

Islamic bank performance: Does low-cost fund and labor cost affect it? (Empirical cases in Bank Syariah Mandiri-Indonesia)

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Abstract

During the Covid-19 Pandemic, all sectors, including banking, were affected. The impact that occurs in the banking sector, including Islamic banking, is excess liquidity. However, Bank Syariah Mandiri (BSM), as a sharia bank with the largest market share in the Indonesian Islamic banking industry, maintained its performance during the Covid-19 Pandemic. Therefore, this research aims to analyze the factors that affect the Return on Assets (ROA) based on the aspects of low-cost funds (CASA) and the ratio of labor costs (BTK) in BSM. The method in this research is quantitative, using multiple regression. The years of observation in this study were from 2018 to 2020. The regression test results were that BTK had a negative and significant effect on ROA while CASA had an insignificant effect on ROA. Based on these results, it is known that although the CASA funds from BSM are pretty good, BSM has not been able to optimally distribute these funds to the community due to the current Covid-19 Pandemic. Also, BSM's good performance is contributed by employee productivity and employee competence.


Keywords: Islamic Bank, Low-Cost Fund, Labor Cost, Return on Asset


JEL Codes: E3, G21, G33.


1. Introduction

Islamic finance studies have become increasingly important in recent decades. The milestone in developing the Islamic economy in Indonesia was marked by the first Islamic bank's existence in Indonesia, namely Bank Muamalat, in 1992 (Aziz et al., 2021). However, the existence of Islamic financial institutions has contributed to society since 1984, which was marked by the existence of the Islamic financial cooperative or Baitul Maal wa Tamwil (BMT) Salman mosque at the Institut Teknologi Bandung (ITB) (Mashuri, 2016). Furthermore, Islamic financial services' purpose is to provide welfare to the community. Islamic banks, Islamic Rural Banks (BPRS), and Islamic Cooperative (BMT) are essential for Indonesia's people as the most prominent Muslim population. According to Soekapdjo et al. (2019), banks are vital elements to push the country's economic growth. Therefore, the bank's going concerned is the focus of all stakeholders, especially the government (Boubakri et al., 2005; Cole et al., 2008). The bank's essential contribution to economic growth is in line with the bank's function as an intermediary from the surplus party to the deficit party to collect funds from the public, distributed to the community again for business and financial activities.

Furthermore, the banks' excellent function will contribute to their economic growth (Nugroho, 2020). On the other hand, Islamic banks have a mission to benefit the community and contribute to the Indonesian people's welfare. However, the banking industry's intense competition has demanded that every Islamic bank management work efficiently and effectively (Aisyah, 2018). Therefore, Islamic bank management must manage the sources of funds and costs incurred by Islamic banks. Furthermore, to obtain an efficient-cost structure, Islamic banks must manage the low cost of funds optimally and

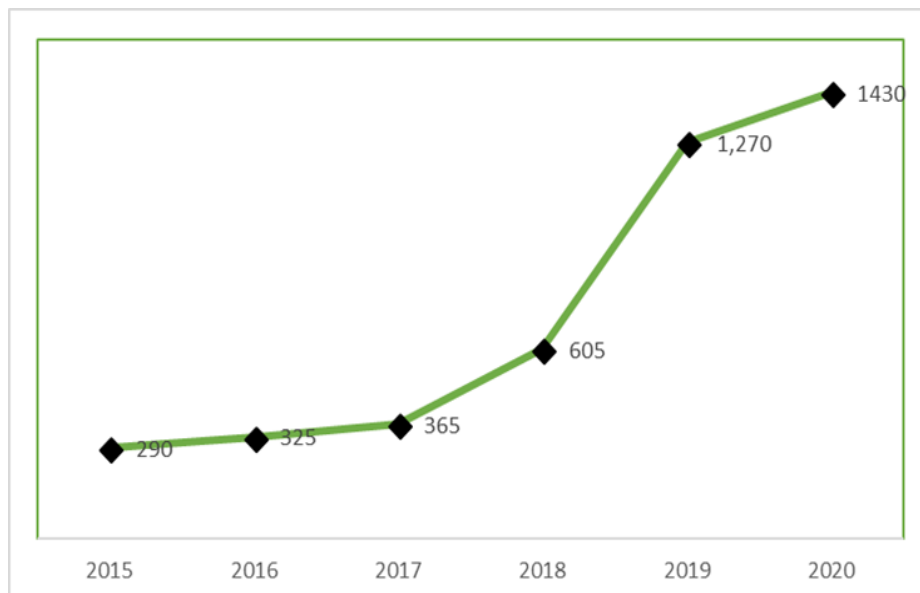
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maintain cost expenditures, especially labor costs, to increase the performance. The current phenomenon where the Covid-19 Pandemic occurred resulted in decreased income from all industrial sectors, including the bank's sector. Thus, during the Pandemic Covid-19, Islamic banks must maintain their income to achieve optimal performance. In Indonesia, Bank Syariah Mandiri (BSM) is a sharia bank with a market share of more than 20%-29% of the Islamic financial industry (Nugroho, Suganda, et al., 2020). Therefore, BSM has a majority market share that makes BSM one of the Islamic banks that can cause systemic risk to the economy if BSM goes bankrupt. During the conditions of the Covid-19 Pandemic, the bank's industries sector experienced a decrease in income due to the large number of customers who were constrained in making installments (Sitanggang & Handoyo, 2020). Therefore, because of this condition, Islamic banks had to find solutions or strategies to overcome the customer's installment constrain by increasing the employees' productivity (Nugroho, 2020a; Nugroho et al., 2020). Meanwhile, for third-party funds, the bank focuses more on funding obtained from the public with cheaper or lower costs, such as savings and current accounts (Beverly et al., 2004; Vivas, 1997).

