Etikonomi
Volume 23(1), 2024: 183 - 200
P-ISSN: 1412-8969; E-ISSN: 2461-0771
https://doi.org/10.15408/etk.v23i1.35082

Should Islamic Window be converted into a Full-Fledge Islamic Bank? A case study in Indonesia

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JEL Classification:
G21
G28

Received: 02 October 2023

Revised: 10 February 2024

Accepted: 12 February 2024

Available online: April 2024

Published regularly: April 2024

Abstract

Research Originality: This research provides fresh perspectives on the future landscape of Islamic banking, particularly concerning the Islamic window. The paper stands out for its originality as it undertakes an empirical study utilizing a mixed method. This study is also expected to answer the research gap between literature studies, empirical studies, and implemented policies. Additionally, it is driven by the objective of contributing to the existing literature on Islamic finance.

Research Objectives: This study dives into whether converting Islamic Windows (UUS) into full-fledged Islamic Banks (BUS) leads to performance enhancement.

Research Methods: There are two types of data analysis methods, namely qualitative and quantitative. The qualitative analysis method comes from a collection of literature reviews and institutional opinions from Islamic banking experts in the world. This study employs a multi-pronged quantitative approach to investigate the performance and consumer perception of Islamic banking services with an emphasis on UUS and BUS.

Empirical Result: The results indicate that UUS and BUS structures adhere to Sharia principles and achieve commendable performance. However, analysis of financial reports across many countries, including Indonesia, shows that UUS's financial performance is generally better than BUS. The research further emphasizes that internal factors like capital adequacy, asset quality, and management capabilities, rather than the institutional structure itself, hold greater sway in driving performance improvement. Forced conversion of UUS could even hinder overall progress.

Implications: Beyond financial considerations, the study explores consumer behavior through surveys with educated individuals. The results indicate that their choice between BUS and UUS products is guided by practical factors such as financial returns, costs, and service reliability offered by each structure.

Keywords:
Full-fledged Islamic Bank, Islamic Windows, Spin-off

How to Cite:

Abimanyu, A., & At Tamimi, R. A. (2024). Should Islamic Window be Converted into a Full-Fledge Islamic Bank? A Case Study in Indonesia. *Etikonomi, 23*(1), 183 – 200. https://doi.org/10.15408/etk.v23i1.35082.

INTRODUCTION

The emergence of the dual banking system, namely, full-fledged Islamic Banking (BUS) and Islamic Window (UUS), in numerous countries can be attributed to the goal of providing service differentiation to meet the diverse needs of a clientele with varying religious affiliations and socioeconomic backgrounds (Delle Foglie et al., 2023; Ibrahim et al., 2012; Noor et al., 2020). *Sharia* banks have experienced rapid development in Indonesia since 2008, initially with a few banks competing in the market. Kasri et al. (2009) conducted a study and found that banking competition tends to be monopolistic and imperfectly contestable in Indonesia. Specifically, within Islamic banking, competition revolves around securing third-party funds, acquiring high-quality human resources, and offering Islamic financing services. Given the relatively small market size, limited consumer base, and restricted product offerings, Islamic banks are advised to adopt a more aggressive and innovative approach to attract deposits, enhance business efficiency (especially in human resource and financing risk management), and foster collaborative efforts to advance the overall development of Islamic banking.

Striking a balance between rigorous banking governance and adherence to *Sharia* principles presents a unique challenge for regulators in the realm of Islamic banking. This sector necessitates a more intricate regulatory framework compared to conventional banking, further complicated by inherently higher business risks. While full-fledged Islamic banks grapple with dual compliance demands, their counterparts operating as Islamic windows within conventional institutions tend to achieve greater operational efficiency due to parental support, even though it is facing less stringent regulations (Delle Foglie et al., 2023; Ibrahim et al., 2012).

Several studies underlined that Sharia compliance and risk management are paramount in Islamic banking due to their heightened complexity compared to conventional banking (Alsaqa, 2022; Fatmawati et al., 2022; Setiawan, 2021; Triyanto, 2022). Al-Saqa (2022) proposes integrating Islamic auditors for unified assessments, while Fatmawati et al. (2022) urge for stronger *Sharia* governance in Indonesia with its "moderate" adherence and low transparency. Triyanto (2022) highlights fraud risks and suggests adopting Islamic Corporate Governance principles with regular self-assessments via Islamic Income ratio and Profit-Sharing Ratio (PLS) to gauge *Halal* income proportions.

A study by Noor et al. (2020) suggests that Islamic banks in the Middle East and North Africa (MENA) region require stricter supervision, limitations on non-banking activities, and more intense oversight to enhance their performance. While additional capital is crucial for improving financing and overall performance, simply increasing capital requirements without addressing the other three factors will likely hinder the banks' progress. This is in line with Prasetyo et al.(2019) findings.

Indonesia's Law 4 of 2023 (P2SK) aims to modernize and strengthen the Indonesian financial sector, including its unique dual banking system and conventional and Islamic banks operating in the same environment. The law emphasizes flexibility, inclusivity, and technological adaptation. One key issue addressed is the potential conversion of UUS

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DOI: https://doi.org/10.15408/etk.v23i1.35082

operated by conventional banks BUS (Kemenkeu, 2023; Yulyantfi & Juniwati, 2022). Some studies show that conversion into full-fledged Islamic banks can be an exit strategy for the small parents banks (Al Arif et al., 2020; Al Arif et al., 2023; Al Arif et al., 2024).

