it is shown that the F -test value is 11,746.72, meaning that the existing variables have an influence on the amount of third-party funds contained in Islamic banking.

Based on the results obtained, there are several things that can be discussed, e.g., the effect of office channeling policy on the growth of Islamic banking in Indonesia, which is measured by the growth and development of assets and third-party funds. By definition, office channeling is the term given to mark the possibility of banking operations based on Islamic principles and branches or sub-branches of conventional banks. Previous version of Bank Indonesia Regulation No. 4/1/PBI/2002 about the windows is based on the Islamic bank principles, which explains that the two windows systems allow commercial banks (conventional), which do not have branch offices or sharia banking unit, to conduct transactions with the Islamic laws in one office. In other words, in a bank, there are two service systems at the same time: the conventional and Islamic laws.

Based on the statistical test results, it is shown that office channeling does not have a significant influence both on asset and third-party funds dummy variables. It means that office channeling policy still does not have a significant effect either on the growth of assets or third-party funds committed by Islamic banking. These results provide a justification about why until the end of 2011, Islamic banking has not yet reached the target of the 5% national banking market share that was actually to be achieved in 2008.

Haryanto (2007) found a different result concerning this topic, the aim of Haryanto's (2007) research is to see how much the influence of the office channeling policy on financial performance at Islamic banking unit PT Bank "X" is, in terms of financial ratios PT Bank "X" Tbk., also third-party funds, finance, assets, and earnings from Islamic banking unit PT Bank "X". The samples were taken from quarterly financial reports before office channeling policy in June, September, and December 2005 and after office channeling policy in March, June, and September 2006. The analysis tool used in these studies is one-sample Kolmogorov-Smirnov test. Results of normality test (one-sample Kolmogorov-Smirnovtest) showed a normal distribution, then for subsequent analyses, parametric statistical analysis is used. Paired sample t -tests were used to determine differences in third-party funds, financing, and asset, before and after office channeling.

The result from Haryanto's (2007) research shows that financial performance measured by third-party funds, asset, and financing has a significant influence (probability < significance level of 0.05). The conclusion from this result is that office channeling policy can influence the third-party funds, assets, and financing in Islamic banking unit PT Bank "X". The difference between this paper and Haryanto's (2007) research is that Budi Haryanto took a sample only from one Islamic banking unit, whereas this study used data derived from Islamic banking statistics issued by Bank Indonesia which includes data on both the overall Islamic banking business units and Islamic banks.

The same result from Haryanto's (2007) study can be found in the research that had been done by Hadiyati (2010). The aim of Hadiyati's research is to see how much the effect of a number of sharia unit services is on third-party funds at BNI Syariah Bank before and after office channeling policy. The method used is chow test,

and the result shows that the number of sharia unit services has a significant influence on third-party funds at BNI Syariah Bank.

Rohaya (2008) conducted a study related to the office channeling using a quantitative approach. The sample used comprised the data on assets of Islamic banking, data on third-party funds, data on the number of Islamic banking office networks, and data on the number of conventional banks in Indonesia from 2005 to November 2007. Regression analysis was used to determine the effect of the development of the Islamic banking business scale after the office channeling policy. This can be determined by using a qualitative variable (dummy) to measure the effect of variable office channeling. In general, the total asset was used as a dependent variable in the model from this study. The independent variables used in this study are third-party funds, office network, competitor, and dummy variable office channeling.

From the results of the regression analysis conducted by Rohaya (2008) by testing the hypothesis, it is shown that variables X_1 (third-party funds) and X_2 (Islamic banking office network) have a significant and positive effect on total assets of Islamic banking, while variable X_3 (conventional bank office network) and dummy variables do not have a significant influence on the total Islamic banking assets. The results obtained by Rohaya (2008) are in accordance with the results obtained in this study in which the office channeling policy does not affect the assets of Islamic banking in Indonesia.

Suryanitaningrum (2007) conducted a study that seeks to explain the change of third-party funds volume in Islamic banking unit Permata Syariah Bank after the office channeling policy. The variables used were: (1) variable X , office channeling, in this case, the number of offices that opened the services; and (2) variable Y : third-party funds from March to September 2006. The results of these studies show that the Islamic bank's deposit growth is quite good from period to period, and then continues to increase. After that, there is also a significant correlation between the openings of sharia office channeling at Permata Syariah Bank on third-party funds collected by Permata Syariah Bank. However, research conducted by Suryanitaningrum (2007) has weaknesses, because it only uses the data in a very short period of time that is only seven months, so there is the possibility of bias in the study results.

Other studies related to office channeling are done by Santoso (2011), where research is conducted aiming to: (1) describe the strategy formulation of Bank Rakyat Indonesia (BRI) in the development of Islamic finance; (2) make an assessment of the BRI from middle managers to office channeling pattern Islamic services; and (3) design and analyze the implementation of the program priorities sharia office channeling services at the Bank BRI. The study was conducted at the BRI. The method used is descriptive approach. Types of data used are primary and secondary data. Data were collected using questionnaires, discussions, and interviews as well as literature. The analysis method used in this study is analytical hierarchy process (AHP).

