Comparison of Liquidity Risk and Credit Risk Stability of Islamic Banking and Conventional

Nurlailatul Muafiah1, Sudarto2, Najmudi3
1 Faculty of Economics and Business, Jenderal Soedirman University
2 Faculty of Economics and Business, Jenderal Soedirman University
3 Faculty of Economics and Business, Jenderal Soedirman University

Abstract. The purpose of this study is to analyze the stability of Islamic banks compared to conventional banks measured by bending credit risk and liquidity risk. The researcher chose the variable for bank stability with accounting-based measures, namely Z-score as a proxy for bank stability to examine the impact of liquidity risk on bank stability. To examine the relationship between liquidity risk and credit risk using a descriptive statistical approach, the classic assumption test and use the Mann-Whitney U test to compare the performance of Islamic banks and conventional banks. This study uses data from Islamic and conventional banking companies in Indonesia for the period 2008-2018 to then compare and analyze the results of the tests. The expected result is that there is a negative impact between the risk of liquidity on bank stability and the performance of Islamic banks better than conventional banks.

Keywords: Liquidity Risk, Credit Risk, Stability Bank, Comparison of Islamic and Conventional Banks.

1. INTRODUCTION

The one important part of the center of Islamic finance is a banking system that Islamic banks Although Islamic banking initially started for Muslims in the Muslim population, the concept of banking has been widely spread around the world, especially after the financial crisis of subprime (Hassan et al, 2018). Since the 2008-2009 global financial crisis, there is growing concern about the financial stability of all financial institutions. Because of the complicated relationship between financial stability and macroeconomic stability, financial stability is not assured even under conditions of a stable macroeconomic environment. Therefore, the analysis of financial stability can not be ignored (Phan et al, 2019).

The last few decades have been observed an increase in the number of Islamic banks operating in different parts of the world. Islamic banking grew extensively during the last thirty years (Hassan et al, 2018). It can be seen more and number of banks, branches and the amount of capital invested (Khan, 2010). In Indonesia alone, according to the Financial Services Authority also berpendapt that the national Islamic banking industry continues to grow at a growth rate varies according to economic conditions and the various factors that influence its development for more than two decades, precisely since 1992.

Islamic banking has the same function as conventional banks but the nature and structure of their products differently, Islamic banks are not allowed to engage in transactions based on interest (riba), uncertainty (gharar), and speculation/gambling (qimar) (Hassan et al, 2018). The fundamental difference between Islamic and conventional banks is in the profit and loss-sharing mode, ie on the liabilities side of their balance sheets (Obaidullah, 2005). Although according to the Sharia system in its operations, but Islamic banks can not be considered free from all risks faced by the conventional banking system (Hassan et al, 2018).

There are many studies explained that Islamic banks are more stable, especially during the financial crisis (Abedifar, et al, 2013; Beck, et al, 2013; and Uddin Miah, 2017), but the fact remains that some of them are closed (bankruptcy) due to lack of liquidity. For example, Ihlas Finans in Turkey started its operations in 1995 to facilitate small investors and savers to park their investments in flowers for free.

* Email Address: Nurlailatul9@gmail.com
Research on the stability of the bank is carried out by the researchers include there are few studies that analyze the impact of liquidity risk to the stability of the bank such as (Wagner, 2007; Čihák and Hesse, 2010; Cornetta, et al., 2011; Beck, et al., 2013; Almarzoqi, et al., 2015). Wagner (2007) argue that liquidity risk has a negative impact on the stability of the bank. Cornetta et al. (2011) found that banks with high illiquid assets, could increase their liquidity and reduce borrowing during the financial crisis. Almarzoqi et al. (2015) also found similar while Čihák and Hesse (2010) found no association between the risk of liquidity and stability to a large Islamic bank but a significant negative correlation hampered for small Islamic banks. Furthermore, Hassan et al 2018, found that Islamic banks better manage risk management than conventional banks. Moreover, Phan et al, 2019 found the addition to credit risk, the size of the bank and the market concentration can also positively affect the stability of the bank.

In Indonesia is there are two main problems faced by Islamic banks. First, low asset quality and capital are limited both. Both of these barriers faced by Islamic banking in Indonesia both Islamic banks (BUS) and sharia business unit (UUS) (Tri Adi). This statement is also supported by the evidence Progress reports total assets, the Labor Office Network, and Islamic Banking - 2016-2019 period reported by the Financial Services Authority through Islamic Banking Statistics data (SPS) is a media publication that presents data periodically Indonesian Islamic banking.

The graph above explaining that the LDR steadily increased over the past three years, it can lead to decreased liquidity of a bank which may result in increased liquidity risk of banks in Indonesia, but it also LDR increasing has exceeded the maximum limit of the LDR predetermined by the FSA of 90%.

