

# Islamic Bank Performance Improvement Through the Value Added Intellectual Creation Strategy

**Didit Supriyadi**

***Abstract---** The aims of this study is to analyze the performance of Islamic banking through Value Added Intellectual Creation Strategy (VAIC). The sample is 33 banks in the sharia banking industry in Indonesia consisting of 13 sharia commercial banks and 20 Sharia business units in Indonesia. Some variables used as objects in this study include financial risk, value added intellectual creation, and Islamic banking performance. The method used is descriptive and verification with data collected through a questionnaire instrument and interviews with leaders and policy holders in Sharia banks that are sampled. While the data analysis technique used is Partial Least Square. The findings show that Value Added Intellectual Creation is a very important strategy in improving the performance of Islamic banking which is significantly influenced by financial risk and cost efficiency. Nevertheless, there are still other factors that can affect the performance of Islamic banking in Indonesia.*

***Keywords---** Value Added Intellectual Creation (VAIC), Performance, Islamic Banking, Financial Risk, Cost Efficiency.*

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## I. INTRODUCTION

Islamic banking has grown since it was founded in the mid-1970s and has entered most of the global financial markets (Mallin et al., 2014). Islamic principles are the single most important factor that makes Islamic banking profitable for customers (Metawa & Almosawi, 1998; Ahmad & Haron, 2002; Archer & Karim, 2012; Kamal et al., 1999). The management of Islamic banking aims to eliminate injustice in the financial system caused by usury and introduce ways to do halal business (Bidabad & Allahyarifard, 2008; Imam & Kpodar, 2010; Jalil et al., 2010; Rarick, 2011). As a social and financial institution the Islamic Bank aims to implement principles that are in accordance with sharia rules and eliminate interest in any form (Saleh & Zeitun, 2006).

Indonesia is a country with the largest Muslim population in the world is a very promising market for the growth of Islamic banking. But in reality the current growth of Islamic banking in Indonesia has not shown good performance. The growth rate can be seen from the number of banks, the amount of funds raised and the value of assets held which shows minimal growth and is still far compared to conventional banking. Sharia banking market share in Malaysia has reached 20% while in Indonesia is still around 5%. Various institutions have revealed the causes of the growth of the sharia banking industry in Indonesia which is still small, one of which is the Indonesian

Financial Services Authority which states that delays are triggered due to several things such as government support that is still low, the value of capital owned by Islamic banks, Islamic banking funding structures, products and services that are not varied, the number of qualified human resources and inadequate use of technology, public knowledge and awareness of sharia banking as well as regulations and supervision that are not optimal towards sharia banking (Aditiasari, 2015). Seeing the low growth of the sharia banking industry in Indonesia, further analysis is needed to be able to tackle this problem and make sharia banking a wheel capable of advancing economic conditions in Indonesia.

Measurement of business performance needs to be done as an evaluation of whether the company has reached the target set or not (Hameed et al., 2004). Islamic banking performance evaluation not only focus on financial performance, but also must ensure that Islamic banking complies with the principles of Sharia in their business (Anwar, 2003; Rehman & Askari, 2010). Previous research related to improving company performance has been done a lot before, including confirming that Value Added Intellectual Creation can significantly improve company performance. Business performance is also influenced by other factors such as value creation (Bhatti & Zaheer, 2014; Robu & Ciora, 2010; Teti et al., 2014), Environmental Analysis (Cymbidiana, 2012; Gupta, 2013; Kolios & Read, 2013; Retnowati, 2010), Board Characteristics (Nomran et al., 2018; Titova, 2016; Yammeesri & Herath, 2010), Financial Risk (Hood & Young, 2005; Platon et al., 2014), Cost Efficiency (Nițoi & Spulbar, 2015; Shade et al., 2013; Shen et al., 2009) and Funding (Pachter et al., 2007).

## II. METHODOLOGY

This research was conducted at 13 Islamic commercial banks and 20 Islamic business units in Indonesia. Some of the variables used as objects in this study include financial risk, cost efficiency, value added intellectual creation, and Islamic banking performance. The method used is verification or causality research, namely research to test the truth of the causal relationship (cause and effect) between the independent variable and the dependent variable (Malhotra & Birks, 2010). The hypotheses tested in this study consisted of 1) The Effect of Financial Risk on VAIC, 2) The Effect of Cost Efficiency on VAIC, and 3) The Effect of VAIC on Islamic Banking Performance. Data collected through a questionnaire instrument and interviews with leaders and policy holders in Sharia banks were sampled. While the data analysis technique used is Partial Least Square.

