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Challenges inhibiting Islamic banking growth in Indonesia using the Analytical Hierarchy Process

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Abstract

The banking sector has an essential role in supporting economic growth in the world. Islamic banking has become an increasingly popular method for reducing poverty, financial inclusion and economic development. Its existence is needed in developing countries like Indonesia. The purpose of this study is to identify and prioritize challenges that hinder the growth of Islamic banking in Indonesia. The study was conducted in two stages: the first stage of investigating the challenges in the sharia banking industry in Indonesia. The second phase identifies and determines the priority challenges that hinder the growth of sharia banking using Analytical Hierarchy Process (AHP). The results reveal that the biggest challenge is the regulatory framework. Islamic banking requires favorable government policies and regulations and a positive effect on Islamic banking. Government policies to expand the market share of Islamic banking is one of the priority to be done soon. The second challenge is the lack of qualified human resources. Human resources in Islamic banking should be knowledgeable both sharia law and economics. Hence, providing qualified human resources need specialized education institutions concerning in Islamic finance. The third challenge is the lack of awareness of Islamic banking even in a Muslim community. They have a less understanding about the terms, products, and also Islamic principles of Islamic banking.

Keywords: Islamic banking growth, regulatory environment, human resources, public awareness, Analytical Hierarchy Process

INTRODUCTION

Global Islamic Finance Report (GIFR) reported that global Islamic finance was growing up in the last ten years. Based on GIFR 2018, total assets of global Islamic financial reach to US\$ 2.431 billion. It was increased 400 percent than 2007 which reach to US\$ 639 billion (GIFR, 2018). 78 percent of global Islamic finance assets dominated by Islamic banking (Earnest & Young, 2016). Not only in a Muslim country, but also in the UK, Islamic banking reached numerous popularity and growth since the growing Muslim community (Mishra, 2018).

Islamic banking is likely to contribute to economic growth. Abduh and Omar (2012) revealed evidence that Islamic financial growth is positively and significantly related to Indonesia economic growth and the accumulation of capital in the long-term. The local financing offered by Islamic banking has been proved to affect the Indonesian economy growth. It means that Islamic banks can be an effective financial intermediary where the surplus and the deficit household met. Tabash and Dhankar (2014) confirmed that Islamic finance through its principles and instruments are important for economic development and people well-being. Through the unique financing products, Islamic banks can lead job creation in a country. Imam and Kpodar (2015) also confirmed that Islamic banking is positively correlated with economic growth even though its size is relatively small compared to the overall size of the economy.

Islamic bank established at the first time in Indonesia in 1992. It means Islamic banking has been existing over 25 years. Nonetheless, the market share of Islamic banking is still under 6 percent of the national banking market in Indonesia with its asset amount to IDR 389,74 trillion (Financial Authority Services, 2018). It is in contrast with the fact of the Muslim population in Indonesia as the largest Muslim population in the world. In the global context, Indonesia is the 9th ranking country with the biggest Islamic financial assets. Islamic banking has the second largest assets in the Islamic financial sector in Indonesia after Sukuk. Islamic banking growth in 2013-2015 is relatively decreased although in 2016 grew up to 29,65 percent (Financial Services Authority, 2017). Between 2004 to 2014 the average growth of Islamic banking assets is 33,2 percent (Tampubolon, 2015).

There will be a big question, what challenges that inhibit the growth of Islamic Banking in Indonesia as the biggest Muslim country? Even though Salim (2015) found that there's no statistical correlation between challenges and market share, It is important to examine what challenges that are inhibiting Islamic Banking growth in Indonesia. This study aims to investigate the challenges that are inhibiting Islamic banking Indonesia by using Analytical Hierarchy Process.

