

Generic Sharia Governance and Expertise in Indonesian Digital Islamic Bank Ecosystem

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Abstract

The implementation of Islamic Bank is still way too far from maturity due to the fact that questionably asymmetrical practices and letterlijk practices of Syariah Compliance. It's no wonder that consumers have troublesome experience in distinguishing between the Islamic Banks and the conventional counterparts, leading them to believe that the Islamic Banks have the same process with the conventional ones come with only labels to differentiate. Indonesia comes with the advantage of moderation, but in the other hand, it offers the dynamic demand of Islamic Bank adoption than makes the infant Islamic Bank practices become even more challenging in this digitalization. On this subject, the capacity of Islamic banks to maintain current customers loyalty while attracting new ones by demonstrating the generic value of Islamic Bank as implemented in good corporate governance and sharia expertise human capital is a significant determinant of the Islamic banks performance and sustainability in the digital industry. This meta-analysis, based on recent studies, provides a broader perspective of Islamic Bank, stating that Islamic Bank is more than just a unique system based on specific compliance to specific rules (Sharia Law), but the implementation of Good Corporate Governance and Sharia Expertise Human Capital, both of which serve as the generic product of Islamic Bank. This study allows banking supervisors, boards of chiefs, and other stakeholders to be more proactive in the current ongoing sharia governance discourse and raise concerns about the current implementations.

Keywords : Market Digitalization, Islamic Bank, Intellectual Capital, Credibility, Market Value



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INTRODUCTION

Despite the fact that modern Islamic Banking (Islamic Bank) has been studied for hundreds of years, its implementation is still far from mature due to the prevalence of questionably asymmetrical practices and letterlijk practices devoid of spirit in Islamic Bank. It is unsurprising that consumers see similarities between Islamic Bank and conventional banking, and as a result, they believe Islamic Banks and conventional banks are actually the same thing with different labels (Ariff, 2014). To accommodate the diversity of Islamic perspectives, Indonesia has been known to practice moderate Islam. On one hand, this has the advantage of moderation, but on the other hand, it provides a dynamic demand for Islamic Bank adoption, making the Islamic Bank practices even more difficult. Even though the country has adopted Islamic views as part of its legal power, the implementation of Islamic views in commerce (muamala) is entirely voluntary and optional (Otto, 2010). Such proves that the implementation of Islamic Bank is still-on-progress and implies that more effort is needed to approach the dynamic nature of Islamic Bank ecosystem in Indonesia, especially the marketing viewpoints which even more needed in such voluntary Islamic Bank adoption, despite the fact of compliant nature in most Islamic Bank consumers.

Disagreement about whether a banking transaction are halal (permitted) or haram (forbidden) due to the different interpretations of Sharia is widespread among Islamic Bank practitioners and outsiders (Evans, 2014). This dynamic is even more pronounced in Indonesia, where being moderate allows for a variety of Islamic activities, particularly in the optional muamala rituals (Otto, 2010). Such circumstances highlight the importance of qualified human capital and strong governance within the Islamic Bank, allowing them to take proactive steps toward a dynamic ecosystem rather than relying on the complying Islamic Bank's rigidity.

Islamic Banks experience more competitions in the business, not only among the banks which use the same Islamic frame of value, but also among the Islamic banking windows which are actually belong to the conventional banks, offering Islamic bank products as alternatives. In this extremely challenging environment, Islamic banks must improve their delivery and attract new customers as well as keep existing ones to stay loyal. It is especially challenging to retain existing consumers in this day and age of digital information and communication technology since customers obtain information about the banking services alternatives available on the market at ease. Customer satisfaction coming from service quality becomes increasingly crucial in their decision and retention as the competition heats up (Abduh *et al.*, 2013). Therefore, generic sharia spirit as implemented in the good corporate governance and the sharia expertise human capital are highly needed to make difference between the real Islamic Bank and those counterparts, which will benefit Islamic Bank in the long run.