## III. RESULTS AND DISCUSSION

Increasing cost efficiency is inseparable from the role of management in making decisions and evaluating the company's financial performance. Cost efficiency refers to technical efficiency and allocation. Technical efficiency is defined using the minimum input level provided and the input mix. Allocative efficiency, on the other hand, implies that a company uses its inputs in optimal proportions. Information on financial performance can be useful for investors as well as for testing the benefits of accounting information and financial ratios that can be used to detect

economic events. Bank managers and banking regulators need information about cost efficiency and industrial technology structures to support their business and policy decisions (Kasman, 2012).

The results of hypothesis testing based on data processing using Partial Least Squared are presented in Table 1.

Table 1. Hypothesis Testing

	<i>Original Sample (O)</i>	<i>Sample Mean (M)</i>	<i>Standard Deviation (STDEV)</i>	<i>T Statistics ( O/STERR )</i>	<i>P-Values</i>
CE → VAIC	0,380	0,383	0,156	2,426	0,016
FR → VAIC	0,383	0,395	0,158	2,422	0,016
VAIC → KPS	0,354	0,393	0,175	2,030	0,043

FR: Financial Risk

CE: Cost Efficiency

VAIC: Value Added Creation Intellectual

KPS: Performance Islamic Banking

The value of  $R^2$  for constructing the value added intellectual creation is 0.442, meaning that financial risk and cost efficiency are able to explain the variant VAIC of 42.2%.

H1: The Effect of Financial Risk on Value Added Intellectual Creation

The relationship between financial risk and value added intellectual creation is significant with a t-value of 2.422 (> 1.96). The original sample estimate value of 0.383 means that the direction of the financial risk relationship with value added intellectual creation is positive. Thus the hypothesis in this study which states that "Financial Risk significantly influences the value added intellectual creation of Islamic banking in Indonesia" is accepted.

H2: The Effect of Cost Efficiency on Value Added Intellectual Creation

The relationship between cost efficiency and value added intellectual creation is significant, this can be seen from the value of t-value > t-table (2.426 > 1.96). Judging from the value of the original sample estimate of 0.380 shows that the direction of the relationship of cost efficiency with value added intellectual creation is positive. Based on the test results, the statement "Cost efficiency significantly affects the value added intellectual creation of Islamic banking in Indonesia" is accepted.

The value of  $R^2$  to construct Islamic banking performance is 0.126, meaning that the value added intellectual creation strategy is able to explain the variant of Islamic banking performance by 12.6%.

H3: The Effect of Value Added Intellectual Creation on Islamic Banking Performance

The relationship between VAIC and Islamic Banking Performance is significant, this is indicated by t-value > t-table (2,030 > 1.96). The direction of the VAIC relationship with Islamic Banking Performance can be seen from the original sample estimate value of 0.354, meaning that the direction is positive. Thus the hypothesis in this study which states that "Value added intellectual creation significantly influences Islamic Banking Performance in

Indonesia." be accepted. The amount of contribution of each variable can be seen from the path coefficient value (path coefficient) as follows.

