

The Effect of Information Asymmetry on Financing Market Structure of Syariah Bank in Indonesia

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Abstract

Theoretically syariah banking have advantages (1) syariah govern every aspect of Muslim's religious practices every live and economic activities; (2) main oriented of syariah banking is improving social welfare. Syariah banks has grown rapidly of size and the number of new player. In Practice advantages not yet contribute in market share of islamic banking in Indonesia, market share of syariah banking just only $\pm 5\%$ since 1992 until now. Information asymmetry is one of the problem in syariah banks. Interest is tool of screening information asymmetry and profit and loss sharing have fundamental problem information asymmetry.

The aim of this study is to evaluate the effect of information asymmetry on financing market structure of Syariah bank in Indonesia.

Result of this research were (1) margin of syariah bank were higher than interest (2) There is gap theory and practices, syariah banking is not very different from conventional banking, profit-loss sharing (mudharabah and musyarakah) in financing are little proportion ($< 35\%$); (3) Consumer financing is main market segment of syariah banking ($> 42\%$) and the trending to growth (4) Financing in business sector (working capital) is trending downward trend. That is different from conventional bank that loan of business sector is rapidly growth and main segment (consumer loan is $\pm 20\%$). Syariah bank has to look for solution to design new model of business financing that more competitive and syariah so the market segment and loyalty of customer will be growth.

Key words; information asymmetry, margin, working capital, consumer loan.

1.1. The Background.

Syariah banking suggest rapid growth in muslim and non muslim country (Jouber dan Mehri, 2011). In Indonesia growth of new customers was 25% p.a. On perspective of theory syariah banking is in contrast to conventional bank due to normatively syariah banking is based upon Qur'an and Sunnah Rasulullah. Syariah banking prohibits interest system because according to fatwa of Indonesia Ulama Council interest is *riba*. Profit-loss sharing is an identity of syariah banking (Haq and Mirakhor, 1986; Dar and Presley, 2000; Jouber and Mehri, 2011; Farooq, 2007).

Profit-loss sharing system has several advantages such as bank customer loss absorbed by deposit (Haq and Mirakhor, 1986; Iqbal 1997); allows bank to provide longer period of financing (Chapra, 1992; Mills and Presley, 1999), profit-loss sharing improves performance motivation and efficiency (Florkowski, 1987; Khan 1986; Sugema et al., 2010) and profit-loss sharing avoid exploitation on weak party (Lewis, 2009). In Practice these advantages not yet

contribute to growth syariah banking in Indonesia, market share syariah banking in Indonesia still $\pm 5\%$ from 1992 until 2018.

Information asymmetry is the main problem in the financing/credit (Akerlof, 1970; Stiglitz and Weiss, 1981; Moerman, 2010; Berber et al., 2001; Liu et al., 2009; Ivashina, 2009). Information asymmetry within syariah banking is revealed by Haque and Mirakhor (1986), Dar and Presley (2000), Aggarwal and Tarik (1996), Febianto and Kasri (2007), Safieddine (2009) Nadeem (2010), Jouaber and Mehri (2011), Haque and Mirakhor (1986) reveal that information asymmetry on financing of profit-loss sharing due to economic behavior customer. Dar and Presley (2000) reveal that reluctance of syariah banking to perform financing of profit-loss sharing due to information asymmetry. Febianto and Kasri (2007) and Jouaber and Mehri (2011) indicate that the availability of information asymmetry within syariah banking particularly on financing of profit-loss sharing and they apply a proposal to resolve.

Theories and research on information asymmetry in banking found that information asymmetry influenced the interest rate (Akerlof, 1970; Stiglitz and Weiss, 1981; Berger et al., 2001; Liu et al., 2009; Ivashina, 2009; Moerman, 2010, Singagerda et al. 2019). Debtors with high information asymmetry, the interest rate is high. Information asymmetry also affects the credit period, continuity of cooperation and level of assurance (Norman and Witenberg, 2009; Kelly and Patricia, 2009; Koford and Tschoegl, 1977; Hahm and Mishkin, 2000).

