A COMPARATIVE STUDY OF FINANCIAL PERFORMANCE OF ISLAMIC BANKS AND CONVENTIONAL BANKS IN INDONESIA

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Abstract

The paper compared and examined financial performance of Islamic banks against conventional banks before and after the enactment of Indonesia's Islamic Banking Act No. 21/2008. The law aims to strengthen the regulatory environment for further growth of Indonesia's market Islamic finance. The data was based on selected financial statements of Islamic commercial banks in Indonesia from year 2000 to 2007. Financial performance measures were expressed in terms of various financial ratios in which were categorized into profitability, liquidity, risk and solvency and efficiency. To test the hypotheses, Mann-Whitney was employed to compare financial performance of Islamic banks and conventional banks. In general, the study found no major difference in financial performance between Islamic banks and conventional banks, except in terms of its liquidity. This indicated that Islamic banks are generally more liquid as compared to conventional ones.

Keywords: Islamic banks, conventional banks, financial performance, comparative study.

1. Introduction

The salient feature of conventional banking system that oppose to Shari'ah compliance is upon the payment and receive of interest (*riba*) which resulted from the banking transactions (namely from loan and fixed deposit). This prohibition of *riba* or interest explicitly appears in Holy Qur-an (2:278-279). *Riba* is translated strictly as usury, but interpreted by modern Islamic scholar as being equivalent to interest. Islamic banking somehow, has certain characteristics that make it different with the conventional banking system. Besides interest free, Islamic banks should also avoid transactions that are illegal from Islamic point of view. Some of them are; activities that associated with alcohol, gambling, pornography, meat packing (of pork) and liquor in which are harmful for human in nature. Additionally, Islamic banks also implement *zakat*, profit and loss sharing and avoiding speculative transactions and activities. These characteristics, therefore makes Islamic Banking opposed to conventional banking system. Recently, the growth of Islamic banking has shown remarkable report. According to Ahmad (2000) there were more than 176 Islamic bank and other financial institutions with deposits exceeding $112.5 billion and operating in 40 countries including Indonesia. Compare to only one Islamic bank in 1992, now, there are 3 Islamic banks, 26 banks open their Islamic banking unit, and nearly 115 Islamic rural banks have been operating in Indonesia (Indonesia Central Bank, June 2008). Islamic bank's asset also grows significantly from 1,790 billion rupiah in 2000 to 36,537 billion rupiah in 2007. This sharp trend however is not followed by the high market share.

In term of asset, Islamic bank only acquires 1.84% in 2007 compare to total domestic banks while in 2000 it only acquired 0.17%. Therefore to encourage the development of Islamic banking, Indonesian government had enacted The Indonesia's Syariah Banking Act on July 2008 (Act No. 21/2008). With this law, government expects in 15 years the total asset of Islamic banks to reach 20% of the total assets of domestic banks. Further explanation about this act is provided in section 2. The objective of this paper is to examine the financial performance of Islamic banks against the conventional banks before the enactment of Act No. 21/2008. Previous studies have observed the financial performance of Islamic banks in Indonesia such as in Widagdo and Ika (2007), Utami et. al (2006), Wibowo and Saptutyningsih (2004). The current study will extend the literatures by observing the financial performance of Islamic banks in their early stage until the period prior to the endorsement of Act No. 21/2008. Further, the paper will also examine the performance of the third Islamic bank in Indonesia, Bank Mega Syariah (BMS hereafter) in which as far as the authors' concern, never been examined by other literature in the comparison with conventional banking.

The paper is organized into seven sections. Following section will describe briefly about the Islamic banking development in Indonesia. Section three (3) will provide some literature reviews referring to the subject matter. Then, section four (4) will explain the research methodology, including financial performance measures, data used in this study, and data analysis on the result will also be provided in this section. Section five (5) will provide empirical results and discussion, while conclusion will be presented in section six (6) and finally section seven (7) discussion some limitation and direction for future research.