LITERATURE REVIEW

There are some studies discussing challenges that inhibiting Islamic banking growth. Tampubolon (2015) when presented the roadmap of Islamic finance in Indonesia stated that the challenges facing Islamic banking development are 1) Misleading of the visions between the government and the Islamic banking authorities and also lack of coordination of both parties; 2) Islamic banking has not been effective due to weak capital adequacy and small industry scale; 3) Limited financing segment causes the high cost of fund; 4) Lack of product and service innovations; 5) Lack of quantity and quality of the human resources and also lack of sophisticated information technology to develop the products and services; 6) Lack of public awareness and understanding of Islamic Banking; and 7) Regulation and supervision aspect are still not well-organized yet. Iqbal, Ahmad, and Khan (1998) have an extended the major challenges confronting Islamic banking as follows: 1) Constructing an appropriate institutional framework; 2) Competitiveness of Islamic banks; 3) Networking; 4) Extending the size of Islamic banks; 5) Financial engineering; 6) Sharia compliances; 7) Islamic banking education; 8) Fixed or variable financing modes; 9) Proper legal framework and policies; 10) Desire for establishing equity institutions; 11) Supervision aspect.

The biggest challenge that inhibiting Islamic Banking growth is not always similar in each country. In Gulf Cooperation Council, the major obstacles in a row are theology-based interpretation, low political stability, lack of government support and the regulatory environment, lack of the academic and training, and few numbers of experts in many institutions (El-Ghattis, 2014). Tabash (2017) revealed the most crucial challenges that hampering the Islamic banking growth in India was the regulatory environment. Lack of Islamic banking experts, a minimum standardization, and weak coordination and cooperation among Islamic banking authorities. In Iran, the minimum return on investment opportunities, a mixture of public and trade regulations, non-conventionally of the contract from parties' intentions in the contracts mentioned in regulations, bias definition and concepts predominant in banking (Armat & Ranjbar, 2015).

While in Nigeria, two biggest challenges are confronting the Islamic banking. They are institutional challenges ,i.e. lack of legal framework, lousy supervision, and operational challenges i.e. poor product innovation, low strategic collaborative, lack of knowledge about sharia, lack of awareness, competition with conventional banks (Bello & Abubakar, 2014; Mallum, 2016; Razimi, 2016) and lack of Islamic insurance protection to Islamic banks (Idris, 2017). The legislation is also the biggest factor influencing the success of Islamic banking in Algeria (Gherbi, 2018). Again, legal obstacles are also facing Islamic banking in Malaysia including legislation, jurisdiction, sharia governance, documentation, and money laundering (Hassan, Muneeza, & Wajeeh, 2011). Misinterpretation of Islamic finance concept and lack of its standard found as the most crucial challenge facing Islamic banking in Malaysia followed by the legal challenge and finite market-based financial contracts (Zainordin, Selvaraja, Man, & Hoong, 2016).

Warsame (2017) argued that education is one the biggest challenge facing the Islamic financial industry. Low quality of teaching materials, an inappropriate standard of curriculum, low coordination among the providers of Islamic finance education as well as inadequately qualified

scholars. While Rahman & Riyadh (2016) highlighted the distinction between Islamic finance practice and its theory. It is caused by different views of the practitioners, financial experts, and the sharia scholars.

Volk and Pudelko (2016) concluded four aspects that determine Islamic banking as follows: demand and supply condition, societal conditions, and regulatory conditions. The customers' behavior can determine the demand for this industry. One of the consideration is why the customers patronize the Islamic banks. Rehman & Masood (2012) found that religious factors (such as sharia principles and the awareness of free-interest banking), convenient location, safe feeling (such as confidentiality, professionalism, and friendly of staffs), and quality related issues (consist of service quality and knowledgeable staffs). The most significant are religious and convenience factor. Those four factors above also can be barriers when customers are selecting Islamic banks (Butt et al., 2011).

Ahmad & Bashir (2014) concluded that public awareness is important for the growth of Islamic banking due to customers decision to utilize Islamic banking products and services had a strong positive association with the level of awareness. Gender, race, age, and qualification were also significant in affecting the awareness of consumers (Cheteni, 2014).

This study will highlight the challenges facing Islamic banking in Indonesia as the biggest Muslim population in the world which its market share is still under 6 percent using the Analytical Hierarchy Process. It is expected to describe which challenge that should be the priority to be solved.

METHODOLOGY

In this study, the Analytical Hierarchy Process (AHP) was used as the methodology to prioritize challenges inhibiting the growth of Islamic banking in Indonesia. Primary data was collected from interviews with famous Islamic finance experts and academic professors from selected universities in Indonesia. The secondary was also used in this study.

AHP allows policymakers to formulate complex situations into hierarchical structures. The purpose of using AHP is to identify and prioritize challenges inhibiting the growth of Islamic banking with the views of the experts.

