INFLUENCE OF BANK SPECIFIC FACTORS, MARKET CONCENTRATION AND MACROECOMIC INDICATORS TOWARDS ISLAMIC AND CONVENTIONAL BANKS STABILITY IN INDONESIA

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SULTAN IDRIS EDUCATION UNIVERSITY

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ABSTRACT

The post-global financial crisis caused banking instability and a slowdown in Indonesia's economy. Thus, this study examines the differences in financial stability, the influencing factors during and after the global financial crisis and assess their influence on overall financial stability for Islamic and conventional banks in Indonesia. The theories involved in this study are Signaling, Legitimacy, and Banking theories. The sample is unbalanced panel data, purposively selected from 41 conventional banks and nine Islamic banks, consisting of 500 observations for ten years. Multiple regression analysis with dummy variables was used to determine the influence of bank-specific factors, market concentration, and macroeconomic indicators on Islamic and conventional banks' financial stability. The findings showed Islamic banks were more stable than conventional banks during and after the financial crisis. Further analyses showed that bank-specific factors consisting of capital adequacy ($\beta = 21.501$; $p = 0.000$) and size ($\beta = -8.606$; $p = 0.000$), as well as market concentration ($\beta =75.262$; $p = 0.000$) influenced Islamic banks' financial stability. For conventional banks' financial stability, the influencing factors were capital adequacy ($\beta = 1.514$; $p = 0.000$), size ($\beta = .547$; $p = 0.000$), profitability ($\beta = -47.496$; $p = 0.033$), efficiency ($\beta = -3.778$; $p = 0.003$), liquidity ($\beta = 4.448$; $p = 0.005$), credit risk ($\beta = -52.664$; $p = 0.031$), and market concentration ($\beta = -31.347$; $p = 0.000$). The implication of this study is that Islamic banks must enhance their capitalization to boost profitability. Conversely, conventional banks must improve risk assessments and adopt the current risk management technology to improve financial stability. In addition, the banking sector could capitalize on latent profit potential by expanding to other countries, taking advantage of comparably higher Islamic bank profitability.

PENGARUH SPESIFIKASI BANK, PENTAKSIRAN PASARAN, DAN INDIKATOR MAKROEKONOMI TERHADAP KESTABILAN BANK ISLAM DAN KONVENSIONAL DI INDONESIA

ABSTRAK

Fasa selepas krisis kewangan global menyebabkan ketidakstabilan perbankan dan kelembapan ekonomi di Indonesia. Justeru, kajian ini meneliti perbezaan kestabilan kewangan, faktor-faktor yang mempengaruhi kestabilan kewangan semasa dan selepas krisis kewangan global dan menilai pengaruhnya terhadap kestabilan kewangan bank Islam dan bank konvensional di Indonesia. Teori-teori yang terlibat dalam kajian ini adalah teori *Signaling*, *Legitimasi*, dan Perbankan. Sampel adalah data panel tidak seimbang yang dipilih secara *purposive* daripada 50 bank, melibatkan 500 pemerhatian data dari 41 bank konvensional dan sembilan bank Islam, selama sepuluh tahun. Analisis regresi berganda dengan pemboleh ubah *dummy* digunakan untuk menentukan pengaruh spesifik bank, konsentrasi pasaran dan indikator makroekonomi terhadap kestabilan kewangan bank Islam dan bank konvensional. Hasil kajian menunjukkan bank Islam lebih stabil daripada bank konvensional dalam tempoh semasa dan selepas krisis kewangan. Analisis selanjutnya menunjukkan bahawa faktor spesifik bank yang terdiri daripada kecukupan modal (β = 21.501; p = 0.000) dan saiz (β = -8.606; p = 0.000), serta konsentrasi pasaran (β = 75.262; p = 0.000) mempengaruhi kestabilan kewangan bank Islam. Kestabilan kewangan bank konvensional dipengaruhi oleh faktor kecukupan modal (β = 1.514; p = 0.000), saiz (β = .547; p = 0.000) , keuntungan (β = -47.496; p = 0.033), kecekapan (β = -3.778; p = 0.003) , kecairan (β = 4.448; p = 0.005), risiko kredit (β = -52.664; p = 0.031), dan konsentrasi pasaran (β = -31.347; p = 0.000). Implikasi kajian ialah bank Islam mesti meningkatkan kecekapan penggunaan modal untuk meningkatkan keuntungan. Bank konvensional pula mesti menambah baik penilaian risiko dan menggunakan teknologi pengurusan risiko semasa untuk memperbaiki kestabilan kewangan. Di samping itu, sektor perbankan boleh memanfaatkan potensi keuntungan terpendam dengan berkembang ke negara lain, mengambil kesempatan daripada keuntungan bank Islam yang lebih tinggi.

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CHAPTER 1

INTRODUCTION

1.1 Introduction

Banking soundness and stability will greatly affect the ups and downs economy in a country. The bank with an adequate level of soundness is an obligation for an economy that wants to grow and develop very well. The occurrence of the global financial crisis showed that banking instability had a very large impact, the occurrence of this monetary crisis made the economy in a country weaken, the impact on the banking sector caused by the occurrence of this monetary crisis included a decrease in the general public's trust in the banking system in financial sector and it will take a long time to restore the grade of public trust in the banking system.

The characteristics of Indonesian banking have changed significantly over time. These changes are caused not only by internal banking factors, but also by external factors such as the real sector in the economy, politics, law, and society, interest rates, inflation, and GDP growth. At the period post global financial crisis which caused banking instability, there was also a global financial crisis that was also experienced by Indonesia, one of the impacts it caused was the slowdown in overall economic growth in Indonesia as indicated by the rate of economic growth in 2008, it only reached 6.1 percent. The rate of economic expansion has slowed compared to the previous year's rate of 6.3 percent.