2. Islamic banking development in Indonesia from 1992 to 2008

The first Islamic bank, Bank Muamalat Indonesia (BMI) was established after the enactment of Act no. 1/1992 that opened an opportunity for profit sharing banking. Majelis Ulama Indonesia (Indonesia Ulama Council hereafter MUI) took initiative to set up the bank after conducting workshop on Islamic economic. During the period of 1992 to 1998, there was only 1 Islamic bank (BMI) and 78 Islamic rural banks or Bank Perkreditan Rakyat Syariah (BPRS) were developed. The slow development of the Islamic banks during the period might be due to disincentive by the former leader to support the Islamic economic system. In 1998, was the year of Indonesia's political reformation as the new government (that time) had issued Act No. 10/1998. This act regulated dual banking systems; whereby Islamic Banks operate side by side with the conventional banks. It is considered as a legal basis for further development of Islamic bank in Indonesia. In conjunction with this, Act No. 23/1999 was issued in 1999 which provided that Indonesia Central Bank, as monetary authority in Indonesia must provide regulations and facilities for Islamic Banking operation. After the implementation of these Acts, formation of Islamic banks had increased significantly.

In 1999, Bank Shariah Mandiri, the second Islamic bank in Indonesia was opened, followed by some commercial banks that opened its Islamic Banking units. Furthermore, another significant event took place in 2002, when Indonesia Central Bank issued "Blueprint of Islamic Banking Development in Indonesia". This was considered as a long run planning of Islamic banking in the country. Among others, the blueprint identified major challenges of Islamic bank in future besides stated its vision, mission and strategic goal of Islamic bank. In short, the blueprint has provided clear guidelines for the stakeholders to synchronize their vision and aspiration (Indonesia Central Bank, 2002).

In July 2004, Bank Tugu converted to an Islamic bank namely Bank Mega Syariah and represented as the third Islamic bank in Indonesia. In addition, Indonesia Central Bank issued "office channeling policy", in 2006. Subsequently on July 2007 witnessed the launched of syariah banking logo to socialize and improve the awareness of society regarding Islamic banking. Office channeling policy, on the other hand had allowed conventional banks to open and provide syariah banking service without establishing separate office for their Islamic banking unit. This policy attempts to improve the Islamic banking service network to all over Indonesia by using conventional banks infrastructure to reduce cost. Besides that, the setting up of the new Islamic bank would take huge investment to compete with the existing big capital conventional banks due to the wide archipelago country of Indonesia. Therefore any conventional banks that appearing the Islamic banking logo in their office certainly provides Islamic banking service.The detail growth of Islamic banking development in the following table.

Table 1. The Development of Islamic Institution in Indonesia 1999-2007

Bank Type	1992	1999	2000	2002	2004	2005	2006	2007
Islamic bank	1	2	2	2	3	3	3	3
Islamic Banking Unit	-	1	3	6	15	19	20	8
Islamic Rural Bank	9	78	79	83	88	92	105	114
Total Offices	10	118	146	229	443	550	636	711
Syariah Office channeling							10 banks 456 offices	17 banks 1,195offices
Total Assets*	NA	NA	1,790,168	4,045,235	15,325,997	20,879,874	26,722,030	36,573,637
Share of Total Banking	NA	NA	0.17%	0.36%	1.20%	1.42%	1.58%	1.84%
Financing*	NA	NA	1,271,162	3,276,650	11,489,933	15,231,942	20,444,907	27,944,311
Share of Total Banking	NA	NA	0.40%	0.80%	1.93%	2.19%	2.58%	2.79%
Deposit*	NA	NA	1,028923	2,917,726	11,862,117	15,582,329	20,672,181	28,011,670
Share of Total Banking	NA	NA	0.15%	0.35%	1.23%	1.38%	1.61%	1.85%

Source: Indonesia Central bank (2007)