While P2SK encourages this conversion, it lacks specific timelines and enforcement mechanisms. Article 68 allows indefinite operation of UUS, requiring conversion only when their assets reach 50% of the parent bank's total assets. The Financial Services Authority (OJK) can also mandate conversions for broader *Sharia* banking consolidation. However, detailed regulations and potential sanctions against non-compliant banks are still pending under OJK (Kemenkeu, 2023; Yulyantfi & Juniwati, 2022).

Measuring the performance of Islamic banks presents a multifaceted challenge. Indrianasari et al. (2022) asserted that unlike conventional banks solely focused on asset growth and operating profit, Islamic banks must consider a fundamental pillar: Sharia compliance. This introduces additional dimensions to performance evaluation, including the equitable distribution of profits to depositors through profit-sharing mechanisms (PLS) like Mudarabah, the obligatory disbursement of Zakat (charitable contribution), and adherence to broader Maqasid Sharia principles (objectives of Islamic law). Additionally, Islamic disclosure requirements and ethical considerations demand specific assessments. Notably, Islamic windows within conventional banks often inherit the latter's performance measurement methods, creating a potential discrepancy with the comprehensive evaluation required for full-fledged Islamic institutions. As a result, devising a holistic and universally accepted performance measurement framework for Islamic banks remains an ongoing debate and area of active research.

Khan et al. (2023) analyzed the factors impacting Islamic banks' performance. The study findings established a positive correlation between bank size and return on assets (ROA), indicating that larger Islamic banks generate higher ROA than smaller counterparts. Notably, the study further delves into a comparative analysis of Islamic and conventional banks, highlighting the distinct need for a "cushion" in Islamic banks. This buffer absorbs both unexpected losses and transaction costs arising from Sharia compliance. Importantly, the study underlined the additional income generation requirement for Islamic banks necessitated by the management of Sharia compliance-related costs. These insights collectively paint a nuanced picture of Islamic bank performance, emphasizing the interplay between size, Sharia adherence, and financial sustainability.

On the other hand, while expanding assets and capital enhances competitiveness through increased transactions, it entails inherent trade-offs. Unbridled growth can lead to diminished efficiency, as highlighted by Naseri et al. (2020). Furthermore, exceeding a certain size threshold introduces systemic risk, also known as "too big to fail," potentially fostering moral hazard. This intricate interplay underscores the necessity for a balanced approach to asset growth, ensuring robust performance without jeopardizing financial stability (Naseri et al., 2020).

Some studies found that Islamic banks are experiencing lower performance and efficiency compared to conventional banks. Islamic windows within conventional banks pose lower risks than full-fledged Islamic banks established through spin-offs (Al Arif et al., 2020; Trinugroho et al., 2021). Despite the apparent efficiency advantage of Islamic windows, stemming from their access to the resources and assets of conventional parent banks (Salami & Adeyemi, 2017), their operation presents unique challenges. Abdul-Majid et al. (2011) highlighted that conventional banks must allocate resources to support these dedicated divisions within their broader structure. Additionally, compliance adds another layer of complexity. While financial reports and Sharia business operations are segregated within the conventional framework, they are ultimately consolidated, necessitating careful performance measurement. Furthermore, establishing and maintaining Sharia compliance requires the formation of dedicated committees comprising Islamic banking experts within the Islamic Window (UUS) structure (Abdul-Majid et al., 2011), adding another layer of governance complexity. In essence, while Islamic windows may boast seemingly optimized performance, this comes at the cost of intricate internal structures and ongoing compliance considerations.

Hasan & Risfandy (2021) investigated the stability of Islamic financial institutions by comparing Islamic Window (UUS) with Full-fledge Islamic bank (BUS). Their findings suggest that Islamic Window (UUS) displays greater stability than Full-fledge Islamic bank (BUS). This conclusion is based on key indicators of bank stability, including higher capital adequacy ratio (CAR), lower finance-to-deposit ratio (FDR), larger asset base, and improved cost-to-income ratio (CIR), indicating better efficiency. This condition suggests that Islamic windows, operating within conventional banks, possess certain advantages related to financial stability compared to their fully independent counterparts.

Some Muslims question the Halalness of UUS products due to potentially Riba-tainted capital from its parent conventional banks. Amin (2017) proposes the "Tafriq Al-halal Min Al-haram" theory to differentiate and segregate permissible and forbidden funds within the capital. Interest-derived income would be set aside, allowing the remaining, presumably Halal capital, to be used for establishing Islamic institutions like Islamic Window (UUS), drawing support from Ibn Taimiyah's opinion (fatwa) of separating illicit and permissible wealth. This approach could address concerns regarding the permissibility of Islamic Window (UUS) products.

Indonesian Muslim consumers' choices between full-fledged and Islamic window banks have drawn research attention, highlighting a knowledge gap (Ratnasari et al., 2021). Moreover, the study reveals distinct motivations driving preferences. Full-fledged Islamic bank customers prioritize Sharia compliance, aligning their financial practices with religious principles. Conversely, convenience and service quality are the primary motivators for those opting for Islamic window banks. This condition indicates that different segments of Muslim consumers prioritize various aspects when choosing Islamic banking options, emphasizing the need for tailored offerings and financial literacy initiatives.