Not only that, but another impact was also experienced, namely the decline in the balance of payments performance, which had an impact on the rupiah exchange rate. It may be stated that the global financial crisis demonstrated the importance of financial system stability in designing and maintaining a sustainable economy. An unstable financial system is more vulnerable to numerous shocks that destabilize the economy's wheels.

The development of the Islamic or Sharia system in Indonesia was motivated by the growing Muslim community in Indonesia accompanied by their awareness of the unfairness of conventional banking schemes. As the nation with the most Muslim citizens, Indonesia has become a pioneer and center to further the growth of Islamic finance so that Indonesians become prospective Islamic banking industry clients. The development of Islamic entities in Indonesia is increasingly showing a significant number. This development can be seen with the increasing number of Islamic entities among conventional entities. Islamic bank is a rapidly expanding financial industry (Azhar & Arim, 2016). Another advantage of the Islamic financial development structure is the regulatory regime which is considered better than other countries. In

Indonesia, The Indonesian Sharia Board, namely the Indonesian Ulema Council, has the power to issue Islamic financial fatwas, which is an independent institution. Current banking practices in Indonesia which are regulated in the Banking Law have several types of banks, when viewed from the determination of bank prices, they are classified as conventional banks based on interest and Islamic banks based on loss and profit sharing.

Islamic bank is the alternative system at the condition of global financial crisis. According to Bourkhis and Nabi (2013) global financial crisis represents a straight study to examine the difference of Islamic and conventional banks stability. The Islamic banking intermediation system is asset-based, with a focus on risk sharing and a mark-up system that requires all transactions to be conducted on actual assets, whereas the conventional intermediation system is debt-based, with a focus on risk transfers (Hasan & Dridi, 2010; Zarrouk, Ben Jedidia, & Moualhi, 2016).

Many indicators have contributed to the unprecedented rise of Islamic banking in recent years, mainly due to the increase in oil costs, in addition to the percentage of Muslims in the population. According to several analyses, Islamic banks appear to be enhancements rather than replacements for conventional banks. In this context, significant changes are being implemented to increase competition and promote the soundness and resistance of intermediaries in finance (Louati & Boujelbene, 2015).

According to Odeduntan, Adewake, Hamisu (2016) and Cham (2017) it has been stated that modern observation of Islamic banking is expanding at an astounding rate, to the point that many Muslim and non-Muslim nations have begun to align the industry of banking with sharia rules. The banking business is divided into two systems: conventional and Islamic banks, the operation of which is governed by numerous rules and regulations. According to Chakroun & Gallali (2013) Islamic banks are now a significant component of the economy and the world's financial leader, and they are expanding fast because of the opportunities they provide. However, profitability remains a critical component of those banks' business models. In this context, there is widespread consensus that Islamic banks are more efficient and less hazardous than conventional banks, and that they have a greater impact on economic growth than others.

According to Grais and Pellegrini (2006); Abdullah, Muhammed and Muhammed (2017) The Islamic industry plays an important role in economic growth, and this paper argues that there is a need to pay special attention to corporate governance in Islamic banks, as well as to unique agency concerns provided by the banking sector globally. Furthermore, the agency concept violates the principles and spirit of Sharia law because the main goal of the agency relationship is not to maximize shareholder profits (Abdullah et al., 2017). An issue with the agency might develop from the possibility of influencing the returns on deposited monies, because the deposit, unlike conventional banks, is susceptible to the bank's profit. According to Jusoh, Katmun, and Ismail (2014), the causal link utilized the standard agency theory, which validates management ownership as an essential driver of the company's success.

Islamic banks and conventional banks provide the same role, which is to intermediate and manage risks such as credit risk and liquidity risk. There are also distinctions in banking intermediation. Islamic banking intermediation is asset-based, with an emphasis on risk sharing, and all transactions must be conducted using actual assets, whereas conventional intermediation is debt-based, with a focus on risk transfer (Hasan & Dridi, 2010; Zarrouk et al., 2016). Bank intermediation is defined as a financial entity that receives funds from the public, distributes these funds to the public, and provides additional banking services. Aside from being an institution that collects and distributes funds (lending) from parties with excess funds to parties in need of funds, the bank also serves as an agent of trust, basing its business activities on public trust, and as an agent of development, serving as a national economic development agent. Banking is a type of business that seeks to make money and profits through its operations.

1.2 Background of Study

Islamic banks in Indonesia operate independently separated from conventional banks. Islamic and conventional banks held each intermediary function. According to Indonesia Accounting Association (2009) Banks are institutions that act as financial intermediary between parties who have excess funds with parties who need funds and institutions function to expedite payment traffic.

The worldwide financial sector, particularly the Islamic banking business, is expanding fast and dynamically. Currently, Islamic banks may be found in both Muslim and non-Muslim nations across the world (Zehri & Mbarek, 2016). The end of the 2008-2010 global financial crisis resulted in losses for most conventional banks in the United States and Europe, as well as Asia-Pacific nations, including Indonesia.

The global financial crisis led to bank rate increases to curb inflation, which responded with a conventional bank interest rate increase. Consequently, creditors affordable to pay the loan is decreased, meanwhile conventional banks must pay higher interest to depositors. In this case, conventional bank facing the high risk. This condition directly influence the conventional bank stability because the bank liquidity and profitability have decreased (Rashid, S. Yousaf & Khaleequzzaman, 2017).