Syariah bank financing is grouped into financing with profit sharing (mudharabah and musyarakah) and non-profit sharing (murabahah, salam, istishna) (Isretno, 2010). Financing with profit sharing uses financial statements for profit sharing while non-profit financing uses constant margin until finished.

Financing is grouped into working capital, investment (productive) and consumption (consumer loan) (Hadiwijaya and Wirasasmita, 2000; Ifham, 2015). The market shares for credit productive (working capital and investment financing) is enormous and has an impact on a larger and better economy than consumer financing. Financing with profit-loss sharing use for productive (working capital or investment loan).

This study aims to examine the effect of information asymmetry on syariah bank at market structure on syariah banking at the margin financing/profit-sharing ratio, type of financing and the use of financing. From the results of this study, it is expected to be a trigger for research and policy solutions in syariah bank financing.

2. Review Literature and Hypothesis Development

2.1. Asymmetry and Its Influence on Type Financing and Margin

Information asymmetry is a condition in a transaction in which one of the transacting parties has more information than the other party and the one that has more information, would be benefited in the transaction (Scott, 2006). There are two kinds of information asymmetry: adverse selection and moral hazard (Scott, 2006).

Information asymmetry affects the level of financing risk, due to high information asymmetry will lower the bank's trust in the ability of the customer to pay the obligations on time. To compensate for credit risk, the interest rate is one of the solutions (Akerlof, 1970; Stiglitz, 1981; Ivashina, 2009; Berger, 2001). The interest rate becomes the screening of information asymmetries in conventional banks, and the screening tool of syariah banks is the

profit sharing margin (Jouaber and Mehri, 2011, Singagerda et al. 2019). Design financing is a tool to reduce information asymmetry.

The level of information in banks are less than level of information owned by customers about projects, prospects and customer capabilities. Customer bank could be adverse selection or moral hazard in financing. The use of profit sharing system, make much more information asymmetry. Consequently the level of information asymmetry in shariah banks is higher than in conventional banks (prasetyo, 2016).

The interest rate of conventional bank is set to screening of information asymmetry, that it may change at any time. In a syariah bank the margin is fixed until financing finished. Syariah bank profit margin is also included asymmetric information variable (Jouaber and Mehri, 2011). The level of information asymmetry in syariah bank is higher, so the hypothesis as:

H_{1a}; Margin rate of shariah banks is higher than the interest of conventional bank

2.2. Influence of Asymmetry information on the type and the use of Financing

The statute of shariah banking no. 21 year 2008 states that the financing of shariah banks consists of financing with profit sharing system (mudharabah and musyarakah) and other systems (murabaha, salam, istishna, qardh) in accordance with the rules of syariah. The statute No. 8 of 1992 concerning banking allows banks to operate using interest or profit-sharing systems. The existence of statute no. 8, a syariah bank is only Muamalat Indonesian Bank but since the statute no. 21 of 2008 about syariah bank with profit sharing product and not for profit sharing, syariah bank which has 11 commercial banks and most of them established shariah business unit.

The profit-sharing system uses the customer's financial statements for profit sharing, and financial statements have fundamental problems of information asymmetry. To reduce information asymmetry, the syariah bank may choose the product of financing not profit sharing, hence the hypothesis is follow;

H₂; profit sharing financing is lower than non profit sharing in shariah banking.

One way to reduce risk for banks is by maintaining a balance between income and expenses. The bank's revenues are mostly from financing while funding for financing is from public funds. Deposit of public funds in syariah bank are deposit, savings and current account, banks must manage the balance between financing and charge of source of public funds (Febrianto and Kasri, 2007; Desfiandi et al. 2017). Types of bank funding sources are public funds with a profit-sharing system (mudharabah) and not a profit-sharing system (wadiyah). On the profit-sharing, the cost of bank funds depends on the performance of the bank. This deposit is very profitable for shariah banks because when the banks get a large profit then the charge of the bank's profit is large enough while when the bank losses or getting small profits, then the bank does not spend on funds. Based on it, the hypothesis of this research is follow;

H₃: Deposit of public funds in syariah bank with profit sharing is higher than non profit sharing

The financing setting is designed based on the usage and return source. Designed of financing is a tool of asymmetry information. Working capital loan and investment loan source of repayment come from financed project activities. The financing of working capital and

investment is used for business activities so that the bank must analyze the business capability, condition, capacity, competency and character of the partner. The customers much more information than bank about that.