Despite the potential advantages and disadvantages of converting Islamic windows into full-fledged Islamic banks, a significant knowledge gap remains to be seen regarding the impact on bank performance post-conversion. To bridge this gap, a comprehensive

DOI: https://doi.org/10.15408/etk.v23i1.35082

empirical study is urgently needed. To the best of our knowledge, no existing research definitively addresses the performance resultant of such a conversion while considering crucial factors like bank structure, capital adequacy, asset quality, management capabilities, and consumer behavior.

Our study offers compelling evidence that internal factors such as capital adequacy, asset quality, and management capabilities positively impact performance improvement in Islamic finance. This originality stems from a unique mixed-method approach, bridging the gap between theoretical literature and empirical studies. As a result, our findings contribute valuable insights to the existing knowledge base, inform impactful policy decisions, and advance the development of Islamic finance.

The paper contributes to the field by employing a mixed methods approach to investigate the effectiveness of existing spin-off regulations empirically. The findings, supported by consistent results across methods, conclude that the current framework impedes performance improvement in Islamic banking. Notably, the research goes beyond mere criticism, offering valuable insights for formulating effective Sharia banking policies in Indonesia. Ultimately, the study aims to enrich the existing literature on Islamic finance through its original empirical contribution and policy recommendations.

METHODS

The financial data for this banking study was sourced from OJK for domestic banking information and The Banker database for insights into international banking statistics. A diverse group of respondents was solicited to examine customer behavior within the banking sector, encompassing academics, bureaucrats, and professionals with pre-existing knowledge of both conventional and Islamic banking practices in Indonesia. This study utilized panel data from 2016 to 2020 for 12 banks, consisting of 5 Islamic Window (UUS) and 7 Full-fledge Islamic banks (BUS), three of which are state-owned Islamic banks. Regional Islamic Window (UUS) were excluded to maintain comparability. Moreover, the time frame of 2016-2020 was selected to ensure our analysis was not affected by the Covid-19 pandemic's disruptions to the banking industry.

There are two (2) types of data analysis methods, namely qualitative and quantitative. The qualitative analysis method comes from a collection of literature reviews and institutional opinions from Islamic banking experts in the world. This study employs a multi-pronged quantitative approach to investigate the performance and consumer perception of Islamic banking services with an emphasis on Islamic Window (UUS) and Full-Fledge Islamic banks (BUS). Firstly, the financial performance of Islamic banks will be evaluated through quantitative calculations of metrics like total assets, assets ratio, RoA, NPF (Non Performing Finance), BOPO (Operating costs), and NoM (Net of Margin) (Hanafia & Karim, 2020; Jordan et al., 2011). Secondly, consumer choice analysis utilizes a simple average method to examine reasons for preferring UUS and/ or BUS. Finally, quantitative econometric modeling, specifically regression analysis, will estimate the Z-score (stability level) of both Islamic Window (UUS) and Full-Fledge

Islamic banks (BUS), providing a comprehensive understanding of their performance and appeal to consumers.

Table 1. The Study Methods

No	Sources	Method(s)	Analysis
1	Review Literature	Qualitative	Reviewing the findings of researchers through reputable journals regarding spin-off analysis, UUS and BUS performance/ preferences, global regulation and corporate governance of *Sharia* banking
2	Global Financial Institution (AAOFI, IFSB, INCIEF, The Banker), Country Specific Financial Performance (Saudi, UAE, Oman, Pakistan and Malaysia)	Qualitative/ Quantitative	Reviewing opinions from world institutions regarding the existence of UUS and analyse Global *Sharia* Banking Performance in major Islamic countries
3	Financial Report Aggerate UUS and BUS	Quantitative	Calculating and analysing the financial performance of UUS and BUS in Indonesia, namely RoA, NPF, BOPO and NoM in the 2016-2021 period. Also reviewing the regulations (P-OJK) related to BUS and UUS.
4	Consumer's Survey	Quantitative	Calculating the average survey results regarding the profile of respondents, banking choices and reasons for choosing a bank for *Sharia* transactions.
5.	Bank's Stability Regression Model	Quantitative	Regression model on Bank's stability with several independent variables such as NIM, CIR, FDR, Financial Asset, and a Dummy Variable

Source: Author's Analysis

The standard z-score measure defines how much bank capital is able to meet its losses (Boyd & Runkle, 1993). By formula, the standard z-score is calculated as ROA plus CAR divided by the standard deviation of ROA. A high Z-score indicates the bank is more stable. On the other hand, the lower the Z-score, the more likely a bank is to falter and possibly fail bankrupt (Abedifar et al., 2013). The model used is based on Hasan & Risfandy (2021), with several modifications in sample size and data selection. The banking sample in the study did not use regional banks with relatively small assets but banks that were in the process of significant improvement in financial condition. Table 1 explains the research methods in this study. The econometric model of banking stability uses the following equation:

$$Log\ Z_{it} = a_0 + b_1\ CAR_{it} + b_2 CIR_{it} + b_3 FDR_{it} + b_4 LogTA_{it} + D_{it}$$

Where

Z_{it} = Z-score or Bank's stability as measured by (ROA + CAR)/StDev_ROA

CAR_{it} = Capital Adequacy Ratio

CIR_{it} = Cost to Income Ratio

FDR_{it} = Funding to deposit ratio

TA_{it} = Total Assets

D_{it} = Islamic Window Dummy (equal to 1)

it = refers to banks and time index.