The increase in interest rates does not influence Islamic banks directly because of the system of buying and selling as *murabaha* in the Islamic banks are based on a fixed rate for the margin where the amount does not change throughout the contract period. However, for *mudharaba* and *musharaka* system, the return such as profit and loss sharing will depend on performance of investors, possible global financial crisis will influence the return of Islamic banks as the financial crisis will influence the results of the investors to get optimal profit. Indirectly the Islamic banks return will be influenced by this condition (Hasan & Dridi, 2010; Čihák & Hesse, 2010; Beck, Jonghe, & Schepens, 2013).

The Islamic principle and law are the basic principles that guide transactions in the Islamic banking system, where the performance of Islamic banks is better supervised associated with Islamic principles such as profit and risk sharing, the prohibition of interest, the prohibition of speculation, the backing of real assets and the prohibition of investing in unlawful areas, the avoidance of leverage and debt refinancing are all Islamic concepts refinancing (Chakroun & Gallali, 2013 and Wahid & Dar, 2016).

The distinction between Islamic and conventional banks should be represented in the asset side, since Islamic banks have established interest-free financing products based on two principles: profit and loss sharing (PLS) and the markup concept (Hasan & Dridi, 2010; Bourkhis & Nabi, 2013). According to Bourkhis and Nabi (2013), the behaviour of Islamic banks appears to be similar to that of conventional banks, with virtually all Islamic bank transactions depending on markup financing mechanisms rather than PLS-based financing instruments.

Different from Čihák and Hesse (2010) and Khasawneh (2016), who compared Islamic and conventional banks' financial soundness in some countries based on size to compare industry banking level, this study will focus on the country level data of Indonesia's banking industry, based on size to compare industry banking level, measured by total assets Islamic and conventional full-fledged banks for the perioperative period.

1.3 Problem Statement

Depending on the degree of the banking business, there are many determinants of bank stability. Islamic banks are in a better financial condition than conventional banks. Because they focus on low-risk investment or deposit accounts and fee income, small Islamic banks are more stable than major Islamic banks. whereas major Islamic banks assume a larger risk with quickly expanding investment on financing contracts such as mudharabah and musharakah (Čihák & Hesse, 2010; Korbi & Bougatef, 2017). Some limitation of Islamic banks are the lack of experience and knowledge to adjust their financing risk management and transaction monitoring are becoming increasingly difficult as the degree of industry in which the banking business operates expands (Hasan & Dridi, 2010). Consequently, when functioning on a big scale, Islamic banks become less reliable.

During the global financial crisis, Islamic banks provide an alternative approach. The global financial crisis is a direct examination of the stability of Islamic and conventional institutions. Islamic banks in Indonesia operate independently separated from conventional banks. Islamic and conventional banks held each intermediary function. The Islamic financial intermediation system is asset-based, with a focus on risk sharing and a mark-up system that requires all transactions to be on actual assets, whereas the conventional intermediation system is debt-based, with a focus on risk transfers.

The phenomenon that exists in the banking sector in Indonesia as shown in table 1.1 is that profitability as measured by Return on Assets on Islamic banks is much lower than Return on Assets in conventional banks, whereas according to the concept from previous study of Islamic banks it is more stable than conventional banks.

The recent global financial crisis has drawn attention to several flaws in the banking system (Khasawneh, 2016). The global financial crisis led to a conventional bank interest rate increase so that the system of Islamic banking as an alternative solution to overcome the crisis because rising interest rates have no direct impact on it, making it more stable (Hasan & Dridi, 2010; Beck et al., 2013). Islamic bank not admitted deposit or investment account as liability, because the financing is based on profit and loss sharing contract, which means that Islamic banks are not accountable for money losses. The capital structure of Islamic banks do not include debt (Al-Deehani et al., 2015).

Table 1.1
Return on Assets of Banks (In per cent)

Year	Return On Assets	
	Islamic Banks	**Conventional Banks**
2013	1,36 %	1,72 %
2014	0,91 %	1,32 %
2015	0,49 %	0,94 %
2016	0,63 %	1,15 %
2017	0,63 %	2,38 %
2018	1,28 %	2,55 %
2019	1,73 %	2,47%
2020	1,40 %	1,59 %
2021	1,55 %	1,85%

Sources: Indonesian Banking Statistics, 2011- 2021

In the period following the global financial crisis, bank supervision focused on bank performance and financial stability, including Islamic banks industry which has different operational from conventional banks, therefore it is important to understand the behaviour of Islamic banks, especially those related to system of bank stability (Rokhim & Gamaginta, 2011). When a company's growth matches that of the Indonesian banking industry, the Islamic banking industry remains under pressure due to low growth in financing and asset quality. An examination of the stability of Indonesian Islamic banks is very critical particularly, because based on Central Statistics Office data in 2017 about 85% of the 265 million people in Indonesia are Muslim. Global Islamic Finance Report (GIFR), 2017 showed Islamic Finance Country Index (IFCI) Indonesia ranked seventh country that has potential conducive to following Malaysia, Iran, Saudi Arabia, and the United Arab Emirates, the growth of the Islamic banking industry, Kuwait, and Pakistan. In the previous year Indonesia was ranked sixth. Factors assessed in IFCI, including the size of the Islamic financial services industry, sharia supervisory regime, the Muslim population, education and culture, Islamic regulations and law (IFCI, 2017).