Repayment of consumers financing from the source of return comes wages that a fixed source of income in each month that is from the salary of employees. The consumers financing is given to employees with a source of return from the employee's salary. Repayment capacity of consumer loan has a rate of return that is more definite than productive financing so that the level of information asymmetry is lower, the hypothesis is:

H_{4a}: The proportion of consumer financing in higher and increasing trend

H_{4b}: The proportion of working capital financing decreasing trend

3. Methodology

The data are the published of syariah bank financial statements in Indonesia central bank statistics form 2009 until June 2018, control group the published of financial statement of conventional banking and Indonesia central bank statistics

4. RESULT AND DISCUSSION

The test result of the average difference between the margin level of syariah bank and the conventional bank interest rate found that the margin level of syariah bank is 17,32% p. a. were higher than the conventional bank interest in average 13,71%. The results of this study in accordance with the hypothesis that the level of information asymmetry in syariah banks is higher so that effect on the margin rate.

Main purpose of syariah is to improve social welfare. But in practice there is a gap with theory (Siddiqi, 2006). Practice refers to standards and to setting of standards were referring to the theory, and also influenced by economic and political factors. The syariah bank in running the business is also influenced by the economic and politics factors of the owners, investors and management so that it also seeks to gain profit. Economic factors are quite large then in practice, syariah banks have not pure syariah (Rivai and Usman, 2010, Ifham, 2015). In setting the margin of syariah banks are still influenced by the interest rate of conventional banks (Chong and Ming, 2009; Ifham, 2015; Alamsyah, 2012). The evaluation of performance banking has many factor; i.e. the level of profit so makes the syariah bank also tries get more profit oriented. The economic factor becomes important in running the business of syariah bank.

In setting the interest, syariah banks use the reference of the cost of funding sources, the rate of margin in similar business, and also the interest rate of the conventional bank. (Ifhim 2015; Alamsyah, 2016; Chong and Ming, 2009). The conventional bank sets a floating interest rate that can be adjusted if the interest rate condition in the credit market changes while in syariah bank the rate of margin is fixed, this condition causes the syariah bank puts the variables of the future condition in setting the margin. The conservative principle anticipates the loss than the profit, then syariah bank will set margin by considering if in the future there will be an increase in fund cost margin rate.

Table 1: Proportion Financing Syariah and Conventional Banking

In	Consumer (%)		Working Capital (%)		Investment (%)	
	Conv.	Syariah	Conv.	Syariah	Conv.	Syariah
2009	51,69	29,98	35,15	48,78	13,16	21,23
2010	39,95	33,60	37,97	46,72	22,08	19,68
2011	21,64	41,94	44,53	40,62	33,83	17,44
2012	27,00	43,95	36,56	38,03	36,54	18,02
2013	27,44	42,75	40,30	38,87	32,26	18,38
2014	22,52	40,73	43,45	39,83	34,03	19,43
2015	22,14	38,24	49,08	37,50	28,78	24,26
2016	23,52	40,98	49,07	35,51	27,41	24,41
2017	23,11	41,70	50,07	34,92	26,88	23,38
2018/Jun	23,55	42,88	49,96	33,97	26,49	23,15

Table 2: The Statistics Test Between Conventional and Syariah Bank

Explanation	SYARIAH BANK	CONVENTIONAL BANK	Difference Test	
			t	Sig
Margin-Interest rate	17,323	13,709	4,932	0,0000
Sharing Financing	65,16%		3,346	0,0331
Deposit-sharing	85,49 %		4.836	0,0000
Working capital	35,59	43,61	3.316	0,0372
Inverstment	20,94	28,15	4,309	0.0000
Consumption	39,68	28,25	4,137	0.0000