LITERATURE REVIEW

Islamic Bank and The Recent Challenges

The distinctive aspect of Islamic banking is the real market transaction in every banking transaction. As a result, Islamic financials are based on real assets, all transactions including sharing, exchange or contracts of agency have to involve the real assets with clear ownership (AAOIFI, 2010). Predatory lending (riba) is often acknowledged as the most significant characteristic of Islamic banking, although some Islamic scholar claim that there are different opinions about exploitative riba and harmless time value interests (Ariff 2014). Besides the prohibition of the use of interest (riba), the prohibition in speculation and guesswork (Maysir and Gharar) in the bank operations also be the another key of Islamic Bank differentiation (Ayub, 2007). Islamic banks apply distinctive business models such profit-loss sharing and partnership in equity, so certain methods of accounting are required to accommodate these features. It is crucial for sharia governance to protect these principles, limiting the consequences associated with any noncompliance of Sharia. One organization that is central for such governance is the Sharia Board, which is responsible with the assessments and supervisory mandates, to guarantee Sharia conformity (AAOIFI, 2010). It is acknowledged as a unique corporate governance component for Islamic Banks (Magalhaes and Al-Saad, 2013) and provides some "social wellbeing purposes" (Choudhury and Hoque, 2006).

Uncertainties within the current global financial market is pivotal in part of the continued demand for Islamic bank. Conventional bank customers see the available Islamic Bank services as viable alternatives to their conventional way. Thus, many conventional banks have begun to offer Sharia banking products and services, either by establishing another complete Islamic subsidiary or by utilizing Islamic banking windows (Kader *et al.* 2014). Customer switching behavior in Islamic Bank services is influence by the five determinants: the bank customer relationship, service quality, the sharia compliance, the perceived risk and finally the switching cost (Suryani and Chaniago, 2011),

and finally consumer perceived value on Islamic Bank has a considerable impact on customer satisfaction, ultimately influences the switching intention (Hashim and Latifah, 2010)

Sharia Consumers Compliant Nature and Its Challenge for Good Corporate Governance Practice

Religious motivation is a unique aspect to consider in the customers option of Islamic banking, as the distinctive operations in Islamic bank are based on the compliance of specific muamala rule as cited in the Islamic holy scriptures. It has been discovered that the adherence to the religious value are extremely important criteria for Islamic bank customers (Khan *et al.*, 2008). Furthermore, study conducted by Lee and Ullah (2011) discovered that customers would induce customers to switch banks due to the repeated sharia violations.

According to the 'Agency Theory,' the managers' interests differ from those of the fund providers, resulting in unfavorable decisions by the managers. Agency theory describes how banking schemes, norms rules and routines are anchored as mandatory guidelines for the change and social life within the institution (Dacin *et al.*, 2002). A number of previous studies confirmed the effectivity of internal governance of the banking industry, compared to the control of external forces (Cornett *et al.*, 2009; Leventis, 2012; González & Meca, 2014; Abdelsalam *et al.*, 2016; Mattoe & Francisco, 2018). Giving such complexity, the agency issues, tight regulations, and significant information gaps between outsiders and insiders have brought difficulties in external management supervision (Mersni & Othman, 2016). Because the actual Islamic value system protects stakeholders' rights fairly as its basic principle, it is a misconception to address that proper corporate governance is not needed in Islamic banks (Chapra and Ahmed, 2002). In fact, Islamic banks are no less vulnerable than the conventional counterparts to the risk, or even failure, as a result of corporate governance violations. The failure of Ihlas Finance House in Turkey, and other fraud cases at Dubai Islamic Bank during 2004 until 2007 proved the urgency of establishing corporate governance within the Islamic Bank, regardless their adherence on value of devotions (Ginena, 2014).

If there is insufficient disclosure or transparency, stakeholders may fail to recognize Shari'ah violations. As a result, potential risks within the implementation of Sharia may left unnoticed until it is too late. In the aftermath of the financial crisis, the potential risks will finally be exposed. Hasan (2012) reported on his study that the basic facts in Islamic Bank operations such as the resolutions passed, products approved, and number of meetings held, left unattended in the annual reports. Furthermore, more transparency is required to allow stakeholders to examine fatwa and the consideration evidences, as the absence of adequate evidence is found in the most sharia board rulings nowadays (Hasan, 2012). Product and contract approvals are requested in every transaction, giving enough protection against sharia risk. Many Islamic banks do not update their documents or fatwa on the websites properly, resulting the bad impression of Islamic bank concealing something from the public (Haniffa and Hudaib, 2007).