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DOI: https://doi.org/10.15408/etk.v23i1.35082

RESULT AND DISCUSSION

This section discusses Sharia regulations at the global level. Two global institutions that always provide referrals are AAOIFI and IFSB, both of which state that UUS fulfills Sharia compliance. This section also provides an overview of the performance and development of global Islamic financial institutions, Islamic Window (UUS), and Full-Fledge Islamic banks (BUS) in Islamic countries such as Saudi, UAE, Oman, Pakistan, and Malaysia. Countries with Islamic banking generally refer to AAOIFI and IFSB in making regulations regarding reporting/bookkeeping and supervision of Islamic finance, including as a reference for fatwas. Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI) FAS 40 – Financial Reporting Standards for Islamic Windows AAOIFI (2023) has clearly stated that first, the Islamic Window (UUS) is subject to Sharia provisions. Secondly, a sharia board (DPS) and a Sharia Supervisory Work Unit exist. Third, the Islamic Window (UUS) Sharia Balance is separate from its parent.

In CPIFR 32 – Sharia Business Unit Operations (by the Islamic Finance Sharia Board, IFSB), it is stipulated that Islamic Window (UUS) can commence operations once they meet certain requirements. These requirements include conducting transactions in accordance with Sharia principles, implementing robust Risk Management practices that clearly delineate between conventional and Sharia operations, adhering to good Sharia Governance, and adopting a principle of openness in reporting Sharia activities. These operational standards are crucial for ensuring the integrity and transparency of Islamic business units, and they serve as a guide for their effective functioning.

Table 2. Global Sharia Bank's Performance, 2021 (US Billions)

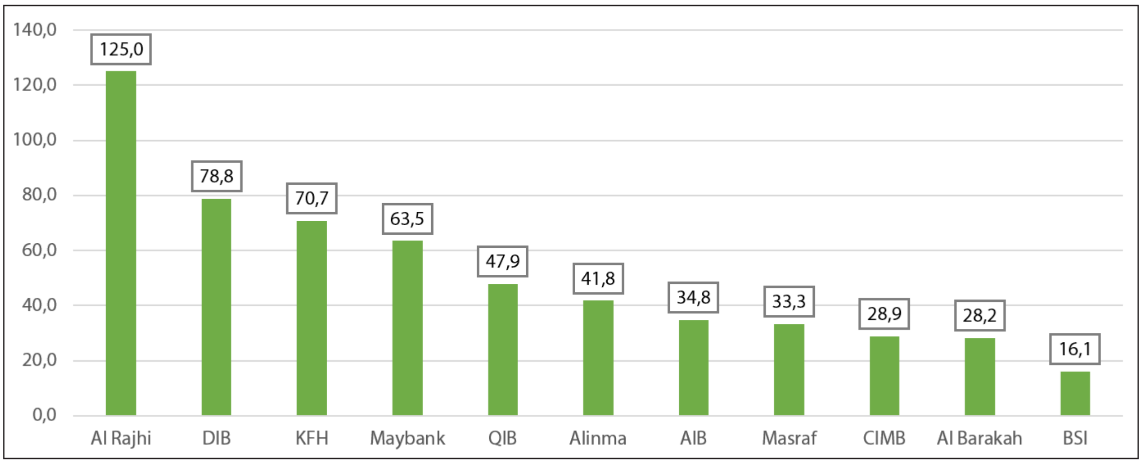
Country	Bank	Total Asset	UUS Asset	%UUS
Saudi Arabia	SNB	243,5	113,9	47%
	Riyad	86,8	38,9	45%
	SABB	72,6	35,2	48%
UAE	FAB	272,3	9,8	4%
	Mashreq	48,2	4,4	9%
	CBD	31,1	3,3	11%
Oman	Muscat	34,0	4,2	12%
Pakistan	Faysal	4,9	3,4	69%
	Habib	24,5	2,5	10%
Malaysia	Citibank	9,5	0,8	8%
	MUFG	7,2	0,0	0%

Source: The Banker and Banks' Website, Financial Report 2021

According to the International Monetary Fund, Sharia banks operate in more than 60 countries worldwide. Until now, many of the most prominent Islamic countries in the world still maintain their legal Sharia banks in the form of BUS and UUS. In almost all countries, there are no regulations in those countries that require UUS in conventional banks to carry out spin-offs. Table 2 shows that large Islamic countries with an Islamic economic system, such as Saudi Arabia, the UAE, Oman, Pakistan, and Malaysia, have a *Sharia* business unit business model. The largest banks in Saudi Arabia, such as Saudi National Bank (SNB), Riyad Bank, and Saudi Awwal British Bank (SABB), have a UUS proportion of more than 45% of their holdings. There is no US obligation to carry out a spin-off in these countries. In countries such as Malaysia, UUS do spin-offs because firstly, it obtains tax incentives for banks, secondly, ownership freedom of up to 100% for foreign investors, thirdly it is allowed to implement a full leverage model, and fourthly it is given other incentives such as services for foreign workers and other incentives.