* In million IDRs NA = Not Available Data

From Table 1, the high growth however is not followed by the high market share. In term of asset, financing, and deposits, Islamic banking share compare to total domestic bank is still less than 2%. To strengthen the regulatory environment, government issued the Indonesia's Syariah Banking Act on July 2008 (Act No. 21/2008). The law regulates: a) Islamic banking unit which has minimum 50% of total assets should be separated from the parent company to become an independent syariah bank. b) Islamic banking units which had been established for 15 years when this act was endorsed should be the syariah bank even though their asset are still below than 50% of total assets c) It allows foreigners to establish syariah banks in partnership with Indonesian citizens or local entities with minimum 25% of shares. d) It also offered more flexibility to commercial banks, allowing them to convert their business into sharia-compliance banks. Under this law, it is hoped that investors would have no more doubt in doing business in the Islamic banking sector in Indonesia. This country has been slow to tap the fast-growing Islamic finance market, and has lagged Malaysia and Singapore in developing syariah- compliant products (Central Office of Islamic Economics News, June 2008).

3. Literature review and hypothesis development

Due to the rapid growth in Islamic banking in these recent decades, it calls for opportunities for the academics to conduct study in analyzing its' financial performance using financial ratios. Some previous studies investigated the performance of Islamic banks during certain period (Sarker, 1999; Arief, 1989; Wibowo and Saptutyningsih, 2004) while the others studied the performance of Islamic Banks and compare it with conventional banks performance (Samad, 1999; Samad and Hassan, 2000; Rosly and Bakar, 2003; Samad, 2004; Kader et. al, 2007; Widagdo and Ika; 2007). Samad, 2004 examined on the financial performance of interest free Islamic banking against interest-based conventional bank in Bahrain. Comparison analysis was made in terms of their liquidity, risk and credit risk and profitability during the period of 1992-2001 (post Gulf war period). The result showed that there is no significant difference between Islamic banks and conventional banks with respect of its' profitability and liquidity. However, the study finds that there exist significant differences in credit performance.

Similar study also conducted in the Middle East countries by Kader et al. (2007), which evaluating financial performance of Islamic bank and conventional banks in UAE. The findings of the study indicated that there's also no major difference in terms of its profitability and liquidity. Different result was found by Mahmood (2005) when he examined the performance comparison between Islamic banks and conventional banks in Pakistan. His study conformed that almost in all ratios; Islamic banks were superior to conventional banks during 2000-2004. Earlier study was conducted in Malaysia by Samad and Hassan (2000). The study adopted inter-temporal and inter-bank performance analysis of Islamic bank (Bank Islam Malaysia Berhad, BIMB) for the period 1984 – 1997. The aim of the paper was to evaluate the performance of BIMB using financial ratios. The result on inter-bank comparison suggested that, Islamic bank appears to be statistically more liquid, less risky and more solvent compared to a group of 8 eight conventional banks. Additionally, the study also revealed that there is no difference in economic participation in terms of community involvement between the periods 1984 – 1997.

Rosli and Bakar (2003), examined the financial performance of Islamic Banking Scheme (IBS) and made comparison analysis with their mainstream bank' performance. The study argued that IBS recorded higher Return on assets (ROA) is not due to efficient investment policy carried out by the IBS. But, rather it is caused by technical default, since most of the overhead expenses were born by the parent company (its' mainstream bank). Furthermore, the study claimed that, into certain extent the IBS failed to direct its' Islamic banking system away from the conventional banking system. Thus, interest-like Islamic banking operation does not appear to outshine mainstream banks in term of efficiency. This argument is supported in the study conducted by Metwally (1997). The study was conducted mainly to analyze differences between the financial characteristic of interest-free banks and conventional banks. Among the results revealed was on the *Murabaha* method of finance that was claimed to be interest-free, but through the use of mark – up concept, it was perceived to be not much differ from the interest charge in conventional banking. However, the statistical evident suggested that the two group of banks may be differentiated in terms of liquidity, leverage and credit risk, but not in term of profitability and efficiency.

