



The Challenge of Merger Result Bank during the Global Economic Recession due to the Covid-19 Pandemic: Case Study of Indonesian Islamic Banks

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Abstract: Bank Syariah Indonesia (BSI) is a new entity resulting from the merger of Bank Syariah Mandiri, BNI Syariah, and BRI Syariah. BSI was inaugurated in February 2021 amid the global economic recession due to the Covid-19 pandemic. It has not much been explained about the fundamental data of the 3 banks that formed BSI when the recession occurred due to the Covid-19 hit. As a result, BSI's record of challenges during the global recession has not appeared much. The aim of the research is to map the challenges that BSI will face when the economic recession due to the pandemic has not ended. BSI's challenge notes are useful for BSI policymakers, so they can mitigate risks. A qualitative method Miles-Huberman model is employed to analyze the data which is done through 3 stages: data reduction, data display, and verification or conclusion. Based on data analysis, BSI will face the challenges of slow deposit and financing growth, rising non-performing financing, declining net profit, and declining sukuk ratings.

Keywords: Merger, Bank Syariah Indonesia, Miles-Huberman Model, and Sukuk Ratings.

Article History

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Introduction

Bank Syariah Indonesia (BSI) has become a new entity resulting from the merger of Bank Syariah Mandiri, BNI Syariah, and BRI Syariah. BSI was inaugurated in February 2021, amid the global economic recession due to the Covid-19 pandemic. The three participating banks published a four pages summary of the merger plan to the public, issued on October 21, 2020. This step is in accordance with the regulations of the Financial Services Authority (OJK), article 10 number 41/2019 paragraph 1 (OJK, 2019).

In the announcement of the merger plan, the background and objectives of the merger of three Islamic banks into BSI are explained. First, the penetration rate of Islamic assets is below 8%. Compared to the penetration of sharia assets in 2019 in Muslim countries, which have been running fast above 20%. Second, Islamic bank funding in Indonesia is still limited. Issuance of rate compared to conventional debt securities in Indonesia is still below 5%.

The low penetration rate and the limited funding of Islamic banks are caused by many interrelated things. For example, there is no bank that has good and strong capabilities in terms of assets and finances. Few competent human resources. Coupled with digital technology systems that are not yet optimal in dealing with the behavior of millennial generation customers. Low asset penetration and low access to funding, make Islamic banks less competitive with conventional banks. Digital technology services are far behind conventional banks. As a result, the market share of Islamic banks lags far behind national banks.

In 2019, the market share of Islamic banking in Indonesia was only 6.18% (see Figure 1). This is very small and very unequal, when compared to the market share of all banks in Indonesia which touched 93.82%. The market share of Islamic Commercial Banks (BUS) dominates more than 50%, compared to the market share of Sharia Business Units (UUS) and Sharia People's Financing Banks (BPRS), 20 UUS with a market share of 32.36%, and 164 BPRS with a market share of 2.56%.

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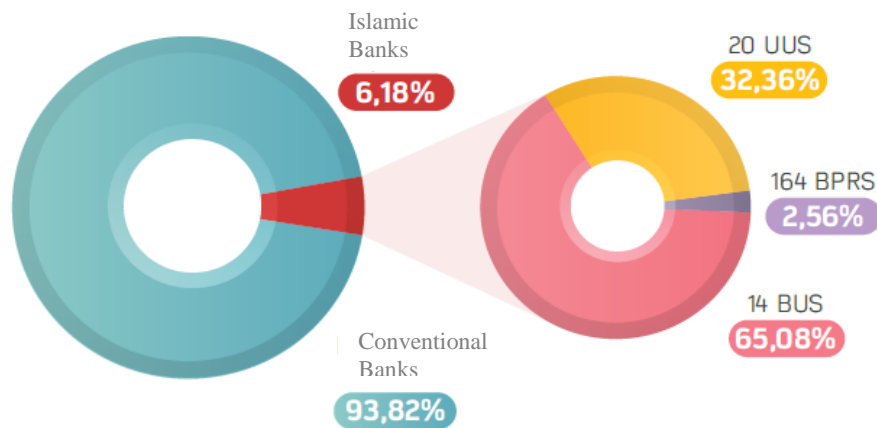


Figure 1. Market Share of Islamic Banks: BUS, UUS, and BPRS
Source: OJK (2019).

Based on OJK data in 2019, there were 14 BUS, with total assets of Rp350.36 trillion. The disbursed financing (PYD) is Rp225.15 trillion and third party funds (DPK) Rp288.98 trillion. The number of UUS in 2019 was 20. Its total assets were Rp174.20 trillion, PYD Rp130.04 trillion, and DPK as much as Rp127.58 trillion. The number of BPRS in 2019 was 164 institutions. Its assets are Rp13.76 trillion, PYD Rp9.94 trillion, and DPK Rp8.73 trillion.

The growth of Islamic bank assets should be appreciated. On the other hand, the core capital problem of Islamic banking must also be parsed and solutions are sought. The core capital of 14 BUS in Indonesia is still dominated by core capital of Rp1-5 trillion (see Figure 2). Meanwhile, there are only 2 BUS which have core capital between Rp5-30 trillion. The remaining 4 BUS have a core capital of less than Rp1 trillion.

As a result, there are only two BUS that fall into the category commercial banks business activities (BUKU) 3. Eight BUS fall into the category BUKU 2. The rest, four BUS fall into the category BUKU 1. Of the 14 BUS in Indonesia, none has yet entered the category BUKU 4. On the other hand, many conventional banks in Indonesia are categorized as BUKU 4. Starting from Banks BRI, Mandiri, BNI, BCA, CIMB, Danamon, and CIMB Niaga.

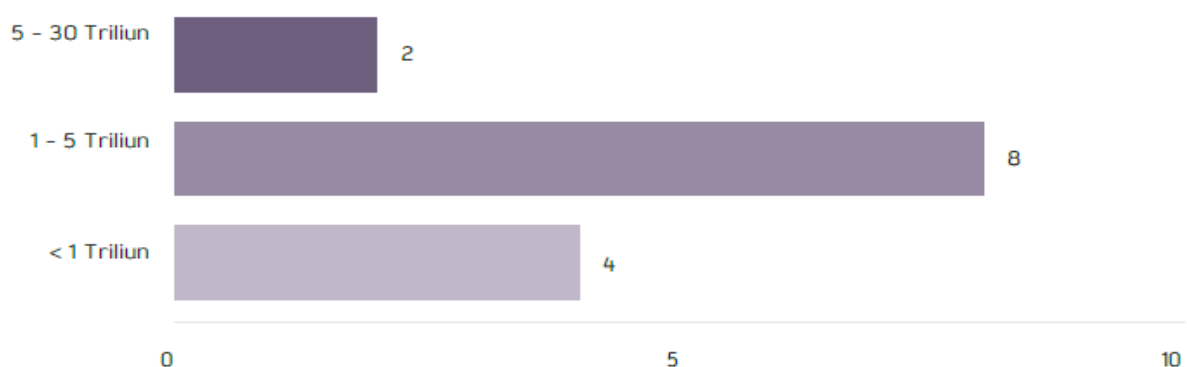


Figure 2. Number of BUS based on Core Capital 2019
Source: OJK (2019).