Currently the Islamic Bank's business growth is still strongly influenced by global financial pressures that plagued strong enough for the Indonesian economy. The asset growth of banking industry in 2017 stood at 9%. Based on data from the Financial Services Authority (FSA) in table 1.1 it appears that although total assets of banks always increase year by year in 2011 to 2016, but the asset growth of Islamic banking industry from the years 2011 to 2015 have decreased. In 2015, the asset growth of Islamic bank rose only 4% from the previous year asset growth of 14%, up 8.4 trillion to Rp.213,4 trillion in December 2015 from the previous year which recorded Rp.204, 9 trillion. Although in 2016 the growth of total assets increased but in 2017 there was a drastic decline in total assets so that total asset growth also fell. Furthermore, total asset growth increased sharply in 2018 from -9% to 29%, but total assets fell again in 2019. Total asset growth increased from 8% to 12% in 2020, with a slight decline in 2021. (*Indonesian Banking Statistics*, 2011-2021).

Table 1.2
Total Assets of Banks (In Rupiah Trillion)

Year	Islamic Banks		Conventional Banks	
	Total Assets	Growth	Total Assets	Growth
2011	116,9	48%	2772,1	17%
2012	147,6	26%	3744,4	26%
2013	180,4	22%	3684,5	(2%)
2014	204,9	14%	3437,1	(7%)
2015	213,4	4%	4589,7	25%
2016	253,9	19%	5240,9	12%
2017	231,2	(9%)	6391,5	18%
2018	298,4	29%	8068,4	26%
2019	323,4	8%	8562,9	6%
2020	362,7	12%	9177,9	7%
2021	401,5	11%	10112,3	10%

Sources: Indonesian Banking Statistics, 2011- 2021

Conventional banks' total assets are significantly more than Islamic banks' total assets. The total asset of conventional banks growth in 2012 increase from 16% to 26% and the following year saw a sharp decline to 2% in 2013 and a decrease of 7% in 2014. Moreover, despite a drop from 25% to 12% in 2016, total asset growth improved again in 2015, rising to 18% the following year. Furthermore, total asset growth increased from 18% to 26% in 2018, but fell again in 2019. Total asset growth increased a bit from 6% to 7% in 2020, and increased even more in 2021. Financial resilience is the primary driver of economic growth since again financial system facilitates most economic transactions. The banking industry provides financial services that have relevance to economic development. Stability and the economy's growth is dependent on the magnitude of the stability of the banking sector (Tabash & Dhankar, 2014).

The distinction between Islamic and conventional banks in the ideal concept is that the relationship or bond between the Islamic bank and its customers is not a bond between debtors and creditors, but a partnership relationship between funders and fund managers. As a result, the profit level of Islamic and conventional banks impacts not only the profit-sharing rate for shareholders, but also the profit-sharing rate available to consumers who deposit cash. Thus, the capacity of an Islamic bank's management to carry out its duty as a repository of assets, entrepreneurs, and professional investment managers will have a significant impact on the quality of its business as an intermediate institution and its ability to produce profits.

As an important Islamic and conventional banking institution in the economy, it is necessary to have good performance monitoring by banking regulators. The firm places a high value on performance because the banking industry is based on trust. Banks must be able to demonstrate their trust so that more and more people would conduct transactions with them, one of which is by growing profitability, which will enhance bank stability. This is related to the extent to which the bank can run its business efficiently, which means that the bank can run its business and is measured by comparing profits with assets or capital. The higher a bank's profitability, the better the bank's performance and the more stable the bank.

1.4 Objective of Study

This study aims to compare the determinant of stability for Islamic and conventional banks and examine factors that influence Islamic and conventional banks stability during and post global financial crises. The following research objectives are addressed:

1. To determine the level of Bank Specific, Market Concentration, Macroeconomic Indicators, and Bank Stability for Islamic and conventional banks during and post global financial crises
2. To examine the differential of Islamic and conventional banks stability during and post global financial crises
3. To examine the influence of Bank Specific, Market Concentration, and Macroeconomic Indicators on Islamic and conventional banks stability during and post global financial crises

1.5 Research Questions

Based on the research objectives stated, the following research questions are addressed:

RQ1. What are the levels of Bank Specific, Market Concentration, Macroeconomic Indicators, and Bank Stability for Islamic and conventional banks during and post global financial crises

RQ2. Are there significant different of Islamic and conventional banks stability during and post global financial crises

RQ3. Do Bank Specific, Market Concentration, and Macroeconomic Indicators have significant influence towards Islamic and conventional banks stability during and post global financial crises

1.6 Hypothesis

Based on the research questions stated, the following hypotheses are addressed:

Ho_1: There is no significant difference of Islamic and Conventional banks stability

$Ho_{2.1}$: There is no significant difference of Islamic and Conventional banks stability during global financial crisis

$Ho_{2.2}$: There is no significant difference of Islamic and Conventional banks stability post global financial crisis

Ho_3: Bank Specific, Market Concentration, and Macroeconomic Indicators have no significant influence on Islamic and conventional banks stability during and post global financial crisis

$H_{o3.1}$: Capital Adequacy Ratio has no positive significant influence on Islamic and conventional banks stability

$H_{o3.2}$: Size has no significant influence on Islamic and conventional banks stability

$H_{o3.3}$: Profitability Ratio has no positive significant influence on Islamic and conventional banks stability

$H_{o3.4}$: Efficiency Ratio has no significant influence on Islamic and conventional banks stability

$H_{o3.5}$: Liquidity Ratio has no positive significant influence on Islamic and conventional banks stability

$H_{o3.6}$: Credit Risk Ratio has no negative significant influence on Islamic and conventional banks stability

$H_{o3.7}$: Income Diversity has no significant influence on Islamic and conventional banks stability

$H_{o3.8}$: Market Concentration has no positive significant influence on Islamic and conventional banks stability.