In Indonesia context, Wibowo and Saptutyningsih (2004) examined the financial performance of two main Islamic banks: BMI and BSM, during period 2000-2003 with tool called CAMEL-modified. The result revealed that performance of BMI was superior to performance of BSM. Then, Utami, *et al.* (2006) tried to define profile of Baitul Maal Wat Tamwil (BMT) in Banyumas Regency based on its financial performance. The result showed that, in most BMTs being surveyed, the level of BMT finance ratio, which included liquidity, solvability, business risk, and productivity of the employee's ratio, increased during the year 2000 until 2002.

A more recent study was conducted by Widagdo and Ika (2007) to examine whether the financial performance of Islamic bank in the period before the release of the *fatwa* regarding the prohibition of interest in Indonesia (2002 – 2003) is different from after *fatwa* (2004-2005). They also examined the comparison of financial performance of Islamic Banks and conventional banks before and after the release of the *fatwa* using financial ratios categorized into profitability, liquidity, risk and solvency, and efficiency. The result indicated that, the financial performance of Islamic bank, before and after the release of the *fatwa*, showed statistically no significant difference. Similar result, for inter-bank analysis also indicates that there no major difference between Islamic and conventional banks both in the period before and after the release of the *fatwa*.

The above study conducted in Indonesia that observe the financial performance of Islamic banks against the conventional banks in Indonesia however did not take up at their early period or included the third Islamic bank (Bank Mega Syariah). Therefore this study will fill this gap. It will examine the financial performance comparison between Islamic banks and conventional banks in two steps. First, the performance of two Islamic banks is compared to conventional banks from 2000 to 2007. Year 2000 is considered at the early period of Islamic banks in Indonesia, because the second Islamic bank was established in 1999. Second, this study also included the performance of Bank Mega Syariah in representing the performance of Islamic banks against the conventional during 2005 until 2007. The comparison starts with year 2005 because in half of the year 2004, Bank Mega Syariah was still conventional bank.

Based on previous studies conducted by Samad and Hassan (2000); Rosly and Bakar (2003) Samad (2004); Kader et. al (2007); Widagdo and Ika (2007) therefore the hypotheses are developed for the study as follow:

H1: There is no significant difference between financial performance of Islamic banks and conventional bank during 2000 – 2007.

As we hope that the presence of Bank Mega Syariah will give contribution to the overall financial performance of Islamic banking in Indonesia, thus the second hypothesis is as follow:

H2: There are significant differences between financial performance of Islamic banks and conventional bank during 2005 – 2007.

4. Research methodology

4.1 Financial Performance Measures

To measure financial performance of bank, this study employed 13 financial ratios that adopted from Samad and Hassan (2000) ; Samad (2004); . These ratios are grouped under four broad categories as follows:

4.1.1 Profitability Ratios

The profitability ratios are used to asses the capability of company to generate earnings as compared to its expenses and other relevant costs incurred during certain period of time. This study uses following ratios for measuring profitability of bank.

a. Return on Asset (ROA) = profit after tax/total asset. It shows how a bank can convert its asset into net earnings. The higher value of this ratio indicates higher capability of firm. This ratio provides indicator for evaluating the managerial efficiency (Samad, 1999; Samad and Hassan, 2000; Samad, 2004; Kader, *et al*., 2007)
b. Return on Equity (ROE) = profit after tax/equity capital. This ratio indicates how bank can generate profit with the money shareholders have invested. The higher value of this ratio shows higher financial performance. Like ROA, this ratio is also an indicator for managerial efficiency.
c. Profit to Total Expenses (PER) = profit after tax/total expense. This ratio indicates profitability of the firm with regard to its total expenses. A high value of this ratio indicates that bank could make high profit with a given expenses.
d. Return on Deposit (ROD) = profit after tax/total deposit. This ratio shows percentage return on each dollar of customers' deposit. In the other words, it indicates the effectiveness of bank in converting deposit into net earnings (Rosly and Bakar, 2003, p. 1257).