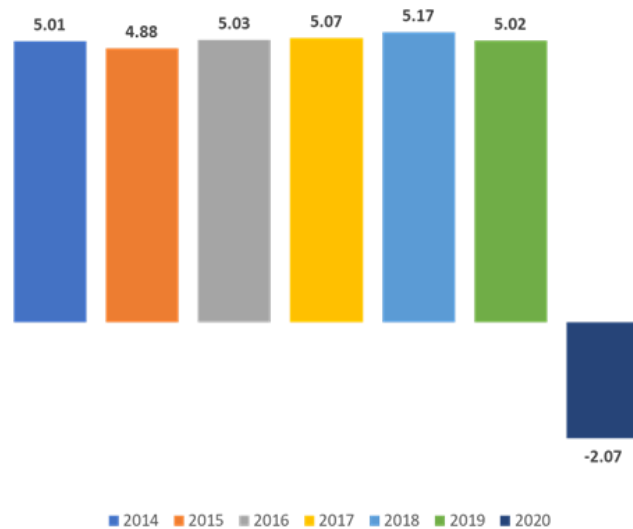
The phenomenon that occurred during the current Covid-19 Pandemic is that the growth in profit or performance of BSM for the past six years has performed very well. For example, the performance of BSM for six years back can be shown in figure 1 below:



Source: Mola & Lili Sunardi (2021)

Figure 1. Profit of BSM (2015-2020 Period)

Following Figure 1 above, BSM's profit growth for six years has increased by 393%. In 2015, BSM's profit only reached Rp290 billion, and in 2020 it reached Rp1.43 trillion. Achievement of good performance during the Covid-19 Pandemic needs to be further analyzed because, during the Covid-19 Pandemic, Indonesia's economic growth contracted to minus 2.07%. In contrast, BSM can maintain profit growth from the previous year of 13%. Furthermore, in 2020, BSM could generate a profit of Rp1.43 trillion, while in 2019, BSM's profit reached Rp1.27 trillion. The phenomenon of Indonesia's economic growth over the past six years is shown in Figure 2 below:



Source: OJK (2020)

Figure 2. Indonesia Economics Growth (2014-2020 Period)

Following figure 2 above, Indonesia's economic growth in 2020, which was also during the Covid-19 Pandemic, has decreased compared to the previous year. The decline in economic growth can reduce people's purchasing power to reduce the community's consumption. Therefore, if there is a decrease in society's consumption, it will impact the number of business and trade transactions. Furthermore, the decline in trade transactions will decrease requests for additional capital from the banking sector entrepreneurs. Therefore, during the Covid-19 Pandemic, many business people had wait-and-see behavior.