As of 2020, Saudi Arabia's Al Rajhi Bank is the top-ranked Islamic bank in the world, with total assets up 22% to US$125 billion for the year. Al Rajhi Bank made a net profit of $2.8 billion in 2020. This profit is more than 25% of the total net profit of 100 Islamic banks (Al Rajhi, 2019). The ranking order for the top 10 Islamic banks in 2020 has not changed, except for CIMB Islamic Bank. CIMB Islamic Bank, which rose one level to ninth position, replaced Al Baraka Banking Group, which fell to tenth position. Dubai Islamic Bank (DIB) from the UAE and Kuwait Finance House (KFH) from Kuwait were able to maintain second and third places, respectively (DIB&KFH, 2019). Fourth place is Maybank Islamic, the largest Islamic bank in Asia.

Figure 1. Largest Global Full-Sharia Banks, 2020 (USD Bio)



Source: The Asian Banker (2022)

Figure 1shows the top 10 BUS in the global arena. The first rank is Al Rajhi Bank (Saudi Arabia), the second is Dubai Islamic Bank or DIB (UAE) and the third is Kuwait Finance House or KFH (Kuwait). Malaysia has two banks ranked 10th, namely Maybank (ranked 4th) and CIMB ranked 9th. Bank of Shariah Indonesia (BSI) is ranked 20th in global Islamic banks. To be ranked in the top 10 in the world, besides additional capital, BSI also needs equal and strong local counterparties in terms of interbank, risk sharing, syndication and squaring hedge positions.

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DOI: https://doi.org/10.15408/etk.v23i1.35082

Table 3. KSA Sharia Banks' Compositions, 2021

Conventional	BUS (40%)	UUS (60%)
21%	79%	
Citi	Al-Rajhi	SNB
Standard Chartered	Aljazirah	Riyad
MUFG	Albilad	SAAB
BNP Paribas	Alnima	SIB
Deutsche		Gulf Bank

Source: Banks' Website on the 2021 Financial Report

Table 3 shows the fact that banking in Saudi Arabia, 21% is in the form of conventional banks, generally foreign banks, such as Citi (US), Standard Chartered (UK), MUFG (Japan), BNP Paribas (French) and Deutsche (Germany). The proportion of 79% of them are banks with Sharia principles, namely Full-fledge Islamic banks (BUS) and Islamic Window (UUS). The 60% share of 79% of banks with Sharia principles is in the form of UUS. These include giant Islamic banks, such as Saudi National Banks (SNB), Riyad Bank, and SAAB (Saudi Awwal British Bank).

Table 4. Financial Performance BUS and UUS, 2016-2021 (%)

Key Ratios		2016	2017	2018	2019	2020	2021	Average
RoA	BUS	0,66	0,96	1,18	1,58	1,51	1,86	1,42
	UUS	2,13	2,54	2,40	1,92	2,08	2,23	2,23
NPF	BUS	5,26	4,71	4,28	3,42	3,32	3,22	3,77
	UUS	3,49	2,97	2,35	2,75	3,16	2,91	2,83
NPF Net	BUS	3,17	2,75	2,46	2,07	1,79	1,30	2,07
	UUS	2,01	1,61	1,45	1,69	2,11	1,59	1,69
BOPO	BUS	96,02	92,89	90,10	86,27	85,18	83,15	87,52
	UUS	79,41	74,21	73,09	78,83	76,50	71,25	74,78
NoM	BUS	0,74	1,06	1,34	1,78	1,49	2,02	1,54
	UUS	2,28	2,74	2,55	2,06	2,01	2,30	2,33

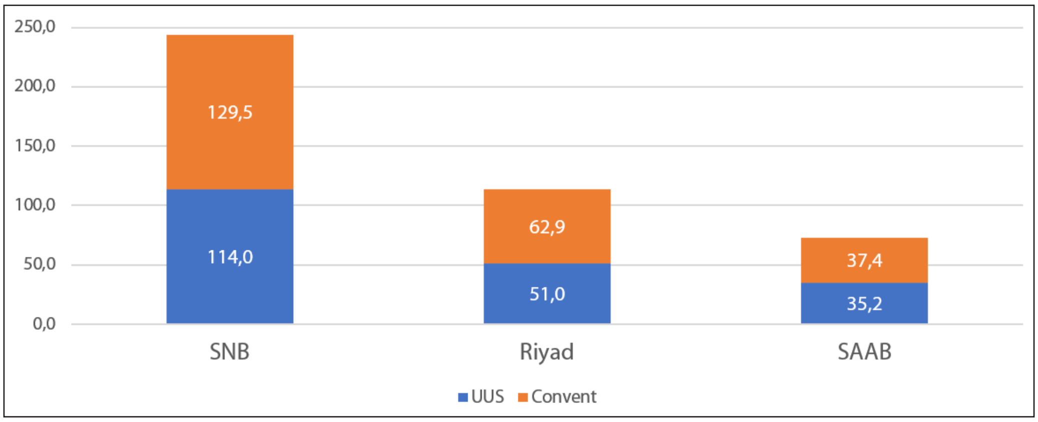
Source: Indonesian *Sharia* Banking Statistics (SPS)", Various Publication, OJK.
BUS = Full-Fledged *Sharia* Banks; UUS = Islamic Windows.