4.1.2 Liquidity Ratios

The liquidity ratios measure the capability of bank to meet its short-term obligations. Generally, the higher value of this ratio indicates that firm has larger margin safety to cover its short-term obligations. Among the various liquidity measures, this study uses ratios as follows.

a. Cash Deposit Ratio (CDR) = cash/deposit. The higher value of this ratio shows that a firm is more liquid.
b. Loan Deposit Ratio (LDR) = loan/deposit. The low value of this ratio indicates that bank has excess liquidity. This ratio also indicates effectiveness of mediation function of bank. In the Islamic bank context, this ratio is well known also as Financing Deposit Ratio (FDR).

c. Current Ratio (CR) = current asset/current liability. This ratio indicates the capability of firm to meet the current liability with the current asset. The high value of this ratio indicates that firm is more liquid.
d. Current Asset Ratio (CAR) = current asset/total asset. This ratio shows composition of firm's asset. The high value of this ratio indicates that firm has more liquid asset than long term asset.

4.1.3 Risk and Solvency Ratios

The following ratios measure for risk and solvency.

a. Debt equity ratio (DER) = debt/equity capital. This ratio shows how firm finances its operation with debt relative to the use of equity.
b. Debt to total assets ratio (DTAR) = debt/total assets. This ratio indicates the proportion of assets financed with debt. A high value of this ratio provides indication that firm involves in more risky business.
c. Equity multiplier ratio (EM) = total assets/share capital. This ratio shows how many dollars of assets must be supported by each dollars of equity capital. The higher value of this ratio indicates signal for risk failure.
d. Loan to deposit ratio (LDR) = loan/deposit. Besides measuring liquidity, this ratio also indicates credit risk for a firm. High value of this ratio indicates possibility insolvency.

4.1.4 Efficiency Ratios

Two ratios are used for measuring efficiency of a bank.

a. Asset Utilization ratio (AU) = Total operating income/total asset. This ratio measures capability of firm to generate revenue with its asset. The high value of this ratio indicates the high productivity of firm's asset.
b. Operating Efficiency ratio (OE) = total operating expenses/total operating income. This ratio indicates how efficiently firm uses its assets, revenues and minimizing the expenses. In other words, it shows how well firm could reduce the expenses and improves productivity.

4.2 Data, Sample, and Data Analysis

All three Islamic banks were used to represent the sample of Islamic banks. Two banks, Bank Muamalat Indonesia and Bank Syariah Mandiri were examined in the period during 2000-2007 while in the period 2005 -2007 bank Mega Syariah was included. Additionally, we got sample of conventional banks consisted of six banks with the following criteria:

a. The banks were under the same category with Islamic banks based on Indonesia Central Bank directory; private foreign exchange bank.
b. The banks do not have any loss during 2000-2007.
c. The "true conventional bank" during the assessment period. It means that these banks did not have Islamic banking unit during 2000 – 2007.

The complete list of banks could be seen in Table 2.

Table 2. List of the Sample

Sample of Islamic banks		Sample of conventional banks
The period of 2000 -2007	The period of 2005- 2007	
1. Bank Muamalat Indonesia 2. Bank Syariah Mandiri	1. Bank Muamalat Indonesia 2. Bank Syariah Mandiri 3. Bank Mega Syariah	1. Bank Bumi Putra 2. Bank Buana 3. Bank Central Asia 4. Bank Lippo 5. Bank NISP 6. Bank Pan Indonesia

The samples of financial statements of banks were derived from its website and also Indonesia Central Bank database which can be accessed from its website. The above ratios were calculated based on these financial statements. For data analyzing, Mann-Whitney test was used to compare means from two or more samples drawn from two or more populations. Samad (2004, p. 6-7). To determine whether the differences in means were significant, ρ-value must be less than the 0.05. If the ρ-value was less than 0.05 the null hypothesis (no difference among the groups mean) would be rejected.