The merger process opens the opportunity for BSI to have a strong core capital and is included in the BUKU 4 category. Large assets, adequate liquidity, and product development according to community needs. In addition, with large capital, Islamic banks can develop digital technology that is capable of meeting millennial generation customers.

The research conducted by [Sitompul \(2008\)](#) confirms that the bank merger policy is an effective step to improve the banking financial industry. The banking merger policy which gave birth to the concept of a single presence policy in fact has an effect on governance, especially regarding the ownership of the merged bank. Apart from limiting the number of bank ownership compositions, banking mergers also create derivative problems, such as system adjustments, alignment of work culture and the possibility of termination of employment.

To anticipate and avoid the negative impact of banking mergers, a rule of reason approach is needed that takes into account the principle of efficiency – the negative and positive consequences of an action on the competitive process. According to him, banking mergers must also pay attention to Law No. 5 of 1999 concerning the Prohibition of Monopolistic Practices and Unfair Business Competition ([Sitompul, 2008](#)).

[Bansal and Almalki \(2020\)](#) describes the impact of mergers and acquisitions on shareholder value in the banking sector in Bahrain. The results of his research reveal that mergers and acquisitions can improve the performance of the combined institutions and reduce operational costs. It is confirmed that shareholder value is increasing ([Bansal & Almalki, 2020](#)).

[Afdi and Nasir \(2016\)](#) respond very positively if banks under the auspices of SOEs merge. This is reinforced by the reason that bank mergers are a good strategy to realize the formation of a large Islamic bank. Mergers of Islamic banks are effectively carried out with the prerequisites of an independent controlling shareholder, strong consolidation of bank legality and good management of human resources ([Afdi & Nasir, 2016](#)).

BSI as a bank resulting from the merger during the economic recession due to the Covid-19 pandemic will face many challenges. Hopes to get funding from the issuance of sukuk will be hampered when economic conditions are in turmoil. Third Party Funds sourced from sharia deposits and public savings will also be difficult to boost when the economy is in recession. On the other hand, BSI which is expected to increase the penetration of sharia assets will also face many challenges. During the recession, the demand for financing from the public decreased. Followed by the rate of default or non-performing finance (NPF) will also rise during an economic recession. The decrease in financing and the increase in NPF will certainly erode BSI's profit.

Previous research describes more of the positive impact when Islamic banks run a merger strategy, such as improving performance, increasing assets, reducing operating expenses, and realizing a large Islamic bank. Very few describe the challenges of Islamic bank mergers during the global economic recession. The researchers of the merger of Islamic banks have not elaborated much on the fundamental data of the 3 banks that formed BSI, namely Bank Syariah Mandiri, BNI Syariah, and BRIS Syariah when the recession occurred due to Covid-19 hit. Thus, the research notes of the challenges that will be faced by BSI during the global recession have not appeared much.

Therefore, the purpose of this paper is to map the challenges that will be faced by BSI when the Pandemic has not ended. BSI's challenges during the Covid-19 recession are mapped out with strong data support. Starting from the fundamental data of the three merging participating banks, macroeconomic data, as well as data from Bank Mandiri's experience as a bank resulting from the merger of four banks during the 1998 crisis. The output of this challenge mapping is useful for BSI policy makers, in order to be able to develop appropriate risk mitigation.

Literature Review

Bank Merger

Literally a merger is defined as a fusion. Merger in the definition of the limited liability company law article 1 point 9, is a legal action taken by one or more companies to merge with another existing company ([Law No. 40 of 2007 concerning Limited Liability Companies, 2007](#)).

This results in the assets and liabilities of the merging companies being transferred to the merging companies. The next stage, the legal entity status of the merging company ends.

From the legal explanation, the company merger activity is the process of combining two or more entities, with one company receiving the merger. Broadly speaking, mergers are divided into two categories, namely the category of related products/services. And unrelated product or service categories ([Tarigan et al., 2016](#)).

Companies that offer the same product/service and perform a merger are categorized as related mergers. An example of a merger that falls into the related category is the merger between XL and Axis in 2014. XL became the entity that received the merger, while Axis was the merging entity. So that the assets and liabilities of Axis become one with XL. Meanwhile, the XL entity remains as the beneficiary of the merger.

Bank BNI Syariah, Mandiri Syariah, BRI Syariah merged into one. BRI Syariah as the recipient of the merger. The merger process of these three Islamic banks is included in the category of related products. Because all three, both offer financial services.

Assets and Liabilities of BNI Syariah and Mandiri Syariah switched to BRI Syariah as the recipient of the merger. The shareholders of the merged bank are still co-owners of the combined entity. For more details can be seen in the following scheme.

Bank Merger Scheme

AB

Information:

A : Banks that have merged

B : Bank that accepts merger

B : Merged bank.

Consolidation

Based on the limited liability company law article 1 point 10, consolidation is a legal act carried out by two or more companies to merge themselves, by establishing a new company. which by law acquires the assets and liabilities of the consolidating company. The legal entity status of the consolidating company ends ([Tarigan et al., 2016](#)).

In the history of consolidation in Indonesia, there has been a consolidation of banking companies. Precisely in 2008, there was a consolidation process between Bank CIMB and Bank Niaga from Indonesia. The consolidation process of the two banks gave birth to a new entity, namely bank CIMB Niaga.

A + B C

A: Consolidating banks.

B: Consolidating banks.

C: New Bank Entity

Acquisition

Article 1 number 11 of the limited liability company law explains that an acquisition or takeover is a legal action taken by a legal entity or individual to take over the shares of a company. The process of taking over the ownership of the shares resulted in the transfer of control over the company ([Law No. 40 of 2007 concerning Limited Liability Companies, 2007](#)).

As a result, an acquisition is a type of merger, where one company takes ownership. At the same time act to control the company whose shares were taken over. However, the company that was taken over and controlled by its shares, the name entity still exists.

In Indonesia, the company acquisition process occurred at PT HM Sampoerna. PT HM Sampoerna has been acquired by Philip Morris International. As a result, Sampoerna's ownership is controlled by Philip Morris International, but the Sampoerna name entity still exists ([Tarigan et al., 2016](#)).

The categories of mergers, consolidations, and acquisitions are divided into two, vertical and horizontal. The merger process which is categorized as vertical is a merger between upstream and downstream companies, in other words the products/services offered are different.

The second category is horizontal. Horizontal category is a combination of companies that have the same product and are competitors. The closest horizontal merger is the merger of Bank BRI Syariah, Mandiri Syariai, and BNI Syariah. Which now gave birth to Bank Syariah Indonesia (BSI).

Previous Research

Studies that place Islamic banking as the object and target of mergers and acquisitions still tend to be minimal. Studies on mergers and acquisitions in banking have been carried out by [Samosir \(2003\)](#), [Sitompul \(2008\)](#), [Santoso \(2010\)](#), and [Bansal and Almalki \(2020\)](#). Mergers and acquisitions are carried out by banks as an effort to improve the financial industry system. This is because both are considered capable of increasing economies of scale, more positive market power, and more efficient banking company sizes.

[Samosir \(2003\)](#) conducted research on the performance of Bank Mandiri after the merger and as a recapitulation bank. According to him, the merger of four state-owned banks into one bank, namely independent banks, is a government policy in restructuring unsound and unhealthy state-owned enterprises. This policy is carried out so that the merged banking sector can be competitive at home and abroad. In addition, this banking merger is expected to operate as a financial intermediary that supports real sector activities in Indonesia. [Samosir \(2003\)](#) confirmed that the bank's condition three years after the merger was not healthy, where 73% of the income earned was the result of interest from bonds provided by the government. In fact, when compared to other governments, Bank Mandiri's efficiency is second to last before Bank BTN.