The first ranking bank in the Kingdom of Saudi Arabia, SNB, owns USD114 billion or 47% of the bank's assets are managed in UUS, while Riyad Bank has USD 51 billion 47% and SAAB owns USD 35,2 billion or 49% (Figure 2). In Saudi Arabia, banks, by the regulator, are freed by managing through BUS or UUS by the conditions of each bank. In practice and international experience, Islamic banks develop according to internal conditions, regulations, competitiveness, and markets. SNB, the largest Sharia bank, still maintains 47% of the Islamic Window (UUS) proportion, likewise with Riyad Bank and SAAB. The existence of an Islamic Window (UUS) in

Sharia banks shows Sharia compliance, service optimization, and the competitiveness of their banks.

Table 4 shows a comparison of bank financial performance, such as ROA, Non-Performing Finance (NPF), Operational Cost (BOPO), and net Margin (NoM) at full-fledged Islamic banks (BUS) and Islamic Window (UUS) on average in 2016-2021. It can be seen that the performance of Islamic Window (UUS) is better than that of full-fledged Islamic banks (BUS). ROA is higher, NPF is lower, BOPO is lower, and NoM is higher at Islamic Window (UUS) than at full-fledged Islamic banks (BUS). Full-fledge Islamic banks (BUS) operate as a full-fledged bank, enabling management to focus on and carry out the bank's business according to *Sharia* banking principles. On the other hand, an Islamic business unit (UUS) operates within a conventional bank, so it has parental support and may still have a broader portfolio of services.

Figure 2. Top Three KSA Islamic Windows, 2021 (USD Bio)



Source: The Banker (2022)

As a complete Islamic bank, full-fledged Islamic banks (BUS) may have unique branding and identity that can create loyal customers in Islamic banking services. Meanwhile, the Islamic Window (UUS) can take advantage of the brand reputation of the parent and existing customer base without having to look for other customers. Full-fledged Islamic banks (BUS) and Islamic Window (UUS) may have different operational efficiencies. Full-fledge Islamic banks (BUS), focusing on *Sharia* banking operations, must bear their costs. At the same time, Islamic Window (UUS) can utilize shared resources and infrastructure and share costs with the parent bank. Full-fledged Islamic banks (BUS) must have their own infrastructure and bank capabilities and determine which option offers better operational efficiency.

Table 4 shows the comparative analysis of full-fledge Islamic banks (BUS) and Islamic business unit (UUS) over the 2016-2020 period, based on key financial indicators such as RoA, Gross NPF, Net NPF, BOPO, and NoM, reveals distinct performance patterns between these banking categories. The Islamic Window (UUS) consistently outperformed the full-fledge Islamic banks (BUS) in terms of RoA, with an average of

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DOI: https://doi.org/10.15408/etk.v23i1.35082

2.23% compared to 1.42% for full-fledge Islamic banks (BUS), suggesting a more efficient allocation of assets towards generating profits. Similarly, the NPF and Net NPF ratios were positive for Islamic Window (UUS) over full-fledge Islamic banks (BUS) with an average of (3.77%, 2.07%) and (2.83%, 1.69%) respectively, indicating effective credit risk management

Table 5. Incentive to UUS and BUS

No.	Type of incentives	UUS	BUS
1	Using leveraging strategy with BUK (Conventional Bank)	V	V
2	There is no minimum capital requirement	V	X
3	Does not bear Capital Charge every branch opening	V	V
4	No Need to have *Sharia* BoC and BoD	V	X
5	No Need to form committees	V	X
6	Operational and marketing activities can use BUK resources	V	V
7	Calculation of BMPD using BUK capital	V	X
8	CAR Calculation follows BUK	V	X
9	UUS rating using BUK's	V	X
10	Core Banking can use the same Core Banking as BUK	V	V
11	Bank soundness level (TKB) follows BUK	V	X
12	Using the BUK ATM network	V	V
13	Using the BUK e-banking application	V	X
15	Using Swift Code BUK	V	V
15	Using Dealing Room Treasury BUK	V	V
16	Using IT BUK	V	V
17	BUK joint database	V	V
18	CIF uses BUK's property	V	V
19	BIN Visa Master using BUK's	V	X
20	KBMI regulation follow BUK	V	X
21	Permit and License using BUK's	V	V

Source: OJK, various regulations

Additionally, the BOPO ratio, which measures operational efficiency, was significantly lower for Islamic Window (UUS) (averaging 74.78%) than full-fledged Islamic banks (BUS) (87.52%), indicating that Islamic Window (UUS) operates with greater cost efficiency. The NoM figures further underscore Islamic Window (UUS) financial health and profitability on average (2.33%) versus full-fledged Islamic banks (BUS) (1.54%), reflecting a more robust margin management strategy for Islamic Window (UUS).

Table 5 describes the OJK incentives from Islamic Window (UUS) and full-fledged Islamic banks (BUS). For 25 years, Islamic Window (UUS) have enjoyed 21 incentives, while full-fledged Islamic banks (BUS) have only enjoyed 12 incentives. The differences in incentives include minimum capital requirements, payment of capital charges, the appointment of Sharia Board and Directors, formation of committees, operational and marketing activities, CAR calculations, Banking Soundness Level Assessment, and others.