The results showed that: First, the strategy formulation of office channeling pattern in BRI Bank had been described in BRI Bank Business Plan in 2007 and 2008. The development of Islamic business is a part of the Bank BRI's business strategy. Second, the motivation of middle managers is high, and the score of motivation assessment of the Bank BRI's middle managers to office channeling pattern is 35. The middle managers also have a pretty good response to the strategy sharia office channeling services to be carried out by the Bank BRI. Third, this study provides 12 priority program implementation sharia office channeling services at the Bank BRI.

Nurnasrina (2007) conducted a study concerning office channeling which aims to determine the influence of customer characteristics on office channeling in using Islamic banking products and services. The study was

conducted in BNI Syariah Branch South Jakarta and BTN Syariah Bank Branch Central Jakarta with a sample of 174 respondents. The method of analysis includes descriptive and binary logistic regression. Based on the results of the logit analysis, variable products, economic and social services have a significant effect on the possibility of using the office channeling customers. The promotion and shariah variable do not have a significant effect. Customers' perceptions of the service against the possible use of office channeling had a significant influence and customers' intensity using office channeling is still small.

Summary and Conclusions

From the regression result, it can be concluded that the dummy variable of office channeling policy, NPF, and one-month margin deposit does not have an influence on the growth of Islamic bank assets. The only one variable that has a significant effect is the asset in previous period.

In the next model that attempts to look at the effect of the office channeling policy on third-party funds in Islamic banks, we gained only office channeling dummy variables that do not have a significant influence on the third-party funds in Islamic banks. Whereas other variables, such as third-party funds in previous period, NPF, and one-month margin deposit in Islamic banks, show a significant effect on third-party funds in Islamic banks.

According to the two results, it is showed that office channeling policy still does not have a significant influence on the growth of Islamic banking in Indonesia measured by asset growth and third-party funds growth. This is the reason why until the late of 2012, the 5% market share target still cannot be achieved, while the target of 5% market share is actually targeted to be achieved by 2008.

Reference

- Al Arif, M. N. R. (2010). *Dasar-dasar Pemasaran Bank Syariah (Marketing basics of Islamic banking)*. Bandung: CV Alfabeta.
- Al Arif, M. N. R. (2012). *Lembaga Keuangan Syariah (Islamic financial institutions)*. Bandung: Pustaka Setia.
- Hadiyati, P. (2010). Evaluasi Penerapan Kebijakan Office channeling Terhadap Peningkatan Dana Pihak Ketiga: Studi Kasus pada BNI Syariah (Evaluation of policy implementation office channeling against increased deposits: Case studies in BNI Syariah) (Unpublished thesis, University of Indonesia).
- Haryanto, B. (2007). Analisis Kinerja Keuangan Pasca Kebijakan Office Channeling (Studi Kasus pada Unit Usaha Syariah PT Bank "X" Tbk) (Financial performance analysis of post office policy channeling (Case study at PT Bank Syariah business unit "X" Tbk)) (Unpublished thesis, University of Muhammadiyah Surakarta).
- IDB. (2009). *The 33rd IDB annual report 1428 H (2007-2008)*. Jeddah: IDB.
- Kartika, D. K. (2010). Kinerja Keuangan Perbankan Pasca Kebijakan Office Channeling (Studi Kasus pada Bank Permata dan Unit Usaha Syariahnya) (Banking financial post office policy channeling (Case study on Bank Permata and sharia business unit)) (Unpublished thesis, University of Muhammadiyah Surakarta).
- Kennedy, P. (2008). *A guide to econometrics* (6th ed.). Oxford: Wiley-Blackwell.
- Nurnasrina. (2007). Pengaruh Karakteristik Nasabah Terhadap Office channeling dalam Menggunakan Produk dan Jasa Perbankan Syariah (Effect of customer characteristics of using office channeling in Islamic banking products and services) (Unpublished thesis, University of Indonesia).
- Rohaya, H. (2008). Perkembangan Skala Usaha Perbankan Syariah di Indonesia Pra dan Pasca Kebijakan Office Channeling (Scale development of Indonesian Islamic banking in pre and post office channeling policy). *Journal of Islamic Economics*, 2(2), 191-213.
- Santoso, N. I. (2011). Implementasi Strategi Pengembangan Bisnis Syariah Melalui Office Channeling di PT Bank Rakyat Indonesia (Persero) Tbk (Sharia implementation strategy through business development office channeling in PT Bank Rakyat Indonesia (Persero) Tbk) (Unpublished thesis, Agriculture Institute of Bogor).
- Suryanitaningrum. (2007). Pengaruh Pelaksanaan Layanan Syariah (Office Channeling) Terhadap Dana Pihak Ketiga (Studi kasus pada: UUS PT. Bank Permata, Tbk) (Influence of Sharia implementation services (office channeling) against the third party (The case study: UUS PT., Bank Permata Tbk)) (Unpublished thesis, Syarif Hidayatullah Islamic State University, Jakarta).