The steps of the AHP process as follow:

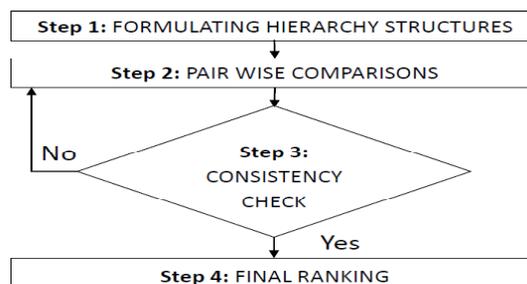


Chart 1 Steps of AHP (Saaty, 1993)

First Step: *formulating hierarchical structures*. The first method in AHP is generating a hierarchical structure. Afterward, determining the main objectives, potential criteria, and subcriteria. Then, the proposed hierarchical tree is structured to prioritize and to evaluate CIF. Predetermined CIF was organized into three challenges which included the regulatory environment, a lack of human resources, and a lack of awareness of the community about sharia.

Second step: *judgments by pairwise comparisons*. Since the model was developed, then the weight was too. Pairwise comparisons give weight to each criterion and subcriteria. In comparison, each criterion is compared to the same level regarding interests and judgments that are taken from the experts. Policymakers indeed compare criteria for relative importance on a nine-point scale.

Third and fourth step: *checking consistency and ranking*. To test the consistency of the assessment Saaty & Vargas (2012) proposed two measures of consistency index (C.I.) and consistency ratio (C.R.). If C.R. < 0.1, the value is accepted; otherwise a new assessment is carried out. Saaty & Vargas (2012) describes the calculation of the Analytical Hierarchy Process method that the elements in each row of the square matrix are the result of pairwise comparisons. Each pairwise comparison matrix is searched for its eigenvector to get local priority. Pairwise comparison scale is based on fundamental Analytical Hierarchy Process values with a weighting of 1 for equally important, up to 9 for very important

	Most Important		Neutral		Most Important					
Elemen A	9	7	5	3	1	3	5	7	9	Elemen B

Based on the composition of pairwise comparison matrices produced some elements in the element within the existing level above. Deviations from consistency are expressed in the consistency index obtained from the following formula:

$$CI = (\lambda_{max} - n) / (n - 1)$$

$$CR = CI / RI$$

λ_{max} = Add the results to the number of elements available

n = The number of the elements

Table 1. List of the Assessment of the Random Index (RI)

n	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
RI	0.00	0.00	0.58	0.90	1.12	1.24	1.32	1.41	1.45	1.49	1.51	1.48	1.56	1.57	1.59

Consistency index (C1), a random matrix with a research scale of 1 to 9, along with its inverse as a random index (R1). Based on Saaty's calculation with 500 samples, if the numerical judgment is taken randomly from a scale of 1/9, 1/8, ..., 1, 2, ..., 9 the average consistency for different size matrices will be obtained.

The comparison between C1 and R1 for a matrix is defined as the consistency ratio (CR). For the Analytical Hierarchy Process, the comparison matrix can be accepted if the value of the consistency is not more than 0.1 or equal to 0.1. The following is a table of pairwise comparison rating scales.

Table 2. Pairwise Comparison Assessment Scale

Interest Intensity	Definition	Explanation
1	Both elements are equally important	Two activities contribute equally to the goal
3	One element is slightly more important than the other	Experience and judgment slightly support one activity than the other
5	One element is more important than the other	Experience and assessment strongly support one activity rather than another
7	One element is more important than other elements	Activity is very liked, and its dominance is shown in practice

Interest Intensity	Definition	Explanation
9	One element is important than other elements	The evidence that supports one activity above another is the highest order of affirmation
2,4,6,8	Values between two values of contiguous considerations	A compromise is needed

The hierarchical structure of the Analytical Hierarchy Process (AHP) is as follows:

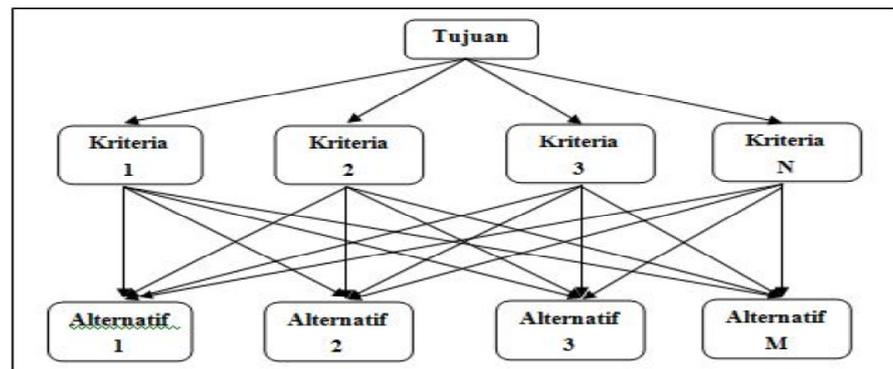


Diagram 2. The Structure of AHP

RESULT AND DISCUSSION

The followings are the results

Table 3. Pairwise Comparison and Consistency Check

	Regulatory Environment	Human Resources	Lack of Awareness
Regulatory Environment		5	6
Human Resources			3
Lack of Awareness			

Source: data processed, 2018

Table 4. The Ranking of Obstacle Challenges

Obstacle Challenge	Points	Percentage (%)	Ranking
Regulatory Environment	0,537	53,7	1
Human Resources	0,324	32,4	2
Lack of Awareness	0,139	13,9	3

Source: data processed, 2018

It is clear from Table 4 that the regulatory environment (53.7%) is more critical than other challenges, followed by a lack of Human Resources (32.4%). The third major challenge is the lack of awareness of Islamic financial products (13.9%). Not only in Indonesia, in some countries, but the regulatory environment is also the biggest challenge to the Islamic Banking growth. In Algeria, Gherbi (2018) states that 70 percents of the respondents admit that the most crucial factor for the Islamic Banking growth is the lack of legislation act. The study of Hassan et al. (2011) shows that Islamic Banking in Malaysia is facing legal obstacles including legislative, juridical, sharia governance, documentation, and money laundering obstacle. The dual system banking Indonesia can arise a conflict due to less of taking consideration about the Islamic values while the legalization process, as a case in Malaysia (Ibrahim, Muneeza, Hassan, Professor, & Ibrahim, 2012). In India, the regulatory environment is also the most severe factor inhibiting the growth of Islamic Banking followed by an inadequacy of Islamic banking scholars and experts (M. I. Tabash, 2017). Nevertheless, in Nigeria, based on Mallum (2016) the major challenge of the Islamic banking is operational challenges that caused by the lack of legal provision for the operation of the Islamic banking. Study of Bello & Abubakar (2014) and Idris (2017) include the regulatory environment as one of the challenges faced by Islamic banking in Nigeria.

Act Number 21 of 2008 concerning Sharia Banking is the operational, legal basis for Islamic banks in Indonesia. However, since the enactment of the act, the market share of Islamic banking has never been more than the 6%. Islamic banking requires affirmative government policies and regulations of Islamic finance. All this time, Islamic banks are competing with the conventional banks. Whereas, Islamic banks are left behind the conventional banks in many aspects such as capital ability. Zulkhibri and Majid (2012) also emphasize in most countries, the regulations of Islamic banking is framed in the image of conventional banking.

Moreover, Amuda (2015) found that Islamic banking was not entirely applying Sharia compliance in some products such as home and vehicle financing. Thus, the political will of the government is needed to develop and supervise Islamic banking even further. Khan & Bhatti (2006) warn us that all efforts including a legal effort to impose Islamic banking system should be made earnestly in order to avoid the system from the damage.

Indonesia currently has an institution which has duties to accelerate, to expand, and to promote the Islamic Finance in order to support the national economic development, namely the National Committee of Islamic Finance (KNKS). The President of Indonesia directly leads it. After the establishment of that committee, there is no salient movement to solve the Islamic banking problems in Indonesia. KNKS should be able to direct the stakeholders of Islamic finance for gathering the same vision according to their recommendations. The coordination between the government and the practitioners also should be synchronized.

Islamic Finance Sharia Board (IFSB) proposes some stressing points regarding the supporting regulatory of Islamic finance such as a proper environment to supervise the uniqueness of Islamic financial products, the standards of accounting and auditing that accommodate the Islamic finance transactions, and the minimum standard the products and the relevant documents (IFSB, 2014). Indonesia has its standard of accounting namely The Standard Statement of Financial Accounting (PSAK). Standard statement of Islamic banking decanted in PSAK 101-110.