Additional incentives obtained by Islamic Window (UUS) in terms of capital, distribution of operational costs, marketing or information technology, the Board of Commissioners, Sharia Board (DPS), Directors and executive officers have been stipulated in OJK provisions, such as POJK No. 38 of 2016 (POJK 38, 2016), POJK No. 28 of 2016 2019 (POJK 28 of 2019), POJK No. 12 of 2020 (POJK 12 of 2020), & POJK No. 16 of 2022 (POJK 16 of 2022). This difference in treatment shows no equal level playing field between full-fledged Islamic banks (BUS) and Islamic Window (UUS). So, this could be one of the reasons investors, especially foreigners, are reluctant to enter and invest in full-fledge Islamic banks (BUS).

Table 6. Respondents' Profile

Characteristics		Percentage
Education	Bachelor degree	27.0
	Master degree	53.4
	Doctoral degree	14.8
	Others	4.8
Ages	20-30	19
	31-40	33
	41-50	16
	51-60	19
	>60	13
Occupation	Academics	33
	Bureucrat	22.3
	Business	17.4
	Others	27.3
Sharia bank account	Yes	58.3
	No	41.7

Source: Data processed

A consumer survey of choice of banks was conducted on 121 respondents to find out the selection of Islamic Window (UUS) and/or full-fledged Islamic banks (BUS). Respondents were selected from different graduates' backgrounds working as university lecturers, bureaucrats, or business. Respondents are graduates with careers ranging from junior to top positions in all fields except in banking. Exclusion of banking respondents to reduce subjective answers. With this background, it is hoped that respondents will have knowledge of Sharia products and be rational in selecting products. The profile of the respondents from this survey is shown in Table 6.

From this profile, it can be seen that the sample of respondents is an educated group (minimum bachelor's degree or S1), most are master's degree graduates or S2 (53,4%) and have worked as lecturers/academicians (33%), bureaucrats (22,3%) and business (17,4%). The age of most respondents is between 31-40 years (33%), followed by ages between 20-30 years (19%) and 51-60 years (19%). Respondents who already

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DOI: https://doi.org/10.15408/etk.v23i1.35082

have an account at a bank with Sharia principles (58,3%) generally choose BUS as the bank's destination (67,1%) for reasons of Sharia compliance (44 of number selection) and better service (30) (see Table 7).

Table 7. Respondents View

Respondents' View		Percentage/ Number
Bank selected	Full-fledge Islamic banks (BUS)	67.1%
	Islamic Window (UUS)	21.9%
	Others	11.0%
Reason bank selected	Full sharia	44
	Service	30
	Return/cost	21
	Internal policy	12
	Others	11
Will select bank	Full-fledge Islamic banks (BUS)	38.8%
	Islamic Window (UUS)	18.3%
	Indifferent	42.9%
Reason to select bank	Service	55
	Return/cost	34
	Full sharia	20
	Others	12

Source: Data processed

Whereas respondents who do not have an account at a bank with Sharia principles stated that if asked to choose, 42.9% of them would be indifferent in choosing between Full-fledged Islamic banks (BUS) or Islamic Window (UUS) (see Table 7). The reason for choosing it is because of bank services and financial benefits. This result is consistent with previous studies such as Ltifi et al. (2016) and Rosyadah et al. (2020). Respondents who do not have a bank account will choose a bank for more rational reasons, namely service and returns. The results of previous research (Ratnasari et al., 2021) concluded that Indonesian Muslim customers did not have sufficient knowledge about the types of Islamic banks.

In this study, the survey used a sample of Muslim consumers who know the field of Sharia products. Previous studies concluded that the selection of Full-fledged Islamic banks (BUS) products was based on Sharia compliance reasons, and the selection of Islamic Window (UUS) products was based on service and economic reasons. The results of this survey conclude that consumers do not have a preference in choosing products because both are believed to be Halal and Sharia-compliant. Even though the decision to have Full-fledged Islamic banks (BUS) products is based on Sharia compliance, the more important considerations are financial return and costs and the reliability of the services provided by Islamic Window (UUS) and Full-fledged Islamic banks (BUS). Educated consumer respondents believe Islamic Window (UUS) products are equally Halal and follow Sharia compliance.

The model that uses common effects is better than the fixed effect model based on the results of the Chow, Hausman, and Lagrange multiplier tests. Meanwhile, an estimation model using random effects cannot be used because the dummy variable does not change over time or is a variable that is relatively invariant over time. In this study, the bank stability model is estimated using the Z-score model, which is influenced by independent factors such as NIM, CIR, Assets, and FDR. NIM reflects profitability, CIR shows the efficiency level, total assets represent the size of the bank, and FRD shows the bank's liquidity.

In this model, differences in bank stability levels will also be tested. The dummy variable equals 1 for Islamic Window (UUS) and 0 for Full-fledge Islamic banks (BUS). If the Dummy shows statistical significance, it means there is a proven difference between UUS and Full-fledge Islamic banks (BUS) in the level of bank stability. From Table 8, it can be concluded that the independent variable, namely CAR, NIM, FDR, and TA, jointly influences the Z-Score model with a deterministic coefficient (R2) of 0,5673 or 56%. Even though the coefficient level is not very high, according to the F test, the model is significant with a probability above 99%.