5. Empirical result and discussion

This section provides the findings of this study that are presented in figures and tables. Further analyses in light of the significant result are discussed in detail in this section. Table 3 outlines the financial performance comparison between Islamic banks and conventional banks in the period 2000-2007 (without Bank Mega Syariah) whereas; table 4 showes the comparison of those banks during 2005-2007 (including Bank Mega Syariah).

Table 3. Financial Performance Comparison without Bank Mega Syariah (2000-2007)

		Islamic Bank		Conventional Bank		Z	Sig. 2 Tailed
No.	Ratios	Mean	Std. Deviation	Mean	Std. Deviation		
1	ROA	.02000	.001414	.01617	.008208	-.667	.505
2	ROE	.13400	.050912	.17033	.110995	0.000	1.000
3	ROD	.01900	.001414	.01633	.010132	0.000	1.000
4	LDR	.83350	.057276	.65983	.280871	-.667	.505
5	PER	.21150	.125158	.15767	.092774	-.667	.505
6	CDR	.31450	.133643	.26250	.098857	-.667	.505
7	CR	2.50150	.745998	1.31300	.458474	-2.000	.046*
8	CAR	.30800	.090510	.31117	.085019	-.333	.739
9	DER	9.06950	1.721805	9.02583	2.248908	-.667	.505
10	DTAR	.84750	.091217	.88617	.058796	-1.000	.317
11	EM	14.785000	.878227	33.88633	30.430245	-1.000	.317
12	AU	.01800	.000000	.01767	.008892	0.000	1.000
13	OER	.86000	.014142	.86917	.076906	-.667	.505

Table 4. Financial Performance Comparison including Bank Mega Syariah (2005-2007)

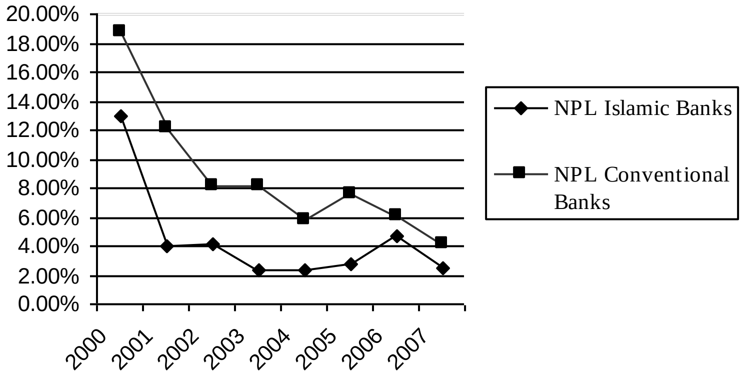
		Islamic Bank		Conventional Bank		Z	Sig. 2 Tailed
No.	Ratios	Mean	Std. Deviation	Mean	Std. Deviation		
1	ROA	.01333	.004041	.01500	.010257	-.258	.796
2	ROE	.20233	.096423	.12533	.093119	-.516	.606
3	ROD	.02133	.008505	.01983	.008635	-.775	.439
4	LDR	.63767	.430995	.70417	.204885	-.256	.796
5	PER	.06333	.039954	.18533	.121401	-.256	.796
6	CDR	.21867	.044736	.26017	.031959	-.516	.606
7	CR	3.72200	3.210828	1.31617	.496209	-2.324	.020*
8	CAR	.34133	.132100	.26217	.051650	-.775	.439
9	DER	11.32233	1.935010	8.17067	2.326055	0.000	1.000
10	DTAR	.92000	.018735	.90633	.081439	-.648	.517
11	EM	20.06133	7.508158	40.45767	39.646647	-1.291	.197
12	AU	.01933	.006028	.02000	.013312	-.259	.795
13	OER	.8193	.01436	.7990	.12996	-.258	.796

* : significant at 0.05

5.1 Profitability Analysis

In terms of inter- bank analysis, as shown in Table 3 and Table 4, all measure of profitability do not show any statistically difference between Islamic banks and conventional banks in the period both 2000-2007 and in the period 2005-2007.