Sharia Expertise Urgency for Long Term Islamic Bank Practices

Several evidences indicating that human capital investments are positively related to firms' value-creation processes (Crook *et al.*, 2011, Chang, 2015). Simultaneously, with the advent of the economic study, it has become necessary for firms to nourish knowledge workers in order to create and maintain a competitive advantage to survive in the market (Hislop, 2013). Swart (2006), on the other hand, suggests distinguishing "firm- and industry-specific" human capital investments. Human expertise serves as a unique advantage that is difficult for competitors to replicate (Kim and

Gong, 2009), especially the Sharia-knowledge. Islamic Banks are ambidextrous (Kang and Snell, 2009), organizations in that they provide alternative banking solutions while adhering to divine guidelines, so the organizations must invest equally in banking and Sharia-specific human capital. Committing to make ethical banking adoption widespread among society, Islamic Banks are utilizing different structural capital, such as digital banking system to provide update publication. Hence, they should invest not only in the technical aspects but also the human capital.

The problem is, fatwa risk on Sharia Boards may be exposed due to the possible chance that a fatwa can be incorrect, vague, or too complex. In this case, there is possibility that Sharia Board misinterpreting a situation to mean something they do not. This could be the consequence of insufficient investigation or negligence. If Sharia Board failure to solicit legal counsel's feedback on the development of their fatwa, they may receive some misrepresentations. Bringing together relevant department representatives in certain meetings are required for Sharia Boards to develop precise and holistic grasp of matters and finally publish fatwa correctly (DeLorenzo, 2007).

The Propositions:

- 1) The first proposition: Corporate Governance Implementations serves as generic product of Islamic Bank will retain Islamic Bank consumer loyalty.
- 2) The second proposition: The expertise of sharia human capital serves as generic product of Islamic Bank that will retain Islamic Bank consumer loyalty.

RESEARCH METHODOLOGY

To test aforementioned propositions, we conducted meta-analysis of prior studies on the evidence of the effect of good corporate governance practice and sharia expertise on the consumers decision, either for adopting new Islamic Bank or their retention behavior. Meta-analysis is analytical technique that combines the findings of multiple primary studies (Bennett & Huffcutt, 2011). Due to the limitation of the paper, the result expresses all in one with the perspective offered in the following parts of the paper.

FINDINGS

Generic Sharia Spirit and Expertise as Market Value Determinant in the Dynamic Islamic Bank (Meta-Analysis)

Good Corporate Governance Practice as Generic Product of Islamic Bank

The agency problems in Islamic financial institutions are distinct from those in other financial institutions, resulting the urgency to separate and address distinct approaches to examine and finally resolve the issues. Maximizing shareholder benefits is not only the job to be expected in Islamic banks managers, but they are also required to follow Sharia regulations (Nawaz, 2017). Both account holders and Islamic banks have contracts in place, allowing them get Internal Attitude Hold uninvolved in the decision and their financial management. As a result, the managers tend to unproportionally publish profits than the losses. For instance, the contracts exacerbate agency-related issues (Bukhari *et al.*, 2013). Banks that provide Sharia's-compliant services should be subjected to a separate section of scrutiny because they are not only expected to upscale the invested value of their shareholders, but also to conduct all of their operations in accordance with the sharia (Safieddine, 2009).

Maintaining the efficient and cost-effective supervision system is pivotal in the good corporate governance. It gives supervisors more assurance to count on the bank's internal processes, protects the funds and solves the problems during the hard times of financial distress (BCBS, 2010). Supervisors are supposed to seek additional involvement in finding appropriate solutions and be more careful with their implementation from the Board of Directors. Good bank governance improves not only the better performance and easier external financial access, but also resulting in stable financial system and the community benefits by contributing to people welfare (Grais and Pellegrini, 2006).

Sharia governance is the holistic system that govern Islamic banks adherence to Sharia beliefs that apply to all commercial transactions within. Sharia governance study covers a wide range of topics because the topic involves a wide range of stakeholders and issues. In emphasizing the topic's significance, Ali's (2003) and Chapra and Ahmed's (2002) studies asserted that Sharia noncompliance could result in excessive pullout of the funds, leading to bank failure; thus, the structure of Islamic Bank should be upgraded to guarantee their conformity to Islamic value.

An Islamic bank that claims the adherence to the tenets of sharia but proves poor delivery on that claim may face lawsuits from who are dissatisfied with the false advertisement. This possibly cause trust issue in the Islamic Banks' integrity due to the "possibility of adverse publicity about a bank's business practices and associations, whether accurate or not." (BCBS, 2006), as earning and maintaining customer trust is critical for the Islamic Bank. Losing their credible reputation is easy when their commitment to Sharia is questionable (Archer and Haron, 2007).