In contrast to Samosir's study, [Sitompul \(2008\)](#) confirmed that the bank merger policy is an effective step to improve the banking financial industry. The banking merger policy which gave birth to the concept of a single presence policy in fact has an effect on governance, especially regarding the ownership of the merged bank.

Apart from limiting the number of bank ownership compositions, banking mergers also give rise to derivative problems, such as system adjustments, alignment of work culture and the possibility of termination of employment. To anticipate and avoid the negative impact of banking mergers, [Sitompul \(2008\)](#) proposes a rule of reason approach that considers the efficiency principle of negative and positive consequences of an action on the competitive process. According to him, banking mergers also pay attention to Law No. 5 of 1999 concerning the Prohibition of Monopolistic Practices and Unfair Business Competition.

[Santoso \(2010\)](#), by utilizing the data envelopment analysis (DEA) method and historical data from 1998-2009, he revealed that mergers and acquisitions are not significant for increasing efficiency. This condition is highly dependent on the bank's qualitative factors, such as organizational effectiveness and post-merger banking governance. The conclusion of this article is confirmed from the data on the efficiency ratio of Bank Mandiri which was stable after the merger and acquisition until 2009. In addition, this condition was not affected by the crisis but significantly affected the efficiency of its peer groups at the time of the merger and acquisition.

[Santoso \(2010\)](#), mergers make the bank's financial structure stronger in dealing with the economic crisis, because with the larger scale of business and the bank's capital structure, the bank's health condition will be stronger in facing the economic crisis because banks are required to be more professional in their management aspects by increasing its span of control of the bank's organization. According to him, only Bank Century was affected by the global financial crisis in 2008 and other banks that merged before 2008 were not affected by the crisis.

Another study can be read in [Bansal and Almalki \(2020\)](#). They describe the impact of mergers and acquisitions on shareholder value in the banking sector in Bahrain. This article is based on quantitative research using electronic questionnaires and analyzed using SPSS statistical tools. The results of this study reveal that mergers and acquisitions can improve the performance of the combined institutions and reduce operational costs. It is confirmed that shareholder value is increasing. However, this article recognizes the weakness of this research which does not include other parties affected by bank mergers and acquisitions, such as managers, banking institutions and the government.

In contrast to the studies above, the theme of mergers and acquisitions in Islamic banks has also been written by [Nizar & Nasir \(2016\)](#). These two authors place Islamic banking in Indonesia as the object and target of their study. This article responds very positively if banks under the auspices of SOEs merge. This is reinforced by the reason that bank mergers are considered a good strategy to realize the formation of a large Islamic bank.

Research Methods

The research uses qualitative methods. Analysis of qualitative methods using data analysis model Miles and Huberman. Data analysis activities mapped the challenges of the merger of 3 national Islamic banks using the Miles and Huberman model through 3 stages, namely data reduction, data display, and verification or conclusion (Sugiyono, 2006).

The research was conducted for two months. Starting November-December 2020. Data reduction summarizes basic data sourced from official data releases from three merger-participating banks, namely Bank Syariah Mandiri, BRI Syariah, and BNI Syariah. Other sources of data that are reduced and sought for pattern points are macroeconomics and information from online media which are intertwined with banking mergers. Additional data that is reduced is the findings of previous studies that focus on the study of banking mergers.

After the data reduction process, the next step is data display or data presentation. The data presented is organized and structured. To make it easier to digest. Tables, charts, and pictures are also presented (Sugiyono, 2006).

The next step is to verify and then draw conclusions. The systematic identification and verification process aims to determine the structural pattern of opportunities and challenges of national Islamic bank mergers during the global economic crisis due to the Covid-19 pandemic. The verification process is carried out by comparing and looking for patterns in the data of the merged participant banks. Then compare the data on Covid-19 and economic growth, with the fundamental data of sharia banking participants in the merger. The verification process also uses fundamental data from banks that were merged during the economic crisis. Such as the fundamental data of Bank Mandiri and Bank CIMB Niaga. The process of comparing is a process of verification and looking for patterns. As material for drawing conclusions.

Result

The Merger Pattern of Bank Mandiri, Bank CIMB, and Bank Syariah Indonesia

Semester 1 2020, the world was hit by the Covid-19 virus. The Covid-19 virus caused the lockdown policy to roll. As a result, the Indonesian economy experienced a growth contraction of 1.26%

Despite the economic contraction, the total assets, profits, deposits and PYD of BRI Syariah and BSM banks continued to grow. However, PYD and profit BNI Syariah decreased. BRI Syariah assets in Semester 1 2020 grew 14.97%, total assets were Rp49.6 trillion (see Table 1). Net profit increased significantly by more than 200%, amounting to Rp117.2 billion. Deposits grew by 20.35%, amounting to Rp41.1 trillion. Financing grew by 36.69%, by Rp37.4 trillion (Kompas, 2020).

BSM's performance during semester 1 2020 remains positive. Net profit continues to grow 30.53%. BSM DPK continued to grow 16.52%. PYD consistently grew 5.8%. BSM assets also grew 13.26% (Jawa Pos, 2020).

Bank BNI Syariah assets continued to grow 19.48%, total assets in the first semester of Rp50.76 trillion. Third party funds also grew by 20.15%. On the other hand, due to the impact of the crisis due to Covid-19, BNI Syariah financing fell 1.07%, followed by net profit which fell 15.49% (Bank BNI Syariah, 2020)

The merger of 3 state-owned enterprises (BUMN) Islamic bank entities will have a total asset of Rp214.76 trillion. After the merger, total assets of Rp214.76 trillion will certainly be a strong stepping stone for Islamic banks to jump higher especially to enter the ranks of the top 10 banks with the largest assets in Indonesia.

Its post-merger core capital would become Rp20.4 trillion. This amount is considered relevant for BUKU 3. After the merger, the sharia bank entity remains a public company and is listed on the Indonesia Stock Exchange (IDX).

The hope is to raise funds from the wider community. Large assets after this merger can give birth to large-scale Islamic banks. Plus competent human resources, development of digital technology for millennial generation customers, development of products and services according to the needs of urban and rural communities. As a result, the market share of Islamic banks can grow rapidly.

The history of the merger of state-owned banks in Indonesia after the 1998 crisis gave birth to Bank Mandiri. Meanwhile, the merger of private banks after the 2008 crisis gave birth to the bank CIMB

Niaga. The two banks, which were merged after the severe crisis, were still exist and growing, and are even included in the category of 10 banks with the largest assets in Indonesia. Bank Mandiri and CIMB Niaga have very different backgrounds in the merger process. The process of merging Bank Mandiri was based on the restructuring after the 1998 crisis, while CIMB Niaga was based on the Single Presence Policy of Bank Indonesia in 2008 (Miftah & Wibowo, 2017).