$H_{o3.9}$: GDP Growth Rate has no significant influence on Islamic and conventional banks stability

$H_{o3.10}$: Inflation has no negative significant influence on Islamic and conventional banks stability.

1.7 Conceptual Framework

Differences in basic operations of conventional banks In carrying out its responsibilities as an intermediate bank, most banks rely on debt and enable the transfer of risk, whereas Islamic banks rely on assets (asset-based) and place a focus on risk sharing (Hasan & Dridi, 2010), more often known as a profit-and-loss sharing premise Islamic banking is likewise prohibited by Islamic law from speculative and uncertain transaction that could potentially harm either party (Rokhim & Gamaginta, 2011).

Islamic and conventional banks have different intermediation concepts. Islamic banking is asset-based and focuses on risk sharing, whereas conventional banking is primarily debt-based and allows for risk transfer. According to Hasan and Dridi (2010), the primary distinction between Islamic and conventional banks is that the loss and profit-sharing model prohibits investing in or financing the types of instruments that contributed to the global financial crisis. Derivatives and conventional financial institution securities are examples of such instruments. Islamic banks, according to Karim (2001), use various accounting methods for investment accounts. While some banks report these treatments as equity or liabilities, others report them as off-balance-sheet accounts, which can conceal negative information about investment accounts, such as losses caused by misconduct or negligence. The following figure is a summary of the concept of the intermediation function of Islamic banks and conventional banks according to Hasan and Dridi (2010), Chakroun and Gallali (2013), Zarrouk, et al (2015), and Wahid and Dar (2016).

According to Bourkhis and Nabi (2013), the financial crisis provides an excellent opportunity to evaluate the gap between the two banking models. Islamic banks have shown some resilience and stability in the face of the recent crisis, but they have suffered because of this, their increased vulnerability to real estate and their limited reliance on risk-sharing. Either deposit or investment accounts is both Islamic and conventional banks' primary source of funding. Basically, conventional banking operational system based on interest. Conventional banks admitted deposit or investment as bank liabilities, this mean capital structure of conventional banks including debt and equity. This is causing the bank will be facing the higher risk along higher liabilities. Based on Islamic rules, Islamic banks is prohibited to pay or receive interest. In Islamic banks deposit or investment accounts is facing neither a liability nor equity, causing free of risk (Al-Deehani et al., 2015).

Rashid et al (2017) argue the global financial crisis prompted banks to raise interest rates to combat inflation, which was met by conventional bank interest rate increases. As a result, creditors' ability to repay the loan is diminished, while conventional banks must pay more interest to depositors. In this situation, the conventional bank is exposed to a significant level of risk. Because bank liquidity and profitability have deteriorated, this circumstance has a direct impact on conventional bank stability.

The Different of Islamic and Conventional Banks

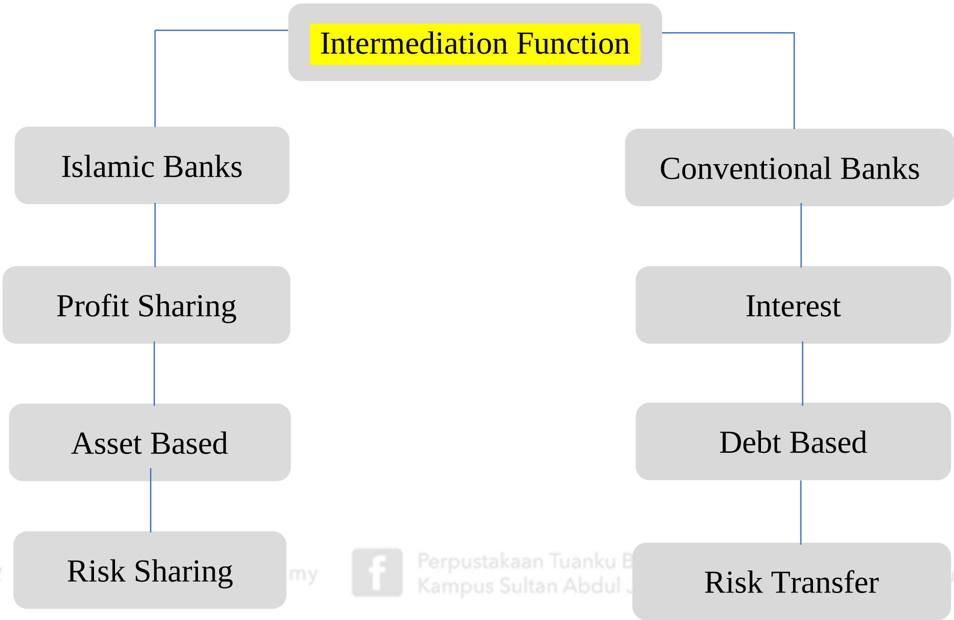

Figure 1.1. The Concept of Intermediation function of Islamic and conventional banks Summarized from Hasan & Dridi (2010); Chakroun & Gallali (2013), Zarrouk, et al (2015), Muhammad & Humayon (2016).

The method of buying and selling in Islamic banks is based on a fixed rate for the margin, which does not vary throughout the contract duration, thus an increase in interest rates has no direct impact on them. However, for the mudharaba and musharaka systems, the return, such as profit and loss sharing, will be determined by the performance of the investors. A possible global financial crisis will influence the return of Islamic banks, just as a financial crisis will influence the results of the investors to maximize profit. This circumstance will have an indirect impact on the return of Islamic banks (Hasan & Dridi, 2010; Čihák & Hesse, 2010; Beck, Jonghe, & Schepens, 2013).