Different result found by Warsame (2017). His study revealed that the most crucial challenges confronting Islamic finance are the educational problem. Zainordin et al. (2016) also found a different result from this study. They revealed that a misunderstanding of Islamic financial concept and its standardization is the biggest challenge faced by Islamic banking in Malaysia. Notwithstanding, the regulatory challenges are the second biggest challenge then followed by the lack of products which are needed by the market. While the third challenge is the lack of risk management function. In Kenya, based on the study of Kinyanjui (2013), the convergence of religious obedience and customer need is the most influencing factor of Islamic banking growth. It is distinct from our finding. The awareness of the public about Islamic banking is still an inhabitant, not a supporting factor. El-Ghattis (2014) highlighted that theology-based interpretation is the major obstacle facing Islamic banking followed by lack of political stability.

This study shows the second biggest challenge inhibiting Islamic Banking growth in Indonesia is the lack of qualified human resources. Habib Ahmed as Islamic finance expert from Durham University said that one of the biggest problems in the Islamic finance industry is the human resources because

most of them come from conventional banking education background (Budi, 2018). *Metrotvnews.com* (2016) reported that 90 percent of the employees in Islamic Banking in Indonesia have no Islamic economics education background. Warsame (2017) found that the inadequacy of teaching materials quality, minimum standard of the curriculum, lack of coordination among Islamic finance education stakeholders, and the less number of qualified scholars are biggest challenges in education programs.

Qualified human resources can be achieved if they have a high competency in managing the Islamic banking. However, based on the study of Asri (2017) the competency of human resources in Islamic banking is still poor so the companies should add the cost for training and education. The financial performance of the Islamic banking will be increased as much as spending on education and training. Qualified human resources also can guarantee a healthy organization then improve the employee performance (Muafi, Suwitho, Purwohandoko, & Salsabil, 2018). To improve the employees' productivity in Islamic banking, there are some suggested influential factors as follows: 1) Implementation of Islamic ethical value; 2) Components of quality; 3) Employee's commitment level; 4) Empowered employee; 5) Staff training; 6) Long-term HRM strategy; 7) Increasing woman's opportunity; 8) Gap between human resources and academic literatures; 9) Organizational behavior; and 10) Retention (T. N. Khan, 2015).

The lack of qualified human resources can be overcome by improving the quality of higher education institutions that offering Islamic economics study programs. In every Muslim country and also several western universities, there are so many study programs that focus on Islamic finance either undergraduate or postgraduate programs. Some educational institutions offer professionals who want to explore Islamic finance, accounting, and banking, such as International Centre for Education in Islamic Finance (INCEIF) in Malaysia, Bahrain Institute of Banking and Finance, or web-based Islamic finance diploma programme at *Netversity.org*. Short course, seminar, workshops, and conferences can be other options to generate qualified human resources in Islamic banking (Nienhaus, 2007). Islamic banks in Indonesia need to establish a school or institute that will be the provider of Human Resources for Islamic banking such as Perbanas which has Perbanas Institute, an alliance of Islamic banks can also do the same. The establishment of educational institutions is vital to be implemented as quickly as possible considering that Islamic banking always lacks of qualified human resources. Hence, Islamic banks have taken shortcuts by taking bankers from conventional banks.

The least challenge showed by this study is the lack of public awareness about Islamic banking. It is strengthened by several prior studies. For instance, Bodibe, Chilya, & Chikandiwa (2016) indicated that most respondents are not aware of Islamic banking. Ahmad & Bashir (2014) also found that there is less awareness among the people about the Islamic Banking products, services, and also terms. The customers' awareness has a significant positive association with the service utilization decision. Hence, Islamic banking should increase the people awareness in the order they utilize the Islamic banking services. Other than that, Islamic banks may concern about gender, race, age, and qualification of the customers since those factors have a statistical significant affecting awareness of the customers. Even though the customers' understanding regarding Islamic principles in Islamic banking is still weak (Cheteni, 2014).