Table 1. Total Assets, Net Profit, TPF, and PYD Semester 1 2020

| Nama Bank | Total Assets (trillion rupiah) | Net profit (billion rupiah) | DPK (trillion rupiah) | PYD (trillion rupiah) |
|----------------------|-----------------------------------|--------------------------------|--------------------------|--------------------------|
| Bank Syariah Mandiri | 114,4 | 718,6 | 101,78 | 75,61 T |
| Bank BRI Syariah | 49,6 | 117,2 | 41,1 | 37,4 T |
| BNI Syariah | 50,76 | 266,64 | 43,64 | 31,33 T |
| Total | 214,76 T | 1,102 T | 186,52 T | 144,34 T |

Source: Data processed from the first semester 2020 report of BRI Syariah, BSM, and BNI Syariah.

Bank Mandiri was born when the economic situation in 1998 was very bad and politically unstable. While Bank CIMB Niaga was born in 2008, when politics in Indonesia were not in turbulent, but the world economy was in crisis. Bank Mandiri is the result of the merger of four state-owned banks, namely Bapindo, Bank Dagang Negara, Bank Bumi Daya, and Bank Exim. Meanwhile, Bank CIMB Niaga is the result of the merger of two private banks. The process of merging the four state-owned banks that gave birth to Bank Mandiri involved the National Bank Restructuring Agency (IBRA). Meanwhile, Bank CIMB Niaga involves shareholders, namely Khazanah Group, CIMB Group, and Lippo Group (see Table 2).

In the early stages after the merger, the two banks had different profit journeys. Bank Mandiri scored negative profits in the first and second years after the merger. This is as a result of unstable economic conditions and the high value of bad assets inherited from the 4 national banks participating in the merger.

Table 2. Comparison of the Merger of Bank Mandiri and Bank CIMB Niaga Comparison of Bank Mandiri Bank CIMB Niaga

| Comparison | Bank Mandiri | Bank CIMB Niaga |
|---------------------|---|---|
| Merge background | <ul style="list-style-type: none"> Restructuring | <ul style="list-style-type: none"> Single Presence Policy |
| Year | <ul style="list-style-type: none"> 1998 | <ul style="list-style-type: none"> 2008 |
| Economic condition | <ul style="list-style-type: none"> Economic and political crisis | <ul style="list-style-type: none"> Economic crisis, political stability |
| Merger participants | <ul style="list-style-type: none"> Bapindo Bank Dagang Negara Bank Bumi Daya Bank Exim | <ul style="list-style-type: none"> Bank Niaga Bank Lippo |
| Involved parties | <ul style="list-style-type: none"> National Bank Restructuring Agency (IBRA) | <ul style="list-style-type: none"> Khazanah Grup CIMB Grup Lippo Grup |
| Profit | <ul style="list-style-type: none"> Negative profit year 1 and 2 | <ul style="list-style-type: none"> Positive profit |
| Profit determinants | <ul style="list-style-type: none"> Economic crisis Poor asset structure inheritance 4 merge participants. | <ul style="list-style-type: none"> Less severe economic crisis like 1998. Strong asset structure. |

Source: (Miftah & Wibowo, 2017).

At the beginning of the merger, bank CIMB Niaga still made a positive profit. Although the merger process took place during the 2008 economic crisis, Lippo and CIMB's asset structures were considered good and the 2008 economic crisis was not as severe as the 1998 crisis. These two conditions supported CIMB Niaga's profit performance after the merger.

In their analysis, Miftah and Wibowo (2017) reveal that despite being born from different economic and political backgrounds and capital structures, these two banks have a history of successful bank

mergers. This success can be seen in assets that continue to grow, a sustainable business, and become a listed business in the capital market by providing high returns to investors.

There are several similarities and differences in the process of merging Bank Mandiri, CIMB Niaga, and Bank Syariah Indonesia (BSI) (see Table 3). BSI was born due to asset penetration and market share control which is still low and access to funding sourced from sukuk is still small. Meanwhile, Bank Mandiri was the result of the recovery of 4 national banks that were sick due to the 1998 crisis. BSI is a combination of three sharia banks with the status of BUMN with healthy assets and positive moving profits. Likewise with Bank CIMB Niaga, the assets and liquidity of Bank Lippo and Bank Niaga as merger participants are in good health. Therefore, after the merger, CIMB Niaga experienced a positive profit.

A different fate hit Bank Mandiri. Post-merger experienced negative profits. As a result of the structure of assets, profits, and liquidity are already unhealthy due to the storm of the 1997/1998 crisis. In addition, Bank Mandiri had to work hard in the midst of the economic recovery process after the 1998 great crisis.

On the other hand, the timing of the merger of Bank Mandiri, Bank CIMB Niaga, and Bank BSI coincided with the crisis that hit the Indonesian economy. Bank Mandiri was born during the 1998 economic and political crisis. CIMB Niaga during the 2008 world economic crisis, with stable political conditions in Indonesia. While BSI was born during a great economic recession during the 2020 Covid-19 pandemic.

Table 3. Comparison of the Merger of Bank Mandiri and Bank CIMB Niaga

| Comparison | Bank Mandiri | Bank CIMB Niaga | Bank Syariah Indonesia |
|---------------------|--|--|---|
| Merge background | <ul style="list-style-type: none"> Restructuring | <ul style="list-style-type: none"> <i>Single presence policy</i> | <ul style="list-style-type: none"> Low asset penetration. Low access to funding from rate |
| Year | <ul style="list-style-type: none"> 1998 | <ul style="list-style-type: none"> 2008 | <ul style="list-style-type: none"> 2020-2021 |
| Economic condition | <ul style="list-style-type: none"> Economic and political crisis | <ul style="list-style-type: none"> Economic crisis, political stable | <ul style="list-style-type: none"> Recession due to the Covid-19 pandemic |
| Merger participants | <ul style="list-style-type: none"> Bapindo Bank Dagang Negara Bank Bumi Daya Bank Exim | <ul style="list-style-type: none"> Bank Niaga Bank Lippo | <ul style="list-style-type: none"> Bank Syariah Mandiri Bank BRI Syariah Bank BNI Syariah |
| Involved parties | <ul style="list-style-type: none"> National Bank Restructuring Agency (IBRA) | <ul style="list-style-type: none"> Khazanah Grup CIMB Grup Lippo Grup | <ul style="list-style-type: none"> Ministry of state-owned enterprises (BUMN) Directors and Commissioners of BSM, BRIS, BNIS. |
| Profit | <ul style="list-style-type: none"> Negative profit year 1 and 2 | <ul style="list-style-type: none"> Positive profit | <ul style="list-style-type: none"> Positive profit |
| Profit determinants | <ul style="list-style-type: none"> Economy crisis | <ul style="list-style-type: none"> Poor asset structure inherited 4 merging participants Less severe economic crisis like 1998 | <ul style="list-style-type: none"> Strong asset structure. Economic recession due to the pandemic. |

Bank Mandiri and Bank CIMB Niaga were again tested for strength in 2020 with slowing economic growth due to Covid-19. This condition is like repeating the 1998 crisis which caused Bank Mandiri to experience negative profits after the merger. In the first half of 2020, Bank Mandiri's profit fell 24.53%. Meanwhile, Bank CIMB Niaga also experienced a 11.2% decline in profit. In semester 1 2020, CIMB Niaga can not get past it by making a profit, like the journey through the 2008 crisis.