Research conducted by Hasan et al (2018) compared the risk of liquidity and credit risks of conventional and Islamic banks affect the stability of each bank, the research found that there is a negative relationship between liquidity and credit risks in Islamic banks. Also, found a positive association between the risk of liquidity and stability of the bank (measured by the z-score and Default Distance) and a negative relationship between liquidity risk and stability of Islamic banks during the financial crisis of the post-subprime. Phan et al (2019) the effect of credit risk and liquidity risk on bank stability was different. However, research shows a positive coefficient for credit risk while turned negative for liquidity risk, and significant for all models. These results menunjukk late that there is a trade-off between credit risk and the stability of the bank; however, banks can improve their stability if their liquidity risk control.
The purpose of this study is to analyze ratings stability in the Sharia Bank compared with Conventional Bank memiliki measured by credit risk, liquidity risk. To do this, according to research conducted by Hasan et al (2018) first to find a relationship between liquidity risk and credit risk and, secondly, look for the impact of liquidity risk to the stability of the bank. Purposes of calculating the liquidity risk is a difference of all liabilities that can be drawn in a very short period of the assets, which can be converted into cash quickly, at low cost, to cover the withdrawal of expected and unexpected. While credit risk is measured by dividing the difference between the cost of borrowing and repaying loans with a credit allowance last year, Hasan et al (2018).

2. LITERATURE REVIEW

Risk management in Islamic banks has a different character from the conventional banks, mainly due to the types of typical risks inherent in banks that operate by sharia. In other words, the fundamental difference between Islamic banks with conventional banks lies not in how to measure, but on what is judged (Adiwarman, A. Karim).

Bank Indonesia as the central bank's regulatory policy-Indonesian banking regulations in consideration of the importance of a risk pengelolalan for Islamic banks (BUS) and sharia business unit (UUS) that operate in Indonesia. Therefore, Bank Indonesia issued Bank Indonesia Regulation Number 13/29 / PBI / 2009 regarding the Implementation of Risk Management Islamic Banks and Islamic Unit. The goal is to accommodate the business characteristics of Islamic Banks (BUS) and Sharia Business Unit (UUS) that is not entirely the same as conventional banking and to meet the mandate of Article 38 of Law No. 21 of 2008 concerning Islamic banking.

A. Relations between Liquidity and Credit Risk

Richard (2015) in its efforts to investigate the role of banks show three different theories in banking include:

1. The bank is defined as an institution that collects funds from savers and lends it to investors.

2. The Bank is a banking reserve theory, assuming that each bank as a financial intermediary who does not have the power to make money but must be created by the collective banking system through "multiple deposit expansion"

3. Banks turned down the role of banks as financial intermediaries and found each bank has the power to create credit and hence new money while providing new loans.

All of these theories, especially the theory of financial intermediaries, implicitly proves that there is some relationship between liquidity and credit risk. A growing literature, especially after the subprime financial crisis, emphasizing the positive relationship between risk (Allen and Carletti, 2008; Cornetta et al., 2011; Gefang et al, 2011; Imbierowicz and Rauch, 2014)

B. The size relationship Bank and Bank Stability

In the Islamic context, studies investigating the risk is rather limited. Cihak and Hesse (2008) showed that small Islamic banks more stable than conventional banks of the same size. In a study conducted by Phan et al (2019) explains that merger and acquisition activity may reduce competition in the banking system, increasing the size of the bank and market forces, and help the bank to benefit from economies of scale. The results revealed that the stability of the bank in the
previous year and the size of the banks seem to contribute to the increased stability of the bank. The larger banks become more stable than smaller ones, and more stable banks in the next year.

3. RESEARCH METHOD

Sampling techniques (sampling) is the process of pick points (items) of the population so that the sample characteristics can be generalized to the population (have now and Bougie, 2017). Sampling involves decisions design selection and sample size. The data used is the data derived from the individual financial statements available to the public on their website each for the period 2008-2018. To achieve the objectives of this study, researchers chose a bank that meets the basic requirements, that is, both types of banks coexist (Conventional Bank SOE and Bank Syariah adjoining) So the authors decided to measure a sample of eight banks, namely (Bank Rakyat Indonesia, Bank Negara Indonesia, Bank Mandiri, the State Savings Bank, Bank BRI Syariah Bank Syariah Mandiri, Bank BNI Syariah, and Islamic BTN)

variable Selection

In this study, the researchers chose the two major risk factors namely liquidity risk and credit risk. There are many studies (Kim and Sohn, 2017; Saeed and Izzeldin, 2016; Imbierowicz and Rauch, 2014) which use liquidity and credit risk either jointly or individually with a different purpose. Based on the literature about the stability of banks, researchers chose a proxy variable for the stability of the bank with accounting-based measures that Z-score as a proxy for the stability of the bank to examine the impact of liquidity risk to the stability of the bank. Z-score is arguably a well-established measure of the stability of the bank among the previous studies and practitioners (ihih and Hesse, 2010: Beck et al., 2013).

Research methods

In doing some research to describe a significant difference between credit risk and liquidity risk to the stability of conventional and Islamic banking company in Indonesia, data analysis performed by processing the data that has been obtained and then analyzed followed a three-stage process:

1. Analyze data using a qualitative descriptive approach and classical assumption.

2. Examines the relationship between liquidity risk and credit risk using virgin regression panels such as those used by (Pujianti and Sitorus, 2016).

3. Comparing the performance of Islamic banks and the conventional banks in terms of LR, CR, and stability of the bank, using the Mann-Whitney U test with the average value of the descriptive statistics such as those used by (Hassan et al., 2009).

4. CONCLUSION

This study bertObjective to analyze the stability in the Islamic Bank ratings are compared to a Conventional Bank is measured by comparing the credit risk by proxy NPL ratio, liquidity risk by proxy LDR and Bank Stability is measured by the Z-Score. The expected result is a negative impact of liquidity risk on the stability of banks and Islamic banks better performance than conventional banks.
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