According to (Nugroho, Badawi, & Hidayah, 2019), profitability is an indicator to assess a company's performance in carrying out its business activities to generate optimal profits. Furthermore, one of the ratios to measure profitability is the return on assets (ROA) (Nugroho, Kuncoro, & Mastur, 2019; Nugroho & Nezzim Bararah, 2018). The better the ROA ratio of Islamic banks, the better the financial performance of Islamic banks. Thus, the indicator for increasing ROA can measure the increase in shareholder welfare (Walkling & Long, 1984). Meanwhile, the greater the bank's profit, the higher the bank's income, and the more productive the bank's position in terms of asset use and expenditure control (Mendes & Rebelo, 1999). In terms of liabilities, where cheap funds come from third parties in the form of savings and current accounts (CASA), and efficiency in labor costs can also save expenses from Islamic banks (Maudos et al., 2002)

This study analyzes the effect of CASA and labor costs on ROA in BSM based on this phenomenon. Furthermore, based on this research, this research is limited by the following research questions: (i) Does CASA affect ROA?; (ii) Does labor costs affect ROA?. Moreover, this research has originality, namely the research period during 2018-2020. Also, no one has conducted research, especially regarding the low-cost fund (CASA) contribution to Islamic banks' profitability in Indonesia. Therefore, the implication of this research is to provide a reference for practitioners and further researchers who want to analyze the relationship between raising funds and the profitability of Islamic banks.

2. Literature Review

Dowling & Pfeffer (1975) consider legitimacy necessary for companies because society's legitimacy is a strategic factor for its future development. The organization seeks to create harmony between the social values inherent in its activities with the norms of behavior in society's social system where the organization is part of the system (Doherty, Haugh, & Lyon, 2014). Legitimacy theory encourages companies to ensure that the community can accept their activities and performance (Nugroho, 2014;

Nugroho et al., 2017). In Stakeholder theory, companies must maintain relationships with stakeholders by accommodating existing wants and needs, especially stakeholders who have power over the availability of resources used for company operational activities, such as labor, customers, and owners (Bridoux & Stoelhorst, 2014). Therefore, the organization's survival depends on stakeholders' support, so that the company's activity is to seek that support. One strategy to maintain relationships with company stakeholders is to improve performance to provide benefits (Greenwood, 2007).

Strategy comes from the Greek word *strategos*, which means General. Therefore the word strategy means Art and General (Bracker, 1980). This word refers to what is the primary concern of the top management to handle the organization. In particular, the strategy is the placement of the company's mission, setting organizational goals by binding external and internal forces, formulating specific policies and strategies to achieve goals and ensure their proper implementation, so that the main goals and objectives of the organization will be achieved (Behn, 2003; Bourgeois III, 1985). Nevertheless, Islamic banks are implementing several strategies in dealing with the conditions of the Pandemic Covid 19, including mitigating risks by restructuring financing that impacts the real sector, namely the inability to pay debtors. Following a Sharia bank's mission, the appropriate strategy under Pandemic Covid 19 is collecting low-cost funds and controlling costs, especially labor. That strategy should be taken because the business climate is not prospective yet.

Banking performance is the income that banks can earn in a certain period through bank business activities through effective and efficient mechanisms (Jacobides, Winter, & Kassberger, 2012). One proof of the success of Islamic banks' performance can be seen from the bank's ability to survive in the future. According to Wiratmini (2020), the Indonesian Sharia Bank Association Business Development chairman conveyed that Islamic banks' profitability is still not optimal. The factor that causes a decrease in profit is an increase in Reserve for Impairment Losses (Wiratmini, 2020). This affects the level of operational performance efficiency so that the company's sustainable ability will below. Furthermore, if costs increase and revenue does not grow significantly, it will disrupt business continuity if Islamic Bank (Nugroho & Malik, 2020).

Act No.10 of 1998 concerning Banking in article 1 paragraph 5 defines deposits in banks as funds entrusted by the public to banks based on a deposit agreement in the current account, deposits, savings, and other equivalent forms. This source of funds obtained by third parties will impact the ability to meet the scale and volume of transactions, which will increase the fee-based income and net interest margin. The third-party fund's contracts in Islamic banking are wadiah and mudharabah (Widayatsari, 2013). Therefore, the greater the available third-party funds, push the Islamic bank disbursing the funding to the customer in financing form. Otherwise, the higher financing with a good quality portion will increase the Islamic bank's opportunity to earn a profit (Nugroho & Malik, 2020).