In the first semester of 2020, Bank Mandiri's assets reached Rp1,318.25 trillion. Despite the contraction in economic growth due to Covid-19, the bank which was merged by Bapindo, Bank Dagang Negara, Bank Bumi Daya, and Bank Exim, still grew 3.12% in semester 1 2020. However,

Bank Mandiri's net profit in the first semester of 2020 fell by 24.53%. Total net profit is Rp10.29 trillion¹.

Bank CIMB Niaga was also born from the merger of Bank Niaga and Bank Lippo in 2008. Semester 1 2020, CIMB Niaga recorded a profit of Rp1.74 trillion and experienced a decrease of 11.2%. Meanwhile, its total assets amounted to Rp274.4 trillion in semester 1 2020, growing 0.94% YoY².

The history of bank mergers is not all successful in becoming large-scale banks such as Bank Mandiri and CIMB Niaga. Bank Century is the result of the merger of three private banks, namely Bank CIC International, Bank DUNPAC, and Bank PAKKO. Bank Century began to serve the public at the end of 2004. However, in its development, this bank was the result of an unhealthy merger and was hit by systemic problems caused by poor asset management.

BSI External Challenges

The integration of three state-owned Islamic banks is not an easy matter. There are many challenges to be faced after the merger. Such as external challenges, namely national economic conditions that will affect the business climate.

Global Economic Recession Due to Covid-19

The national economy is experiencing depression due to Covid-19. Indonesia's economic growth from the first quarter contracted (see Figure 3). Followed by economic contraction in the second and third quarters. The second quarter of 2020, economic growth contracted to touch -5.32. The third quarter of 2020, the economic contraction touched the figure of -3.49. Recession storm blows hard. Forcing small, medium-sized communities, businesses, and governments fasten their seat belts.

The great storm of recession is becoming an external threat to business continuity around the world. Covid-19 has hit Indonesia's economic growth gradually until it is battered. The business climate is bleak. Many businesses are failing and there are so many layoffs. The implication is that people's incomes are in free fall, followed by a decline in aggregate demand.

The banking business has also entered into a cycle of recessionary storms. Conventional banks in the first half of 2020, their profits fell or were lower than the first half of 2019. Islamic Commercial Banks (BUS) were also not strong enough to stem the recession.

BNI Syariah experienced a decline in the level of profit and financing in the first half of 2020. As a result, the world economic recession due to Covid-19 became a formidable challenge that could hamper the growth of financing, market share, net profit, and assets of the merged national Islamic bank.

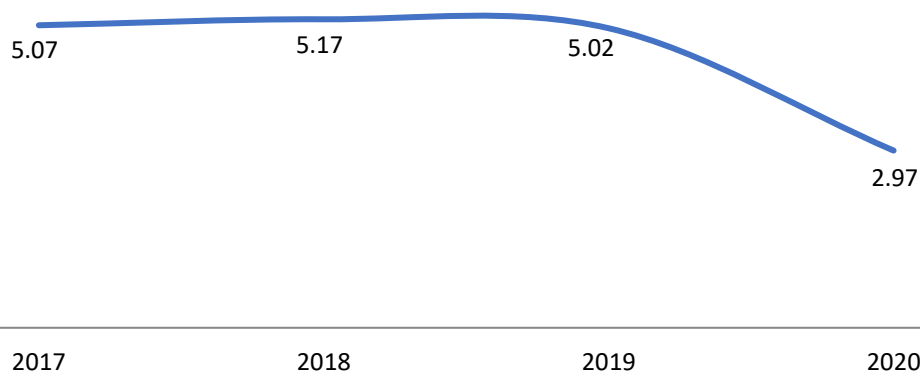


Figure 3. Indonesia's Economic Growth 2018-2020 (in percent)

Source: Katadata (2020).

¹CNBC Indonesia. (2020). Bank seret salurkan kredit, RI resesi lagi? <https://www.cnbcindonesia.com/market/20201130110031-17-205615/bank-seret-salurkan-kredit-ri-resesi-lagi>

²Bisnis. (2020). Di tengah pandemi Covid-19, Bank CIMB Niaga bukukan laba Rp1.74 triliun <https://finansial.bisnis.com/read/20200730/90/1273005/di-tengah-pandemi-covid-19-bank-cimb-niaga-bukukan-laba-rp174-triliun->

The economic recession in 1997/1998 became an appropriate stepping stone to describe the pre and post-depression banking conditions. As well as being the main reference capital for analyzing banking capabilities after the depression due to Covid-19.

Harmanta and Ekananda (2007) examined the demand and supply of commercial bank credit in Indonesia for the period January 1993 - December 2003. This post-crisis 1998 research is a reference choice to see how the recession affected the performance of pre-crisis and post-crisis banking credit demand and supply.

Hermanta and Ekanada (2007) concluded that the credit market in Indonesia experienced disequilibrium during 1993-2003. Pre-crisis period 1993-1997 there was an excess demand for credit from the public. The pre-crisis period was marked by a high-growth economy, triggering increased demand for credit from the public.

Credit grows very fast up to 25.58% per year. Credit growth is faster than lending capacity, which grows at a lower rate of 22.05% per year. Loans that grew and lower third party funds were evidenced by the loan to deposit ratio (LDR) during the crisis period, which averaged 108.72%.

The rapid economic growth pre-crisis 1997/1998 made people complacent, so that the precautionary principle was abandoned by all parties. Banks provide credit beyond their capacity, entrepreneurs have a high debt to equity ratio.

In other words, people's consumption, production, and investment work exceeds their financial capacity. During the 1997/1998 crisis period, the supply of credit from banks decreased. Weakening credit supply was influenced by slowing growth in third party funds (DPK). As a result, the ability of banks to extend credit to the public also slowed down.

During 1999, there was an excess supply of credit from banks. Triggered by the recovery of banking institutions by the government after the crisis, as well as the restoration of depositors' confidence in banking. Coupled with the recapitalization of the national banking system by the government with the merger of four national banks into Bank Mandiri, it has also been a driving force for banks' ability to extend credit.

The increase in credit supply was not followed by an increase in credit demand from the public. People are reluctant to apply for post-crisis credit due to three major variables. First, economic conditions that have not grown as pre-crisis growth. Second, people still think that the business climate has not yet recovered. Third, loan interest rates are still high.

Slow credit growth after the 1997/1998 to 2003 crisis was evidenced by the loan to deposit ratio (LDR) below 50%. Conditions that are very contradictory to the pre-crisis period with LDR of more than 100% (Harmanta & Ekananda, 2007).

The 2020 economic recession became a milestone in the history of the worst credit distribution growth after the 1997/1998 economic crisis. October 2020 banking credit disbursement experienced a contraction. Credit growth in October 2020 was only 0.9%. Meanwhile in September 2020, credit growth experienced a deep contraction touching the figure of -0.4% YoY (see Figure 4).



Figure 4. Banking Credit Growth 2003-2020 YoY (in percent)

Source: CNBC Indonesia (2020).

Gross Domestic Product (GDP) has a positive and significant relationship to credit demand (Harmanta & Ekananda, 2007). Increased economic growth will increase public demand for credit. On the other hand, when GDP is in free fall (recession), the demand for credit will decline. Like the 2020 economic recession, GDP plummeted, followed by a free fall in credit growth.

Figure 4 is a manifestation of the significant effect of macro variables on credit growth or bank financing. Research Syachfuddin and Rosyidi (2017) with a multiple linear regression approach, explains that simultaneously GDP, inflation, third party funds (DPK), and the amount of financing (market share) greatly affect the return of assets (ROA) of Islamic banking.