Figure 1. NPL 2000-2007



This result is consistent with finding of the other studies which found that there was no significant difference in profitability between Islamic banks and conventional banks (Samad, 2004; Widagdo and Ika, 2007). This result might be explained by the fact that revenues of Islamic banks are mainly obtained from financing activities that steadily increased during period 2000-2007. The increasing of financing activities in this period was supported by the low of Non Performing Loan (NPL) (see Figure 1).

As the result, profitability of Islamic banks did not lag behind the profitability conventional banks that also increased steadily in that period due to, particularly, the increasing interest rate.

5.2 Liquidity Analysis

Based on table 3 and 4, CR ratio in both comparison periods consistently shows statistically difference. The mean average of Islamic banks in period 2000-2007 is 2.50150, compared to 1.31300 of conventional banks. In the period 2005-2007, when Bank Mega Syariah is included the mean average of Islamic banks in period 2000-2007 is 3.72200, compared to 1.31617of conventional banks. Statistically, it seems that the capability of Islamic Banks to meet current liability with the current asset is better than conventional banks. This finding is consistent with the finding by Mahmood (2005); Widagdo and Ika (2007). The possible reason for this scenario related to dominant form of Islamic banks financing which is short term nature. Similar to other countries, financing of Islamic banks in Indonesia have been dominated by *Murabahah* receivables (Indonesia Central Bank, 2008, p. 19). Under this type of financing, the Islamic bank purchases for a customer certain product based on his request. The customer will buy that goods from the bank on pre-agreed profit basis that does not seems significantly different from interest charged by conventional banks (Brown, 1994; Metwally, 1997). According Samad (2004, p. 12), this sort of financing is more popular because its' short term nature and low risk investment for bank .Thus, Islamic banks are required to maintain high liquidity to cover their short term financing.

5.3 Risk and Solvency Analysis

Based on data in Table 3 and Table 4, in terms of inter-bank analysis, it shows that all measures of risk and solvency also no significant difference in performance between Islamic banks and conventional banks both in period of 2000 – 2007 and 2005 - 2007. This findings support the previous studies conducted by Mahmood (2000); Widagdo and Ika (2007) that found no performance difference between Islamic banks and conventional banks in terms of risk and solvency ratio.

5.4 Efficiency Analysis

As shown in Table 3 and Table 4, mean average of ratios are relatively equal comparing in the two periods. It indicates that there are no significant differences between Islamic banks and conventional banks in all efficiency measures. Thus, this result is consistent with previous study (Widagdo and Ika, 2007). Overall, the analysis of the result showed that only liquidity ratios have significant differences in the comparison of financial performance between the Islamic banking and conventional banking both in the period; 2000 – 2007 and 2005 – 2007 even after the inclusion of the third bank in Indonesia. This result is consistent with previous studies conducted in the similar area (Samad, 2004; Widagdo and Ika, 2007; Kader et.al., 2007). From the writers' observation, there are several reasons that contribute to this situation.

Firstly, poor former government support during the initial stage of the development of Islamic banking in Indonesia could have contributed to the lack of awareness among the Muslims to utilize the syariah compliance products and services. Where, there were least disseminations of Islamic product campaigns through the media such as newspapers and electronic advertisements. According to Indonesia Central Bank (2000) that conducted a study about potency, preference, and attitude of people in Java Island towards Islamic bank, the percentage of people that viewed interest was forbidden by Islam was slightly lower than percentage of those who had opposite view. Further, in terms of view towards Islamic bank, in general, most people argued that Islamic bank was an identical to profit sharing bank and a bank that followed Islamic law *(shari'ah)*. Additionally, the product offered by Islamic Banking cannot be differentiated to product offered by the conventional banks. This scenario discourages bank customers to change their preference to Islamic bank.