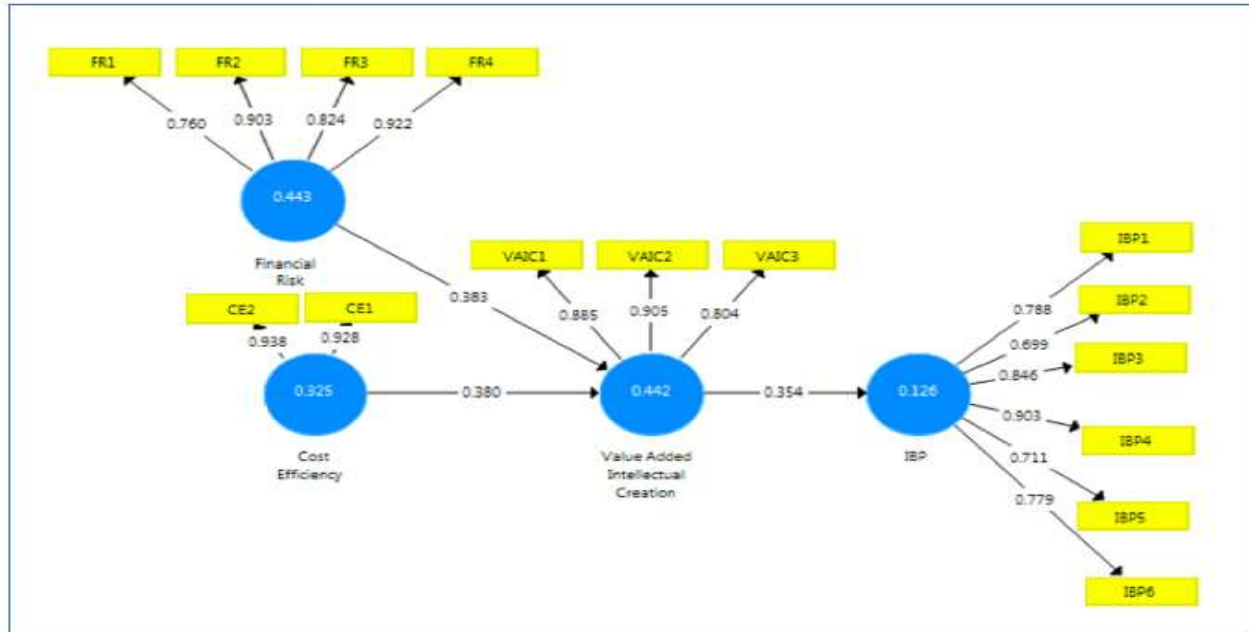


Figure 1. Structural Diagram

The relationship of Input and output in measuring bank efficiency is explained by Hadad et al. (2003) through 3 approaches (1) the asset approach, (2) the production approach, and (3) the intermediation approach. Of the several approaches that are more appropriate in evaluating financial institutions as a whole is the intermediation approach (Kasman, 2012). Because the intermediation approach views a financial institution as a mediator whose role is to change and transfer financial assets from surplus units to deficit units (Hadad et al., 2003).

Significantly, in recent decades as the focus has shifted to regulating public sector risk, this change in orientation has provided a better flow as a real method through integrated risk management in overall management (Hood & Young, 2005). The debt used can provide benefits for the company and increase returns for shareholders if the company's management manages the funds from the debt then is used to obtain operating profit so that it is higher than the interest expense. However, if the company's management cannot manage the funds from the debt properly, the company will suffer losses. Sadiq and Ishaq (2014) states that one of the factors that influences the level of investor risk tolerance is demographics. (Gable & Lytton, 1999) although demographic factors cannot be controlled by investors, it can affect investors' financial decisions due to the surrounding social environment.

This is important because investment behavior can be understood and shaped through one's living environment. Tolerance to financial risks is greatly influenced by one's biopsychosocial factors. These factors influence the risk assessment which has an impact on the decision making process so as to lead someone to modify and adjust the level and behavior of risk tolerance (Gable, 2016).

Corporate social involvement can reduce financial risk (through good shareholder management) which increases resources (provides free resources). The policy to increase VAIC can be taken more by managers if the company has lower risk, so the company faces less financial uncertainty. Companies with good financial performance are not worried about short-term survival and can make long-term investments. A strong VAIC can enhance a company's reputation. With good financial performance, companies do not need to worry about good survival in the short term, even companies can invest in the long term (Fombrun et al., 2000), lower risk and better oversight of potential civil and / or criminal legal processes. This situation reduces the company's actual financial risk, and the low risk creates favorable conditions for strong VAIC involvement. Islamic banking performance provides a deep intuition that the determinants of risk of Islamic banks must be different from the factors that influence conventional banking (Ahmad & Ahmad, 2004).

#### IV. CONCLUSION

The conclusion of this research is financial risk and cost efficiency have an effect positive and significant on VAIC and there is a positive and significant effect of VAIC on the performance of Islamic banking in Indonesia. This research presents a value added intellectual creation strategy in Islamic banking in Indonesia as an effort to improve the performance of Islamic banking. Islamic banking in Indonesia has basically been able to analyze the environment so as to be able to understand the challenges and opportunities contained in environmental change, especially in technological developments, exploiting challenges and opportunities that are important to be developed in order to make the capabilities and capabilities of Islamic banking in the face of global competition, especially in the banking sector. This can be done by utilizing technological developments as one of the media in business development to be able to compete as the first dimension in environmental analysis, as well as increase the ability to adapt to price-determining inflation, the ability to respond to government regulations as the second dimension of environmental analysis. Utilization of technology can be done both in aspects of customer service or in business management media. Technologies that can be used to improve services to customers include the procurement of ATMs, CDMs, e-Money, e-Banking, mobile banking, and other digital-based services, while the use of technology that can be done in improving company management is by using information technology effective as the core banking model that allows Islamic banking to archive, record, and centralize data collection.

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