On the other hand, partially financing growth has a significant and positive effect on ROA. ROA is the ability of banks to generate profits through the use of bank assets. As a result, financing growth has become the main support for the growth of profit and banking assets.

Therefore, financing growth is the key to increasing banking profits and assets. The higher the financing growth, the higher the profit and total banking assets. However, the 2020 economy was hit by a wave of recession.

Of the three sharia banks that participated in the merger, BNI Syariah bank was hit on the financing and profit side (see Table 4). The history of growth in financing and net profit since 2017-2019 was broken by the storm of the 2020 recession that emerged due to the Covid-19 pandemic. Financing and profit from semester 1 2017 – semester 1 2019 experienced a significant increase. The recession storm hit, BNI Syariah financing fell 1.07%, followed by profit which fell to 15.45%.

Table 4. BNI Syariah Bank Financial Ratios Semester 1 2020

| Year | Asset (trillion rupiah) | TPF (trillion rupiah) | Financing (trillion rupiah) | Net profit (trillion rupiah) | NPF Gross (%) |
|-----------|----------------------------|--------------------------|--------------------------------|---------------------------------|---------------|
| June 2017 | 30.7 | 26.7 | 22.5 | 165 | 3.38% |
| Juni 2018 | 37.7 | 32.4 | 25.1 | 202.9 | 3.04% |
| June 2019 | 42.49 | 36.32 | 31.66 | 315.27 | 3.03% |
| June 2020 | 50.76 | 43.64 | 31.33 | 266.64 | 3.78% |

Source: (BNI Syariah Bank Financial Report, 2020)

The recession due to the pandemic is not clear when it will end, becoming a stumbling block that hinders the penetration of Islamic bank assets as the main goal of the merger. Economic growth contracted to -5.32, resulting in a decline in national credit reaching -0.4%.

In the vortex of the decline in national credit, there is data on BNI Syariah bank financing which decreased by 1.07%. This was followed by a decrease in BNI Syariah's profit of up to 15.45%. Data on declining financing and profit for BNI Syariah is a sign that some of the participants in the merger are stumbling due to the recession.

Distribution of financing to the community will be difficult. Like the history of credit distribution after the 1997/1998 crisis until 2003. It takes a long time of up to 5 years for the economy to recover as before the crisis.

Although the supply of financing from banks is high, the demand from the public is low. The public will be reluctant to apply for post-crisis financing with rational considerations. First, economic conditions that have not grown as pre-crisis growth. Second, the business climate has not fully recovered. Applying for financing for business capital where the climate is still bad, has a high risk of failure.

Economic conditions that have not yet grown and the business climate that has not recovered after the recession are the biggest stumbling blocks in the process of financing expansion or expanding the market share of Islamic banking. When market share growth is hampered, the increase in profits and assets (ROA) will also be hampered.

BSI's Internal Challenges during Recession

The economic recession in 2020 triggered a major shock in the internal banking sector. Recession has an impact on increasing financing risk, market risk, and operational risk. Rising risk during a recession is a major challenge for internal banking.

Banking resilience was tested when the economic crisis rocked. Based on historical data, the 1997/1998 crisis devastated the banking sector. State-owned banks such as the Export-Import Bank (Exim), Bank Dagang Negara (BDN), Bapindo, and Bank Bumi Daya (BBD) have ravaged their financial performance (Yulianti, 2005). The ability of banks to provide funds or the capital adequacy ratio (CAR) to overcome the risk of loss is far from standard. In 1998, the CAR of Exim was -114.91%, Bank Dagang Negara -79.3%, Bapindo -30.44%, and Bank Bumi Daya (BBD) -39.57%. The performance of banks in printing profits based on assets owned or return on assets (ROA) also slumped. ROA Exim -158.91%, ROA Bapindo -106.76%, ROA BBD -127.81%, and ROA BDN -106.59%. The level of loan to deposit ratio (LDR) which is an indicator of a bank's ability to meet short-term obligations (liquidity), has exceeded the threshold. LDR BBD reached 130.96%, BDN 174.74%, Exim 191.19%, Bapindo 128.51%. A high LDR indicates that the credit extended to the public is higher than the DPK collected by the bank.

4 State-owned banks that were staggering, sick, and falling were restructured by the government by merging. 4 the failing bank was finally officially restructured on October 2, 1998 and changed its name to Bank Mandiri. The consequence of the merger is a reduction in the number of branch offices and employees.

After the 1998 crisis, it took 10 years to boost economic growth to around 6% like pre-crisis growth. Therefore, at the beginning of the merger period, Bank Mandiri faced extraordinary challenges due to the still sluggish economy.

In terms of profit, the first year Bank Mandiri suffered a loss of Rp124.14 billion. In the second year, Mandiri Bank still suffered a loss of Rp67.79 billion. Bank Mandiri's non-performing loan (NPL) still exceeds the Bank Indonesia threshold which requires it to be below 5%. The 2004 NPF touched 7% (see Figure 5). Even in 2005 it increased drastically by 26% (Yulianti, 2005).

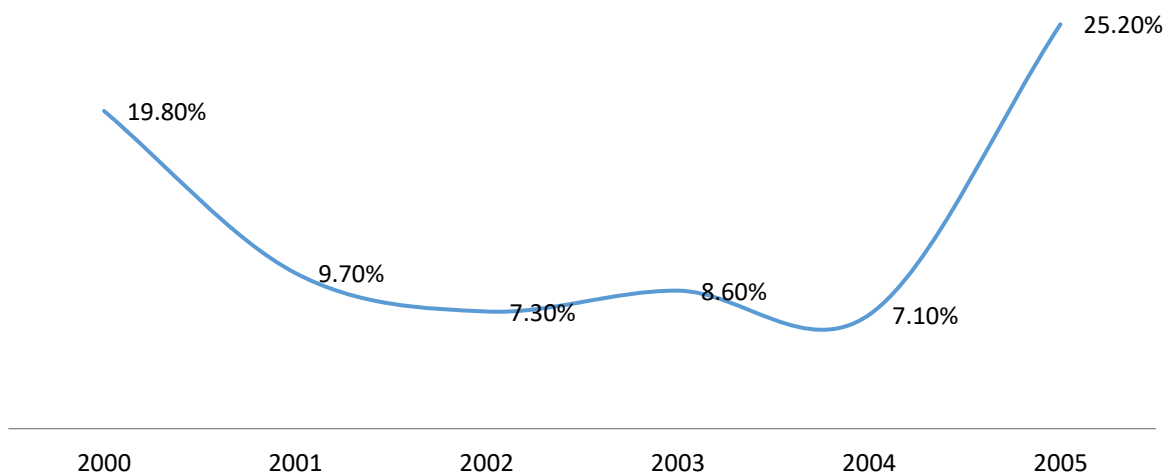


Figure 5. NPL Bank Mandiri Post Merger
Source: Yulianti (2005).