Table 8. Bank's Stability/Z-Score Regression Result

Variable(s)	Common Effect Model		Fixed Effect Model	
	Coefficient	t-stat	Coefficient	t-stat
CAR	-0.1188	-2.1179	-0.1151	-0.1155
CIR	-1.7295	-3.6742	-0.9682	-1.6524
NIM	9.7248	2.4435	6.5659	1.1794
FDR	-0.0112	-0.0173	-0.1896	-0.3101
Log_TA	0.2609	1.9800	0.1083	1.3746
Dummy	0.0494	1.3423	0.0039	1.0140
R-Squared (R^2)	0.5673		0.5296	
F-Statistics	7.8695		7.3953	
Probabilities (F-Stat)	0.000004		0.00004	
Number of Observation	50		50	

Source: Data processed

The independent variables that influence Z-Score are CAR (coefficient of -01188), NIM (+9,7248), and TA (+0,2609). CAR has a negative effect on stability. This shows that increasing bank capital affects bank instability. This result means that Islamic Window (UUS) and Full-fledged Islamic banks (BUS) banks currently have high and sufficient capital, which has little impact on the bank's business profitability and stability. Meanwhile, an increase in total bank assets will increase bank stability, and an increase in bank NIM will positively impact the stability. The decline in CIR affects bank stability, which means there are still opportunities for banks to increase efficiency, and this affects stability. The dummy variable Islamic Window (UUS) shows positive. It is not significant for differences in bank type, Islamic Window (UUS), or Full-fledge Islamic

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banks (BUS) on bank stability. However, the dummy variable significantly influences the 10% probability level.

The regression analysis indicates that the financial stabilities of Islamic UUS and Full-fledged Islamic banks (BUS) in Indonesia exhibit no substantial statistical difference. It is found that profitability, measured by NIM and RoA, significantly and positively affects the stability of banks. On the other hand, a rise in the CIR negatively affects the bank's stability. Similarly, an increase in the CAR is associated with a negative impact on the stability of banks, suggesting that increasing capital reserves makes the bank less stable. Bilgin et al. (2021) show that economic uncertainty increases the default risk of conventional but not Islamic banks.

This research and Hasan & Risfandy (2021) differ in the data quality. In contrast to previous research, this research uses data that is more homogeneous in terms of financial condition and equality of bank size between Full-fledged Islamic banks (BUS) and Islamic Window (UUS) to compare it. The discrepancy in research outcomes is attributed to differing sample sizes and financial condition diversity, with this study focusing on "KBMI 2" category banks, which have a core capital of Rp 1 to 5 trillion, in contrast to earlier research that included "KBMI 1" regional banks with a core capital below Rp. 1 trillion. Despite these non-significant differences in the financial stability between Full-fledged Islamic banks (BUS) and Islamic Window (UUS), both analyses agree on underscoring the critical role of profit growth, operational efficiency, and asset value. This study diverges from previous findings by asserting that capital inadequacies lead to financial instability. In short, separating Islamic Window (UUS) to raise capital may be ineffective, according to bank stability analysis. Bakhouche et al. (2022) suggest that Islamicity has a neutral effect on bank stability..

CONCLUSION

This paper explores the potential of bank spin-offs as a corporate restructuring strategy for Islamic banks in Indonesia. The author argues that current regulations hinder such initiatives, suggesting that OJK could foster a more conducive environment by adopting less stringent rules. Specifically, the author calls for flexibility in areas like Islamic bank capital requirements, advocating for a principles-based approach that empowers banks to navigate spin-offs according to their needs. The choice between establishing a Full-fledged Islamic bank (BUS) or an Islamic Window (UUS) within a conventional bank presents a significant strategic decision for institutions seeking to extend their Islamic banking market in Indonesia.

Both structures offer distinct advantages and disadvantages, necessitating a nuanced analysis considering various factors. While Full-fledged Islamic banks (BUS) structures like BSI (Bank of Shariah Indonesia) benefit from significant capital and dedicated management, more than an equally sized counterpart hinders interbank functions and joint financing. BUS offers focused Islamic banking operations and branding, but the Islamic Window (UUS) leverages existing infrastructure and brand recognition within conventional banks. Both structures offer unique efficiencies. Stability remains similar across both structures, with profitability and total assets positively impacting stability, while cost-to-income ratio and capital adequacy have negative effects. Ultimately, the optimal choice between Full-fledged Islamic banks (BUS) and Islamic Window (UUS) depends on individual bank priorities, desired focus, and strategic goals.

Based on a comprehensive examination of the existing literature, coupled with an analysis of the global and Indonesian practices of Sharia banking, encompassing regression modeling and consumer surveys of Sharia-compliant products, it is imperative to formulate policy recommendations addressing both the regulatory aspects of spin-off institutions and enhancements to the overall operations of Sharia banks. Firstly, should spin-offs necessitate regulation, the Financial Services Authority (OJK) should institute complementary regulations. Fostering an equitable competitive landscape is crucial to ensure that incentives provided to Islamic Window (UUS) are commensurate with those allocated to Full-fledge Islamic banks (BUS). Additionally, to enhance the supervision of both BUS and particularly the Islamic Window (UUS), immediate implementation of an integrated Governance, Risk, and Compliance (GRC) framework is recommended. This strategic measure is underscored by the intricate nature of *Sharia*-centric business operations, demanding the requisite capabilities.

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