6. Conclusion

This study examined the financial performance of Islamic banks against the conventional bank in Indonesia. Financial performance measures were expressed in terms of various financial ratios categorized as profitability, liquidity, risk and solvency, and efficiency. As mentioned earlier in the introduction, this study attempted to examine whether financial performance of Islamic banks during its early stage development until prior to the issuance of the latest Syariah Banking Act on July 2008 (2000 – 2007), is different from financial performance of conventional banks in Indonesia. To make the study more robust, the formation of third Islamic bank in Indonesia was also included in our evaluation in comparing to the conventional banks in 2005 to 2007. Of the result, despite the remarkable growth in the number of total Islamic banks and Islamic units in Indonesia, especially after 2000, the result of this study has shown that, in general, there is no major difference in financial performance between Islamic banks and conventional banks, except the liquidity ratios as represented by current ratio (CR). The ratio showed significant difference between the Islamic banks as compared to conventional banks before and after the enactment of Indonesia's Islamic Banking Act No.

21/2008. Interestingly, this current ratio consistently showed significant in differentiating the performance of Islamic banks and conventional banks both in the period 2000-2007 and in the period 2005-2007. Based on this result, the study concluded that Islamic banks are found to be more liquid than conventional ones. However, the rest of other ratios showed no statistical differences.

The result of this study implies that even though Indonesia is among the biggest Muslim community country in the world, the awareness of consuming syariah compliance products and services are still low. This finding is consistent with previous study (Widagdo and Ika, 2007) that even after the release of fatwa by MUI regarding the prohibition of interest, the financial performance of Islamic banks in Indonesia still showed statistically no differences. It seems that macro economy indicator, such as interest rate, might affect the performance of Islamic banks in Indonesia. This findings support the result in other previous studies (Gerard and Cunningham, 1997; Metawa and Almossawi, 1998; Haron and Ahmad, 2000; Ghafur, 2003) that indicated depositors of Islamic banks were mainly motivated by the return of the money (welfare maximization premise).

7. Limitation and direction for future research

This study has some limitations that must be considered. Firstly, the sample of Islamic banks in this study was only represented by Islamic commercial banks BMI, BSM and BMS. Meanwhile, other Islamic institutions, such as Islamic banking units and Islamic rural banks, have also growing. It would be more meaningful comparison perhaps if, more Islamic banking institutions to be taken up as a part of the sample in future research. It was also suggested by Rachmawati and Syamhulhakim (2004) that number of branch office might also affect the performance of Islamic banks in Indonesia. Secondly, this study only used "conventional" financial ratios to measure Islamic banks' performance. Therefore, further study may use other financial ratios which are more Islamic, such as total zakat to total income, Mudaraba-musharaka ratio, long term loan ratio, government bond investment as suggested by Samad and Hassan (2000) to measure the Islamic banks commitment to economy and Muslim community. Thirdly, this study conducted to examine the Islamic bank performance prior the implementation of Islamic Banking Act (Act No.21/2008) further study may observe the impact of this Act to the Islamic banks performance.

Another angle that can be explored is the disclosure of the financial statement in non-monetary aspect of Islamic institutions. As Baydoun and Willet (2000) presented in his paper, on theory suggest that the presence of the Islamic religion as a cultural variables that indirectly effected in the manner in which accounting information should be disclosed. This type of research could not be easily conducted, as it relies heavily on wisdom of the researcher in interpreting the findings of the "Islamic cultural variables". However, the writers believed that it is very much contributing to our intention to upgrade the way the Islamic financial information should be disclosed in future and the disclosures are more meaningful for all users.

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