The condition of Bank Mandiri as a result of the restructuring in 1998 and the 3 state-owned Islamic banks in 2020 have several similarities. First, they were both merged during the national economic crisis. The economic recession causes people's purchasing power to decline. As a result, many companies have gone out of business. So that the demand for financing from the public will decrease. This was followed by a decrease in public savings. Second, the downward trend in net profit to below zero that hit Bank Mandiri at the beginning of the period had the same pattern as the downward trend in the profits of the 2 sharia banks participating in the merger. Bank Syariah Mandiri and Bank BNI Syariah experienced a decrease in net profit in the first semester of 2020, due to the recession that emerged due to Covid-19. Third, Bank Mandiri's NPL which rose in 2004-2005 was in the same pattern as the trend of increasing NPF of 3 merger participant sharia banks. Bank BSI was formed from 3

Islamic banks that experienced a trend of increasing NPF, due to Covid-19. Therefore, the merger process will face several challenges of internal fundamental financial ratios that can hinder the process of increasing market share and assets of Islamic banks.

Financing Risk Challenges Increase

Financing risk is the risk that arises as a result of the customer failing to fulfill the obligation to return the money that has been disbursed by the bank. Failure to pay arises due to the bank's lack of accuracy in assessing and supervising the customer's business. On the other hand, defaults also arise due to things beyond the control of banks and customers, such as the gloomy business climate due to the recession.

The value of non performing finance (NPF) is an indicator to assess the performance of non-payment of Islamic bank customers. A good NPF standard for banks is less than 5%. NPF is measured by the ratio of non-performing financing to total financing. The more customers who default, the higher the NPF ratio.

The pattern of increasing NPF trends emerged during the economic crisis. At the beginning of the 1998 crisis, the rupiah exchange rate fell sharply against the dollar. On the other hand, many companies have short-term foreign debt. Practically, many companies cannot pay their foreign obligations and find it difficult to repay loans from banks.

Many companies are sick and lying, practically unable to pay obligations that are due. In practice, banking NPLs during the 1998 crisis rose sharply. The consequence of increasing NPL is that banks operate in a loss position and their capital declines and even erodes to negative (Harmanta & Ekananda, 2007).

The trend of increasing NPLs that occurred in Bank Mandiri as a result of the merger of 4 state-owned banks during the crisis and post-crisis 1997/1998 repeated during the 2020 economic recession. The trend of NPF of 3 sharia banks participating in the merger increased, due to the recession.

NPF Bank BRI Syariah in semester 1 2020, higher than Bank Syariah Mandiri and BNI Syariah (see Figure 6). In 2019, the NPF of Bank BRI Syariah 2019 was 3.38%, then moved up to 3.99% in semester 1 2020.

The pattern of increasing defaults for Bank BNI Syariah customers has also increased. From 3.03% in 2019, then it rose to 3.78% in semester 1 2020. Compared to the 3 participating banks in the merger, only Bank Syariah Mandiri had a flatter NPF ratio in 2020, namely 2.57%.

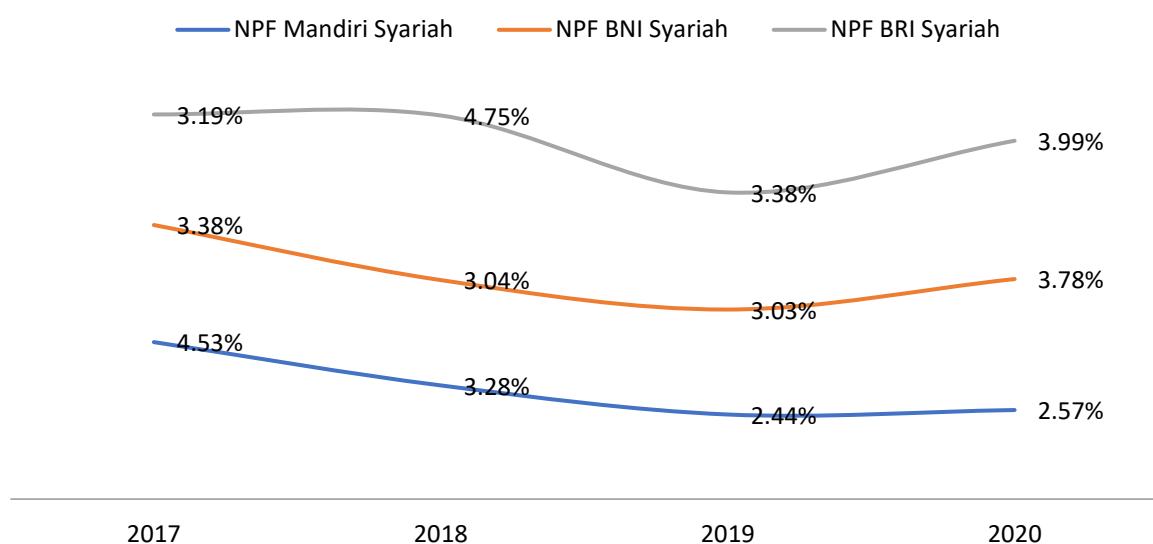


Figure 6. NPF Ratio of 3 Banks Participating in the Merger of BSI Semester 1 2020

Source: Financial Statements of BRI Syariah, BNI Syariah, and Syariah Mandiri.

The increased NPF ratio due to the economic recession has a negative impact on the growth of Islamic bank assets. Research Pratiwi (2015) which examines the effect of NPF, FDR, and ROA on

asset growth with the fixed effect model (FEM) approach provides an answer that partially and simultaneously, NPF has a negative effect on bank asset growth. As a result, the growth of bank assets will increase when non-performing financing decreases. On the other hand, asset growth will decrease when NPF increases.

The ratio of increasing NPF can also reduce ROA levels in the long run. [Yundi and Sudarsono \(2018\)](#) tested the effect of Islamic bank NPF on the ROA level through the vector error correction model (VECM) approach. The test results show that in the long term, NPF has a negative effect on the level of ROA. The coefficient in this study is -0.20. Thus, a 1% increase in NPF has an impact on decreasing ROA by -0,20%.

The decline in NPF is the result of customers' success in returning financing to Islamic banks. At the same time, it also reflect the success of bank management in managing financing risk. However, the 2020 recession conditions with sub-zero economic growth and a hostile business climate have given rise to an increasing trend of customer defaults.

The trend of increasing NPF that afflicted the three merger-participating Islamic banks became a big challenge for BSI's financing risk management. The risk mitigation plan for the increase in NPF must be carried out by BSI, so that Islamic bank assets are not eroded and the ROA level increases after the merger process.

Net Profit Challenges Decline

The 2020 recession which gave birth to a gloomy business climate resulted in an increase in defaults. The inability of customers to repay loans due to an unfriendly business climate has created new problems for banks, namely the decline in profit levels.

Of the three red plate Islamic banks participating in the merger, only BRI Syariah bank experienced a significant increase in profit in semester 1 2020 (see [Figure 7](#)). Net profit of Rp74 billion in 2019, increased to Rp117 billion.

On the other hand, the net profit of BNI Syariah and Syariah Mandiri banks experienced a decline. Profit of BNI Syariah bank Rp315 billion in 2019, slumped to Rp266 billion in semester 1 2020. Bank Syariah Mandiri also experienced a significant decline in profit. The achievement of Rp1.27 trillion in 2019, fell sharply to Rp720 million in semester 1 2020.