This is not the case with Sharia-compliant Islamic banks. The profit-sharing system, on the contrary, allows the global financial crisis to affect the return of Islamic banks because the global financial crisis affects the profit sharing of entrepreneurs as customers to generate optimal profits. A rise in rate of interest makes depositing funds in conventional banks more appealing, but this increase in interest rates would not be appealing to investors who would face a higher tax burden. Meanwhile, rise in interest rates would dissuade people from saving money in Islamic banks because the margin level is lower than the interest rate on conventional bank deposits. Islamic banks, on the other hand, would be more profitable for investors because the margins charged to Islamic bank investors are lower than those charged to conventional bank investors. The following figure is a summary of the concept of the financial crisis effect to the financial stability of Islamic and conventional banks according to Shafique (2012), Bourkhis and Nabi (2013), Zarrouk, et al (2015), and Wahid and Dar (2016), Rashid, et al (2017).

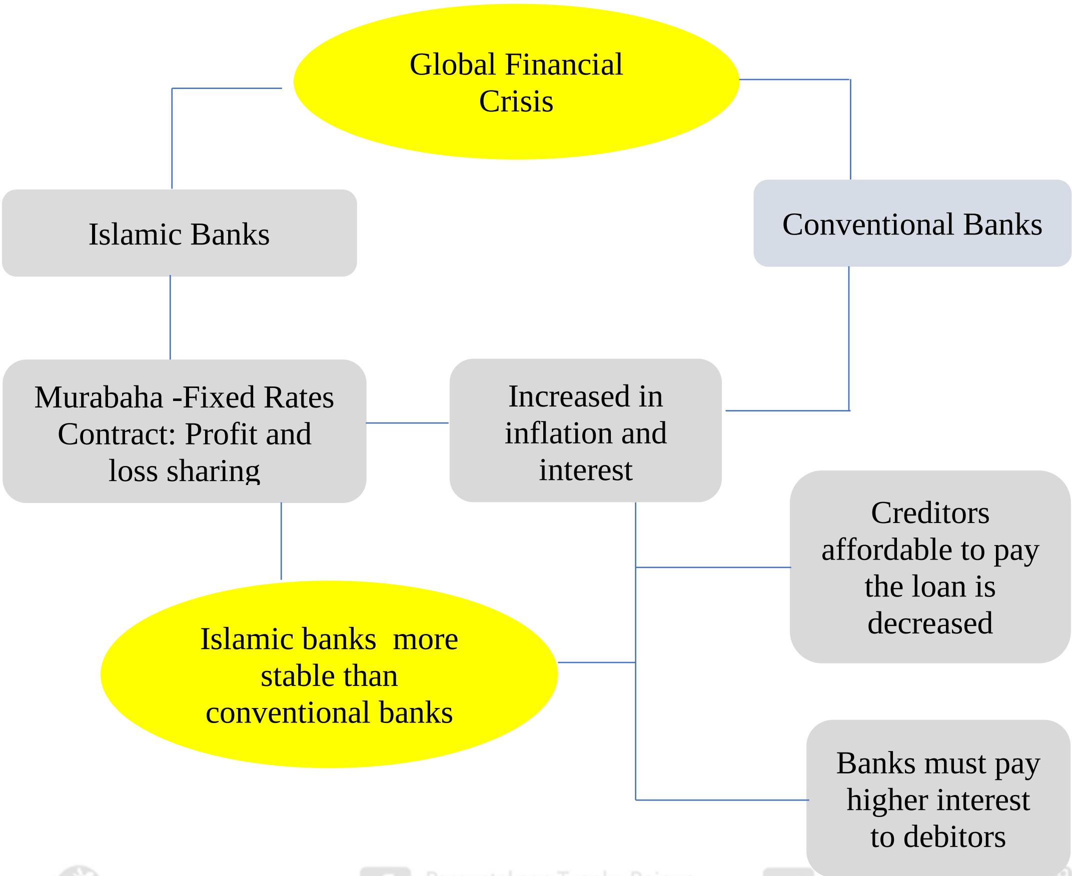

Figure 1.2. The Concept of Financial stability of Islamic and conventional banks summarized from Shafique (2012), Bourkhis and Nabi (2013), Zarrouk, et al (2015), and Wahid and Dar (2016), Rashid, et al (2017).

According to Čihák and Hesse (2010) and Rashid et al. (2017) financial stability can be influenced by internal and external indicators. Internal indicators that are bank specific related to the scope of bank capital adequacy, size, efficiency, profitability, liquidity, credit risk, and income diversity. External indicators are market condition and the macroeconomic indicators that are measured by GDP Growth Rate and Inflation.

Following previous study that have been done by Čihák and Hesse (2010), Shahid and Abbas (2012), Chakroun and Gallali (2013), Wahid and Dar (2016), Korbi and Bougatef (2017), Rashid et al (2017) about bank financial stability during and post financial crisis, this study compares the stability of Islamic and conventional banks in

Indonesia by examining bank stability that are examined by z-score and controlled by bank specific indicators, market concentration, and the macroeconomic indicators over the period between 2008 and 2017. This covers the period of during and post Global Financial Crisis (GFC) when during crisis period between 2008 and 2010 and post GFC period between 2011 and 2017.

This study examines the stability of Islamic and conventional banks in Indonesia especially during global financial crisis between 2008 and 2010 and post global financial crisis between 2011 and 2017 and their influence to the overall financial stability. Besides that, this study compares the determinants of Islamic and conventional banks stability which include the influence of global financial crisis on banks stability. Research framework for this study is as in Figure 1.3.