Customers are likely willing to utilize Islamic banking products, but they have less understanding and proper information about Islamic banking principles Rammal & Zurbruegge (J. U. I. Z. Rahman, 2017; Rammal & Zurbruegge, 2007). Nevertheless, customers might be aware of diverse product in Islamic banking, but they are not necessary to purchase the products (Khattak & Kashif-Ur-Rehman, 2010).

This study shows also has a similar result with the study of Saini, Bick, & Abdulla (2011). It reveals that Muslims are aware of Islamic banks through the level of usage is low. Muslims prefer the banks' efficiency, accessibility of ATM, convenient branch, and a lower rate of bank charges rather than religious motivation. It is slightly different with Sarbo (2016) that found most of the respondents (64,3 percent) were aware of Islamic banking product and services. Muslims' awareness of Islamic banking is more than non-muslims although they are living in a country with Islam as the major population (Saiti, 2015).

Abdul Rehman & Masood (2012) found four factors why customers patronize Islamic banks, i.e. religious factor, convenience, secure feeling, and quality related issues. Based on their findings, the

most influencing factor is the religious factor (contain sharia principles and free-interest banking) and convenience. To increase public awareness, Islamic banks should socialize and introduce about the prohibition of interest in conventional banking as the religious factor. The convenience factor is meant a convenient location of the Islamic banks. Nonetheless, Butt et al. (2011) found a different result. In their study, a narrow Islamic bank branch and discomfort locations of the branch are the obstacles when selecting Islamic banks. Hence, Islamic banking should select the convenient locations wherever they operate.

Bizri (2014) proposed besides those factors mentioned above; customers also consider the modes of finance and each cost, and the quality of service. To get more customers, Islamic banking should improve the quality of services such as treating customers with courteousness, simple and efficient in accomplishing any transactions, and ability to answer any questions about Islamic banks' products. Dusuki & Abdullah (2007) argue that the quality of services will increase the customer satisfaction. The same result showed by Hamzah, Ishak, & Nor (2015). Based on Taap et al. (2011), Islamic banks have a less service quality gap than conventional banks. The gap between expectations and perceptions of respondents are 85 percent for Islamic banks and 72 percent of conventional banks. However, Islamic banking should fix whether its practices are appropriate with the fatwa since Rahman & Riyadh (2016) found the dissimilarity between sharia scholars' fatwa and its practices. It will raise confusion in public.

Shaikh (2014) mentioned that the lack of innovative financing modes, scale diseconomies, sketchy product mix, liquidity issues, and contractual resistance would be potentially faced by the Islamic banking industry. Even though the growth of Islamic banking is rapidly expanded, but it can be a dangerous lie if there's no robust theoretical structure (Ariff, 2014). Islamic banks ought to not fall asleep despite they have better risk mitigation, tend to be more stable, have better asset quality, and tend to be a less risky failure (Narayan & Phan, 2017).

CONCLUDING REMARK

This study aims to examine the challenges inhibiting the growth of Islamic banking in Indonesia using Analytical Hierarchy Process (AHP). The results reveal that the biggest challenge is the regulatory framework. Islamic banking requires conducive government policies and regulations and an affirmative effect on Islamic banking. Government policies to expand the market share of Islamic banking is one of the priority to be done soon. The second challenge is the lack of qualified human resources. Human resources in Islamic banking should be knowledgeable both sharia law and economics. Hence, providing qualified human resources need specialized education institutions concerning in Islamic finance. The third challenge is the lack of awareness of Islamic banking even in a Muslim community. They have a less understanding about the terms, products, and also Islamic principles of Islamic banking.

Therefore, Islamic banks and also government should concern in introducing and socializing Islamic banking to the public. In several studies showed that Muslims prefer the conventional banks than Islamic banks due to some reasons, such as inconvenient location. All of the stakeholders of Islamic banking including government, practitioners, academics, and society should be well-coordinated and synergized to decrease the inhabitants of Islamic banking growth in Indonesia because Indonesia is potential to be the market leader in Islamic finance with the 200 millions of the Muslim population. We are worthy to concern about the sustainability of the Islamic banking industry. To face this challenge, Akhtar (2008) suggested that it will require subsequent efforts such as enhancing legal and regulatory framework, aligning the structures and products with the Islamic principles, encouraging cooperation among stakeholders, and doing financial diversification.

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