Syariah bank financing does not use the interest system but use a profit-sharing system. Profit-sharing systems that use financial statements and financial reports have fundamental issues of information asymmetry so that the payments with profit-sharing systems have higher levels of information asymmetry. Profit-loss sharing financing system is avoided by syariah banks, therefore syariah bank financing 65% of non profit-loss sharing financing. The financing of profit-loss sharing in syariah banking in Indonesia is higher, in Malaysia the financing of profit sharing just only 0.05% (Chong and Ming, 2009), in Pakistan by 2%, Middle East countries by 11%, in South Asian countries 13% (Lewis, 2009) and profit-loss sharing financing in syariah banks worldwide less than 20% of total syariah bank financing (Farooq, 2009). The substantial of profit-loss sharing in Indonesia in addition to the actual for productive financing, it is also partly for the restructuring of non-profit financing to improve bank soundness.

The non-profit-loss-sharing financing design must pay interest and the principal of financing every month. The financing settings are made in accordance with the use and source of the returns so that the financing is expected to proceed smoothly and the obligations are paid on time. The non-profit-loss-sharing financing design is appropriate for a fixed source of payments each month, so it is suitable for consumer financing. Therefore, the consumer financing at syariah banks runs in the trend highest proportion growth.

At the beginning of the establishment of syariah banks in 2009, the proportion of consumer financing 30% then increased every year so that in 2018 the proportion of consumer financing 42%, trend data also shows consumption financing has a tendency to increase. This is different and reversed with conventional banks in 2009 whose consumption financing reached 51% decline every year and in 2018 only 23%. This increasing consumer finance also shows that syariah bank customers have increased in the employee/worker market segment, so some research finds customers of syariah bank financing are mostly employees (Rivai et al., 2007; Noesm, 2004).

Syariah bank financing tends to increase in consumer financing and it causes the working capital financing facing a decreased proportion from 49% in 2009 to 34% in 2018, it is against to conventional banks that tends to increase in the productive working capital and investment financing, the financing working capital from 35% to 50% and investment financing from 13% to 26%. Syariah banks are mostly on the consumer financing while the largest market share of financing are in business sector (productive financing) that causes syariah bank financing market share is only about $\pm 5\%$ of total bank financing from 2009 until 2018. Productive financing is needed by entrepreneurs and the business conditions are so competitive so that the financing charges must be competitive in order that customers can compete. Banks that have higher levels of information asymmetry make the margin level or profit sharing of syariah banks to be higher. Syariah banks should seek financing arrangements for working capital and investment that can compete with conventional banks and which more motivate the customers' performance.

Managing bank risk can be done by managing balance sheet balance that is between financing and fund source (Desfiandi et al. 2017). The syariah bank in this case is done by managing the funding source ie the reverse way with the financing, if the largest financing is not profit sharing, on the contrary for the source of funds with the profit sharing system 85.49% is higher than the source of funds in Malaysia for the profit of 70 % ^ (Chong and Ming, 2009). The source of profit sharing is the lowest risk for syariah banks because bank losses will be merged by depositors.

5. CONCLUSIONS AND RECOMMENDATIONS

Syariah bank financing has a higher level of information asymmetry than conventional banks. It causes the syariah banks impose higher financing margins than conventional bank interest rates and enlarge on financing non-profit sharing. The setting of financing non-profit sharing is more appropriate to the payment of the principal installment while the margin is more appropriate to consumption financing because the source of consumption payments is from a fixed income every month.

The proportion of consumer financing in syariah banks is growing rapidly and shows an increasing trend then the productive working capital and investment financing is getting a downward trend. The largest market share of bank financing is in the productive financing so that the market share of syariah bank financing is difficult to grow to match the conventional banks.

The recommendation of this research is shariah banks need to find solutions to the problem of information asymmetry on productive financing so that they can find appropriate financing arrangements for productive financing. Determination of profit sharing ratio model needs to be learnt and researched so it will find the profit sharing ratio model that can motivate to improve customer performance. Syariah banks in their operations need to revert to syariah rules and reduce economic influence so that the main purpose for social welfare and worship can be achieved, and the religious value as benefits of syariah banks can be felt, it also which differs between syariah bank and conventional bank.

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