Profitability is a measure of the performance of a bank. A bank's profitability shows the bank's ability to generate profits during a certain period at the level of sales, specific assets, and share capital (Kumbirai & Webb, 2010). Furthermore, the money supply plays a significant role in influencing the bank's profitability (Muniarty et al., 2020). Several indicators are used to measure a bank's profitability, including Return on Assets (ROA). According to Satibi, Utami, & Nugroho (2018), ROA is one of the main ratios that show bank profitability. This ratio measures bank management's ability to generate income by utilizing company assets (Al Nimer et al., 2015). According to (Ihwanudin et al., 2020), ROA is a ratio to measure bank management's ability to generate income by utilizing the company's assets they own. In other words, it shows how efficiently the resources of a company are used to generate revenue. Moreover, company management's efficiency in generating net income high because ROA shows that companies are more efficient and effective in using their resources.

The public trust factor is the primary capital for the ongoing banking business. Moreover, the Islamic banking industry improves its reputation in society and is responsible for implementing justice and public welfare (Aydin, 2015). Therefore, research conducted by (Nugroho, Badawi, Hidayah, & Ahmad, 2020) states that savers in Islamic banks are dominated by Muslim savers and dominated by non-Muslim savers who have relatively large amounts of savings. During the Pandemic Covid-19, all

sectors were currently affected by business continuity due to health protocols, resulting in limited business and economic mobility (Gössling, Scott, & Hall, 2020). Furthermore, to maintain their business continuity, Islamic banks must maintain their expenditures or make efficiency effective. One of the efforts to keep the bank's efficient is increasing the bank's low-cost fund portion of the third-party fund. Based on the description above, a research framework can be illustrated as follows

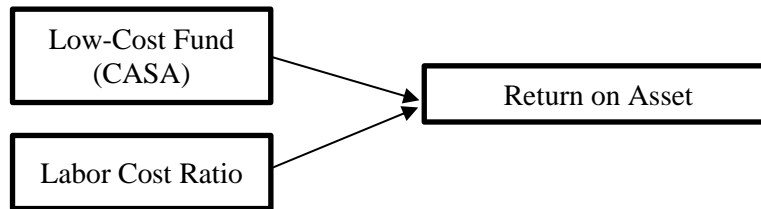


Figure 3. Research Conceptual Framework

Based on previous research and conceptual research framework in figure 3 above, the research hypothesis is as follows:

- The low cost of for-profit shares issued by Islamic banks will have the potential to boost the bank's profit. Therefore, a strategy to improve bank performance focuses on collecting retail funds in current accounts and savings (DeYoung & Rice, 2004; Villanueva & Mirakhor, 1990). Thus, the first hypothesis in this research is as below:

Ha1: CASA affects ROA;

- The ability of workers to carry out creativity and innovation is one of the main assets of Islamic banks to improve their performance (Cabello-Medina et al., 2011; Jiang et al., 2012). Therefore, one of the efforts of Islamic banks is to maintain labor costs to remain optimal in generating income. So the second assumption of this study as below:

Ha2: Labor Cost Ratio affects ROA

3. Research Methodology

The method used in this research is quantitative, using multiple regression. This method aims to determine the relationship and influence of the CASA variable and the ratio of labor costs to ROA. The data source used is secondary data from the monthly reports and annual Bank Mandiri Syariah reports (BSM). Furthermore, the observation period is three years, namely 2018 to 2020; thus, the observation data is 36. Furthermore, the statistical tool used to process the data in Stata version 14. The stages of statistical data processing before carrying out multiple regression tests, the data must meet the classical test consisting of normality test, test heteroskedasticity, and multicollinearity test. The operational variables in this study are as follows:

- Low-Cost Fund Ratio (CASA) is a third-party fund obtained by BSM from the public with a lower cost of funds-saving products than time deposit products. The savings products are wadiah current account, wadiah savings accounts, and mudharabah savings accounts. The formula for the CASA ratio is as follows:

$$CASA = \frac{Current\ Account + Savings}{Total\ Third\ Party\ Outstanding}$$

- The ratio of labor costs is the portion of total labor costs with the income earned by BSM. The formula for the ratio of labor costs (BTK) is as follows:

$$BTK = \frac{Labor\ Cost}{Total\ Revenue}$$

- Return on Asset (ROA) is the ratio of profit to total assets owned by the BSM. Therefore, the formula for ROA is as follows:

$$ROA = \frac{Profit}{Asset}$$

Furthermore, based on the variables used in this study, the research equation is as below:

$$ROA = \alpha + b_1CASA + b_2BTK + e \tag{1}$$

According to equation one above, the independents and dependent variables explanations as follows:

ROA: Return on Asset

CASA: Low-Cost Fund

BTK: Labor Cost Ratio

4. Results and Discussion

The results of statistical data processing using the Stata version 14 application with the first stage classical test using the normality test are as follows:

Table 1. Shapiro-Francia W' Test For Normal Data

| Variable | Obs | W' | V' | z | Prob>z |
|----------|-----|---------|-------|-------|---------|
| CASA | 36 | 0.96098 | 1.578 | 0.845 | 0.19904 |
| BTK | 36 | 0.94121 | 2.378 | 1.604 | 0.05434 |
| ROA | 36 | 0.97296 | 1.093 | 0.166 | 0.43427 |

Based on table 1 above, the data processing results of the variables used in this study have met normality norms. This is indicated by the probability value of all these variables above 0.05. Furthermore, the variables in this study were tested in a classic test using the heteroskedasticity test with the following output:

Table 2. Breusch-Pagan/Cook-Weisberg Test For Heteroskedasticity

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Breusch-Pagan / Cook-Weisberg test for heteroskedasticity
Ho: Constant variance
Variables: fitted values of ROA

chi2(1)      =    11.84
Prob > chi2  =    0.0006
    
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The results of the heteroscedasticity test table 2 above show a probability of 0.0006 < 11.84 so that the research equation model does not have a heteroscedasticity problem. The following classic test is to use the multicollinearity test shown in table 3 below:

Table 3. Multicollinearity Test

| Variable | VIF | 1/VIF |
|----------|------|----------|
| BTK | 1.08 | 0.925642 |
| CASA | 1.08 | 0.925642 |
| Mean VIF | 1.08 | |

Referring to table 3 above, the multicollinearity test results in this study's equation did not occur multicollinearity problems. This shows the total VIF < 5 and the tolerance value (1 / VIF) > 0.20. After the classical test was carried out and there were no problems with the classical test, the next stage was carried out by multiple regression tests with the following results:

Table 4. Multiple Regression Test

| Source | SS | df | MS | Number of obs = 36 | | |
|----------|------------|----|------------|--------------------|----------|--|
| Model | .000262332 | 2 | .000131166 | F(2, 33) = | 4.69 | |
| Residual | .000922776 | 33 | .000027963 | Prob > F | = 0.0161 | |
| Total | .001185108 | 35 | .00003386 | R-squared | = 0.2214 | |
| | | | | Adj R-squared | = 0.1742 | |
| | | | | Root MSE | = .00529 | |

| ROA | Coef. | Std. Err. | t | P> t | [95% Conf. Interval] | |
|-------|-----------|-----------|-------|-------|----------------------|----------|
| CASA | .0973313 | .0643931 | 1.51 | 0.140 | -.0336775 | .2283401 |
| BTK | -.3192683 | .1221781 | -2.61 | 0.013 | -.5678416 | -.070695 |
| _cons | -.0483352 | .041255 | -1.17 | 0.250 | -.1322691 | .0355988 |

Following table 4 above, the output of the multiple regression test above, then the equation becomes as follows:

$$ROA = -0.483 + 0.973CASA - 0.319BTK + e \quad (2)$$

Furthermore, referring to table 4 above, it is found that the R-squared in this study is 0.2214 or 22.14%, the CASA and BTK variables as the dependent variable can affect ROA. Simultaneously, the remaining 77.86% is influenced by other dependent variables not included in this study. Meanwhile, simultaneously, both CASA and BTK variables have a significant effect on ROA. The statistical F value indicates this in table 4 above, which is 0.0161 < 0.05, which explains that the two dependent variables CASA and BTK simultaneously significantly affect the independent variable ROA. While partially, the CASA variable has a positive but insignificant effect. This is shown in Table 4 above, where P> [t] is more than 0.05. However, the BTK variable has a negative and significant effect on ROA where P> [t] is less than 0.05.