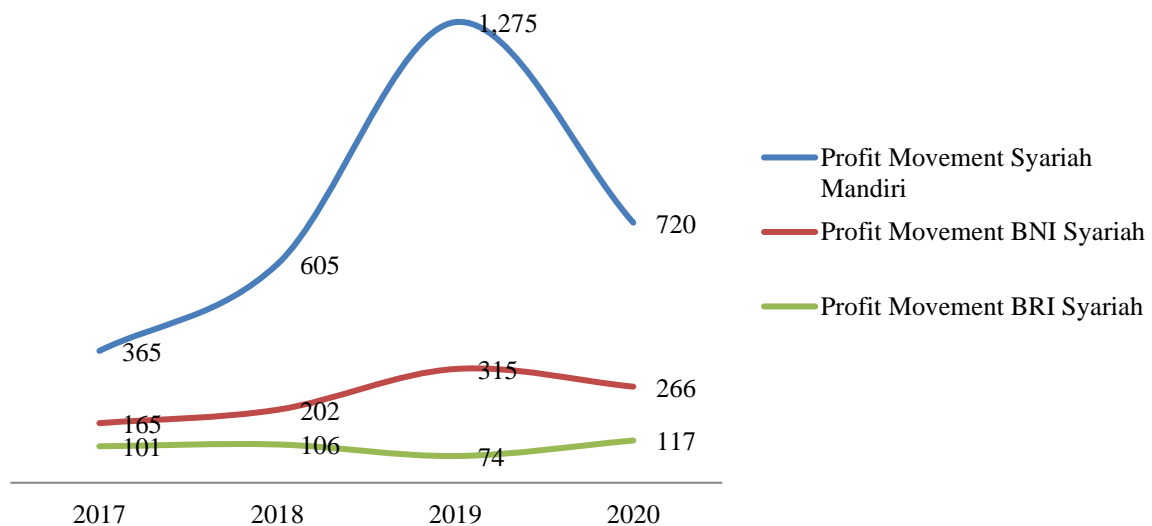


Figure 7. Profit Movements of Three Sharia Banks Participating in the Merger of BSI
Source: Financial Statements of BNI Syariah, BRI Syariah, Mandiri Syariah.

The results of the study [Al Baihaqy \(2017\)](#) regarding the soundness of banks and profits at Islamic commercial banks illustrates that the level of customer default has a significant and negative effect on

the profits of Islamic commercial banks. High problematic financing is certainly a frightening specter for banks.

The scourge is currently roaming the recession. The bad business climate during the pandemic resulted in customers not being able to return financing to Islamic banks in a timely manner. The delay in the return of financing has an impact on the net profit achieved by Islamic banks.

The uncertainty of when the pandemic will end has made the process of economic recovery take a long time. As long as the recession has not recovered, during that time, the NPF level will rise and have an impact on BSI's profit decline.

The challenges of rising NPF trends and declining profits need to be mitigated so as not to create new problems for BSI like the problem of declining sukuk ratings. The declining sukuk rating has prevented BSI from obtaining capital from the process of issuing sukuk. The main purpose of merging three Islamic banks into a BSI entity is to obtain large funding. One of the major sources of funding comes from sukuk. If there is a decline in the sukuk rating due to declining profits and rising NPF, the goal of obtaining fresh funds from sukuk will be hampered.

The Challenge of Declining Sukuk Ratings

One of the backgrounds that triggered the idea of merging the three state-owned Islamic banks was the desire to obtain funding from the issuance of sukuk. So far, bank funding originating from sukuk issuance compared to conventional debt securities in Indonesia is still below 5%. With the presence of BSI as a merged bank, it is hoped that bank funding from sukuk can increase. On the other hand, the issuance of sukuk is not easy, there are many challenges that must be faced. The presence of a recession in 2020, makes the challenges even more difficult.

First, the business climate is not as normal as it was before the recession. Second, when the business climate is not normal and economic growth has not increased, the owners of capital will not allocate their funds in risky investments, such as stocks and sukuk. Capital owners prefer to allocate investments that are safe and not risky, such as investing in gold or precious metals. Third, the declining profit of BNI Syariah and Mandiri Syariah, followed by the trend of increasing NPF of the three Islamic banks that formed BSI had an impact on the sukuk rating. In the context of sukuk, sukuk rating information is an expression of financial information and the condition of banking financial health.

Bank Muamalat has experienced a downgrade of its sukuk rating, due to non-performing financing. From April 2016 to April 2017 the sukuk rating of Bank Muamalat fell from id+ to idA-. The downgrade of the securities rating was due to non-performing financing at the end of 2015 which reached 4.2%. The increase in Bank Muamalat's NPF in 2015 was caused by the decline in commodity prices and the weakening of the global economy (Al Haraqi & Ningsih, 2017).

In addition to NPF, ROA also affects the sukuk rating. The results of the study [Hadinata \(2020\)](#) explain that ROA partially has a significant effect on the sukuk rating. The higher the ROA, the higher the sukuk rating. ROA is the result of the rate of profit on total assets. The decline in the level of profit suffered by Islamic banks in semester 1 2020, can affect the decline in ROA.

The sukuk rating information issued by Pefindo (Indonesian Securities Ratings) is a consideration in making decisions for investors. The better the sukuk rating, the better the bank's strength in repaying principal obligations and distributing profits to investors. In the context of sukuk, investors prefer sukuk that have the best ratings.

The decline in NPF and Profit of Islamic banks in the midst of a recession added a new challenge for Islamic banking after the merger, namely the decline in the sukuk rating. The decline in the sukuk rating has an impact on decreasing investor confidence to invest in the sukuk issued by BSI.

November 10, 2020 Pefindo released the ratings for the sukuk of 3 participating banks. Bank Syariah Mandiri's sukuk rating is in the idAA+ position, BNI Syariah is idAA+, and BRI Syariah is idAA+.

The position of idAA+ in November 2020, could be in danger of dropping to idAA. As a result of the decline in the level of profit at the two participating banks in the merger coupled with the rising trend of non-performing financing that befell the three participating banks in the merger. The decline in the sukuk rating has made investors not interested in the sukuk issued by BSI. Thus, the purpose of the merger to increase funding sourced from rate is hindered.

Conclusion

BSI as a sharia bank resulting from the merger during the global economic recession due to the Covid-19 pandemic will face many challenges. Based on the experience of Bank Mandiri as a merged bank during the 1998 economic crisis, Bank Mandiri scored negative profits in the first and second years after the merger.

The condition of Bank Mandiri as a result of the restructuring in 1998 and the three sharia banks participating in the merger have similarities. First, they were both merged during the national economic crisis. Second, the downward trend in net profit to below zero that hit Bank Mandiri at the beginning of the period had the same pattern as the downward trend in the profits of the two sharia banks participating in the merger. Due to the recession, Bank Syariah Mandiri and Bank BNI Syariah experienced a decrease in net profit in semester 1 2020. Third, Bank Mandiri's NPL which rose in 2004-2005 was the same pattern as the upward trend in the NPF of 3 merger participant sharia banks. Mandiri Syariah, BNI Syariah, and BRI Syariah experienced a trend of increasing NPF due to Covid-19.

Low economic growth, business climate during the pandemic, and uncertainty of the Covid-19 pandemic, are stumbling blocks that hinder BSI's financing expansion. As a result, the economic recession due to Covid-19, which is not yet clear when it will end, creates complex challenges for BSI. Starting from slow financing, increasing NPF, declining net profit, and declining sukuk ratings. These complex challenges must be mitigated by the BSI policy makers. Thus, the goal of penetration of sharia assets and funding from rate can be realized.

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