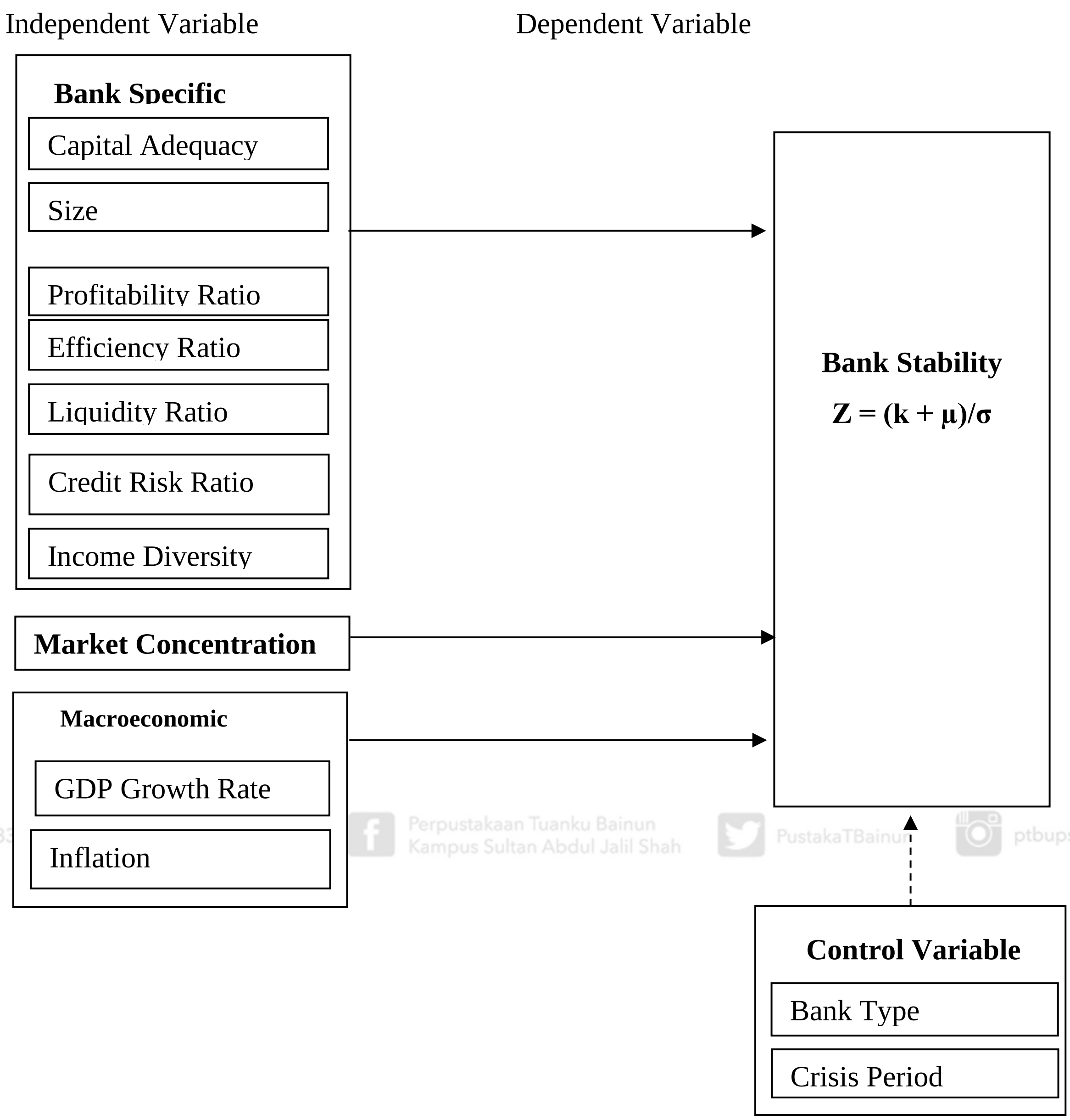

Figure 1.3. Conceptual Framework

1.8 Significance of Study

Financial stability is extremely important in the economy. This is because the financial system in an economic chain is tasked with channeling funds from excess or surplus parties to those with deficiencies or deficits. A bank, as a financial institution, for instance, has the goal of collecting funds from those who have excess mostly financial products such as savings and time deposits and channeling them back to those who lack capital such as through loans or credit (Rashid, et al., 2017).

If this financial system becomes inefficient and unstable, the distribution of funds will be disrupted, which can significantly slow the rate of economic growth on a larger scale and even trigger a crisis. This is because the national economy's wheel is heavily reliant on the stability of the financial system, so any instability will have a significant impact. It would be a different issue if the opposite appeared; in other words, the financial system is important to a country's economic sovereignty. In general, an unstable financial system can create a variety of unfavorable conditions for both the community and the government.

As a major Islamic and conventional financial institution in the economy, good performance monitoring by banking authorities is required. Because the banking industry is one of trust, banks must be able to demonstrate their credibility so that more people will do transactions at the bank, one of which is by boosting performance, which in turn will enhance bank stability. This is connected to the bank's ability to conduct its business efficiently, which indicates that the bank can manage its business, and is assessed by comparing earnings to assets or capital. The higher a bank's profitability, the better the bank's specific performance and the more stable the bank. If the bank's specific performance is excellent, the level of public faith in the bank rises; if the bank's performance falls, the amount of public trust in the bank falls as well. Management may examine the company's progress by analysing its financial performance using ratio analysis of banks specifics, while to determine the influence of external factors using market concentration and macroeconomic indicators.