The study results showed that low cost of funds (CASA) did not significantly affect ROA because the growth of CASA during the last three years was not significant. This is shown in table 5 below:

Table 5. Descriptive Statistics

| Variable | Obs | Mean | Std. Dev. | Min | Max |
|----------|-----|----------|-----------|-------|-------|
| CASA | 36 | .6393306 | .0138883 | .6206 | .6849 |
| BTK | 36 | .0123722 | .0073197 | .006 | .0394 |
| ROA | 36 | .0099417 | .005819 | .0009 | .024 |

In table 5 above, the minimum CASA portion is 62.06%, while the maximum CASA portion is 68.49%. Thus, the highest CASA ratio gap and the lowest CASA ratio is 6.43%, not too high during the 2018-2020 period. Also, there is a possibility that during the Covid-19 Pandemic, people are more interested in saving in time deposit products that provide higher margins for savers. On the financing side, there is the possibility that BSM, during the Covid-19 Pandemic, currently has a tight policy in channeling financing. Even though the CASA from Islamic banks is above 50%, if the funds are not adequately disbursed, then the impact of CASA on ROA is insignificant (Dell'Aricecia & Marquez, 2004; Stiglitz, 1990). This research is different from previous research, which states that CASA has a positive and significant effect (Khabibah, Octisari, & Nugraheni, 2020). The difference can be due to differences in the study period. Previous research before the Pandemic Covid-19, where health protocols did not limit trade transactions and human mobility. At those times, the business climate was excellent, which led to stable demand for capital in financing in the banking sector (Arestis & Demetriades, 1997; Usman, Syofyan, Nugroho, & Soekapdjo, 2018). Meanwhile, during the Covid-19 Pandemic, many business people had a wait-and-see behavior while waiting for the demand for goods and services to push the economic growth to become positive (Brown & Rocha, 2020; Ratten, 2020).

Besides, the variable labor cost (BTK) has a negative and significant effect because the number of BTK in a company has a portion between 60 to 70% of the total overhead cost (Banker et al., 1995). The size of the BTK portion had a significant and negative effect on ROA. When analyzed based on the results of descriptive statistics in table 5 above, it shows a maximum BTK of 0.394 or 39.4% of total revenue. Nevertheless, the minimum BTK is 0.006 or 0.6% of BSM's total revenue during the 2018-2020 period. Furthermore, BSM has three business strategies implemented during the Covid-19 Pandemic, focusing on digital banking, conducting telesales, and not recruiting new employees during the Covid-19 Pandemic. The policy's impact is the performance increasing of the BSM, which reflects the maximum ROA value of 0.024 or 2.4% at the end of 2020, which increased from a minimum ROA of 0.0009 or 0.09% in 2018. Besides, according to Mola & Lili Sunardi (2021), during the Covid-Pandemic 19, BSM could obtain a net profit of Rp1.43 trillion or an increase of 12.51% from the previous year. Although external economic conditions experienced a slowdown and the Covid-19 Pandemic, which caused economic contraction, BSM increased its profits significantly. One of the significant contributions is the productivity of BSM's human resources. According to Utami (2020), employee productivity at Islamic banks is necessary where their goal of working is to earn income and worship or known as altruism. BSM employees' enthusiasm for work is maintained, reflected in their work outcome, namely the significant increase in BSM profits during the Covid-19 Pandemic. BSM's good performance needs to be an example for other Islamic banking industries in managing human resources who have good competence and motivation to work to get compensation and carry out worship.

5. Conclusion

During the Covid-19 Pandemic, the Islamic banking industry experienced excess liquidity or a saving glut phenomenon. Saving Glut is a condition in which people are active in saving just in case, which results in reduced demand for capital for business expansion. As the Islamic banking industry's market leader during the Covid-19 Pandemic, BSM maintained its profit performance and even experienced significant growth. The productivity of human resources contributes to the excellent performance of BSM. Therefore, the ratio of labor costs (BTK) has a negative and significant effect on ROA. Also,

liquidity access and the number of low-cost funds (CASA) have a positive but insignificant effect on ROA. This is because BSM has not been able to optimize the distribution of financing to the public due to the current condition of the Covid-19 Pandemic

Suggestions for practitioners and academics interested in Islamic banks are to analyze the extent to which the distribution of financing during the Covid-19 period can increase Islamic banks' profitability. Besides, Islamic banks must apply prudential principles during the current Covid-19 Pandemic. However, Islamic banks must also continue to channel financing, especially for micro and small segment entrepreneurs, to maintain their business continuity.

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