Sharia Expertise Human Capital as Generic Product of Islamic Bank

A fatwa may be incorrect if the Sharia Boards have insufficient experience. Furthermore, a fatwa that is elusive or lacks proofs and explanations may lead to employees making incorrect assumptions and interpretations. Moreover, such fatwas may lack clear guidance's for implementation, resulting in unintended consequences. If fatwa delivered being too complex, their legal jargon cannot be properly translated by practitioners, thus may result in failure (DeLorenzo, 2007).

The key talent, such as the chief of internal Sharia coordination, may also lead to Sharia risk if the position is left unattended properly. This is also possible if the department relies on merely individual rather than make it a proper system which allow the knowledge being transferred, preserved, and organized. When the Sharia Boards issue a precedent fatwa, the internal Sharia coordination department follows. But what if the organization never recorded fatawa in the archives, and relied on the key talent who left? While other people may attempt to reconnect with the fatwa, this allows the possibility of errors in recollection and sharia risk (Ginena, 2014).

According to Dotzel *et al.* (2013), Human Capital Investments is a pivotal organizational capacity that highly correlates to the proclivity of innovation for customer satisfaction and increasing the value of the firm. The knowledge-based view, which completing the resource-based view, emphasizes the knowledge within the human resource as the vital competitive advantage for the organization. Strategic management literatures highlight the influences of human capital toward firms' market value (Crook *et al.*, 2011). Being intellectual capital, human resources are expected to have not only knowledge and skills related to the conventional banking practices, but also good

Sharia knowledge, human capital is important aspect in every Islamic Bank as this will enhance Islamic Banks' credibility and reputation.

DISCUSSION

It is comprehensible that Islamic Bank focuses on providing generic Shari'a alternatives based on the compliance to the value in the first of their journey, and furtherly put certain amount of focus on Shari'a-based services that differentiate themselves to traditional banking practices (Abedifar *et al.*, 2013). The Sharia Supervisory Board is an additional key feature in the corporate governance mechanism of Islamic financial institutions (Choudhury & Hoque, 2006). Sharia Boards certify and monitor all bank activities, especially the contracts on behalf of stakeholders to guarantee Sharia law affirmation (Alman, 2012), reducing opportunistic behavior of the managers as agents. In opposition with the most common perceptions, Islamic Banks are not immune to the risk of opportunistic behavior. Several studies have shown that both Islamic and conventional banks with centered concentration of ownership use excessive loss provisions on loan (Lassoued *et al.*, 2018; Othman & Mersni, 2014) to achieve expected earnings and profits (Zoubi & Al-Khazali, 2007). Zainuldin and Lui (2018) go on to say that Islamic banks engage in suspecting loan and provisions loss, while reporting lower earnings. Furthermore, the gap of asymmetrical information and clash within interest may stimulate managers to commit unethical actions, despite they contradict to Islamic principles. Hence, the Sharia Board as generic talent of Islamic bank not only offers the vital role of key talent but also the decisive role in establishing the good corporate governance (Safieddine, 2009; Bukhari *et al.*, 2013).

CONCLUSION

In this paper, we will look at how Sharia risk may result in risks involving legal, credit, reputational, compliance, and finally the market risks, as well as how it can affect the market value of an Islamic Bank. According to previous research, this risk may result in costs inefficiency and financial failure due to the financial instability and less credibility (AAOIFI, 2010; El Hawary *et al.*, 2004; Izhar, 2010). To avoid the hazard associated with this risk, banks must carefully manage Sharia risk.

Elaborating recent studies, this meta-analysis offers broader perspective of Islamic Bank, that Islamic Bank is more than just a unique system based on specific compliance to specific rules (Sharia Law) but the implementation of Good Corporate Governance and Sharia Expertise Human Capital, both serve as the generic product of Islamic Bank. This promotes the banking supervisors, boards of directors, senior management, and other stakeholders to actively participate in the ongoing sharia governance discourse and criticize the current implementations. We highly suggest that future research could put these prepositions to the test empirically. The best-performing banks are those who invest more in their knowledge-resources, as the core value of their current digital transformation.

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