Banking stability is important as it represents a sound financial system, which in turn reinforces trust in the system and prevents phenomena such as bank runs, which can significantly change an economy. Furthermore, the banking sector that expands, increases capitalization, and manages risk properly will achieve high profitability, which will have an impact on the bank's stability. According to Kasri & Azzahra (2020) bank stability is critical to ensuring that the country’s banking system is more capable of assisting monetary policy transmissionand more robust in the event of financial crises.

According to Chakroun and Gallali (2013) The study of the determinants influencing bank financial stability has an important place in banking and finance literature. Following the establishment and expansion of the Islamic finance system, a new challenge in this area gave rise: the building of an ethical financial system in which moral standards are generally derived from Sharia law, which varies from the foundation and principles of the conventional system.

Meanwhile, according to Tabash and Dhankar (2014) There is no dispute that the growth of the Islamic finance industry is critical to overall economic development and stability. The significance of this study stems from the fact that Islamic financial stability is a significant industry in the globe. This system is linked to the community and has both good and bad effects on the economy. A fourth of the world's population is Muslim, who are concerned about the demand for Islamic-law-based financial goods from both Muslim and non-Muslim clients.

According to Rashid, et al (2017) a stable financial system and a straight function contribute positively to bank stability. Milhem and Istaiteyeh (2015) states that the evaluation of the financial performance of banks depositors, investors, management, and regulators must all be aware of this, and if the bank is efficient, then will increase profitability, the increase in the number of financings, the price and quality of services better for consumers and safety and soundness better. The application of sharia compliant is a clear difference on the business model of Islamic and conventional banks and to further improve the Islamic banks' efficiency and stability, with the argument that Islamic and conventional banks use different forms but have the same essence.

1.9 Limitation of Study

The current study includes numerous limitations that may affect the interpretation of the results. These limitations should be considered when interpreting the findings or using the approach of this study in order research contexts.

A drawback of this study is the use of a market structure indicator to assess bank stability. The limitation of this study is that, while all the sample conventional banks were listed on the Indonesia Stock Exchange (IDX), measurement of financial market structure was not used in this study because most Islamic banks in Indonesia were not listed, so measurement of market share used the Herfindahl Index (HHI) following Cihak and Hesse (2010). Most Islamic banks in Indonesia are not publicly traded. The market-based indicator could not be used to evaluate bank stability in this study due to a lack of market data for Islamic banks. Other techniques of assessing stability might be investigated in future study on the stability of Islamic banks.

Beside from the limitations mentioned above, this study only looks at the stability of Islamic and conventional banks in one nation. Meanwhile according to Batir, et al (2017), most researchers suggest that next research should be done about comparing and examining stability from different countries to provide global financial stability.

1.10 Summary

The global financial crisis caused a slowing of global economic growth in Indonesia. In comparison to the previous year, the rate of economic growth has slowed compared to the previous year's rate of 63 per cent in 2007. The decline in the balance of payments performance also had an impact on the rupiah exchange rate. It can be concluded that the stability of the financial system is a critical factor in developing and maintaining a sustainable economy.

As the financial system facilitates most economic transactions, financial stability is the primary instrument for economic growth. The banking industry provides financial services that are important for economic growth. The extent of the banking sector's stability determines economic growth and stability. Previous research has been conducted on the measuring of bank stability utilizing the insolvency risk indicator using Z-score models. Because the financial system facilitates most economic transactions, financial stability is the primary instrument for economic growth. The banking industry provides critical financial services for economic growth. The extent to which the banking sector is stable influences economic development and stability.

In Indonesia, Islamic banks operate independently of conventional banks. Both Islamic and conventional banks performed each intermediate role. According to regulation, conventional banks and Islamic banks are divided into full-fledged banking and rural banks based on bank industry level. Islamic banks have employed profit and loss sharing (PLS) and the markup principle to develop interest-free lending instruments. Almost all Islamic banks prefer markup financing over PLS-based financing. Because Islamic banks have fewer assets to sell, the difference between them and conventional banks should be reflected on the asset side.

Islamic banks are in a better financial condition than conventional banks. Small Islamic banks concentrate on low-risk investment or deposit accounts, as well as fee income. Large Islamic banks take on more risk as their investment in financing contracts such as mudharabah and musharakah expands rapidly. Some of Islamic banks' limitations include a lack of experience and knowledge in adjusting their financing risk management. The current global financial crisis has highlighted several weaknesses in the banking system. Rising interest rates have no direct impact on Islamic banks, making them more stable. Because the financing is based on a profit-and-loss sharing contract, Islamic banks do not accept deposit or investment accounts as liabilities. Debt is not included in the Islamic banks' capital structure.

Due to low growth in financing and asset quality, the Islamic banking industry is under pressure. When it comes to the expansion of the banking sector in Indonesia, the Islamic banking industry remains under pressure. Islamic banks operate differently than conventional banks, especially in terms of bank stability. As an important Islamic and conventional banking institution in the economy, good performance monitoring by banking regulators is essential. Because the banking industry is founded on faith, Banks must be able to establish their trustworthiness for more individuals to trade with them. The higher a bank's profitability, the better the bank's performance and stability.

This research investigates at the stability of Islamic and conventional banks in Indonesia, notably during the global financial crisis of 2008-2010 and the post-global financial crisis period of 2011-2017, as well as their influence on overall financial stability. Furthermore, this research analyses the factors that influence Islamic and conventional banks stability, as well as the impact of the Global Financial Crisis on bank stability.