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Islamic Banking in Indonesia: New Perspectives on Monetary and Financial Issues

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The subject of the book "*Islamic Banking in Indonesia: New Perspectives on Monetary and Financial Issues*" is of paramount importance for the academicians, market practitioners, and policy makers in the Arab and Muslim world. The importance of the book does not only stem from the fact that it deals with the peculiar specifics of the Islamic banking industry of the largest Muslim country in the world, namely Indonesia, but also because it tackles interesting issues that are common to other financial markets either in the Muslim world or in the well-functioning financial markets. The book is intended to be a reference for graduate students in Islamic banking and finance programs. The author organizes the book in a coherent manner that helps the readers to start with the basics of the Islamic industry in a general set-up to understand sophisticated quantitative and econometric issues. I do believe that the book will positively echo in South-Asia financial markets. It will further play an operative role in the practice of Islamic banking.

The book consists of a foreword, a preface and seven parts as listed below:

1. Islamic finance and the Indonesian Islamic banking activity.
2. Liquidity risk management: theory and practices.
3. Performance of the Indonesian Islamic banking industry.
4. Assessing liquidity risk.
5. Withdrawal and bankruptcy risk.
6. Financing performance.
7. Current issues of Islamic monetary instruments, bank financing, and performance.

These seven parts are divided into 27 chapters that cover a wide range of issues related particularly to the industry of Islamic banking in Indonesia. The latter started in 1991-1992 with the establishment of the first Islamic bank and has been continuously marked by a steady growth of assets that amounted to around 40% per year. The industry is also characterized by a sizeable increase of the number of depositors and offices all over Indonesia. The establishment of the first Islamic bank brought forth the emergence of other forms of Islamic financial institutions in Indonesia ranging from Islamic cooperatives to Islamic mutual funds. The status of the industry indicates that it is prosperous and has a flourishing potential of development and expansion considering the large Muslim population in the country, the strong local demand for Islamic finance products and services, the real-sector-oriented Islamic banking operations. Four major handicaps challenging the industry are noticeable: (i) there is a problem of liquidity risk in the industry (ii) shortage of qualified human resources (iii) underdevelopment of the Islamic financial market in Indonesia; (iv) high sensitivity of individual customers vis-à-vis the PLS-based return on their deposits. A supplementary reason could also be placed at the front of the handicaps, namely; the scarcity of Islamic financial products. Indeed, the Indonesian Islamic banking suffers from the lack of innovation and the inability of financial engineers to design new financial innovations that are simultaneously profitable to the banks and fulfill the objectives of Islamic law in terms of social justice, equitability of welfare.

In sum, the book is an excellent contribution that will be very valuable for the practitioners and academicians. The following dimensions are particularly appreciable:

1. Although the book is not the first in English, it is innovative since it links the investigation to the peculiar specificities of the Indonesian economy in terms of regulation, macroeconomic aggregates, and firm-specific indicators. The contribution of the book consists in the interesting empirical evidences, practical implications, and policy decisions.

2. In the first part, the author explores the Islamic finance and the Indonesian Islamic banking industry. He starts with the early transactions modes during the era of the Prophet (PBUH), sheds some light on the development of the industry in Indonesia, and elucidates a program

aimed at enhancing the performance of the sector and overcoming the major challenges of the industry (small market share, lack of human resources, and lack of product development). For example, the proposed program is an attempt to solve the problem of small market share by implementing strategic actions that Islamic banks can take in order to educate the public and improve the image of the Islamic banks. Such actions could be enforced by combining the efforts of market players, Islamic banks, banking regulators, governmental authorities, alongside with the Sharīʿah scholars in the familiarization the public with the vital role of Islamic banks.

The proposed program is also an effort to solve the problem of product development. Indeed, the Indonesian Islamic banks should be oriented towards adopting a strategy according to which new products are offered to individual customers, as well as corporations and individual investors. A solution that could exemplify innovative financial products is the combination of existing products such as forward lease and investment of the investor (*muḍārabah*). Furthermore, some financial products that are already traded in the GCC countries and Malaysia could also suit the Indonesian Islamic banking. Ultimately, the combination of Islamic banking products and insurance products could also work perfectly, such as bancassurance products.

3. The second, third and fourth parts deal with the theoretical foundations of liquidity risk and its practical assessment methods. The Islamic banking operations in Indonesia have unique characteristics related to liquidity management and the tools that are used in practice. Indeed, the International Financial Services Board (IFSB), which is the international Islamic standard setting body, provided Islamic financial institutions with qualitative and quantitative guidelines on liquidity risk management. Such guidelines reflect the perspective of Sharīʿah on liquidity risk on the asset and liability sides. The essence of these guidelines is a cooperative liquidity risk management program that engages investors, entrepreneurs, and stakeholders. The author links this general setup with the economic features of the Indonesian market. Indeed, the Islamic banking sector in Indonesia has been working since 1992. Its performance has been assessed, and it turns out that, other things being equal; it is characterized by a healthy financial intermediary function and prudential banking operations. However, the Indonesian Islamic banks should take into account

supplementary factors when considering the investment behavior of individual customers and client firms, alongside with some macroeconomic factors such as the aggregate saving.

The author notes some interesting facts and issues regarding the liquidity risk management in Indonesia. One salient fact is that the liquid deposits on the liability side are subject to potential short-term liquidity withdrawals from depositors. The Indonesian Islamic banks implemented a practice that is not ideal. Indeed, they benefited a positive and regular income from short-term debt financing and thus by locating the funds in short-term financing to manage the short-term demand for liquidity. This practice is not ideal since it does not spur the long-term economic development through financing long-term projects.

4. The fifth and sixth parts deal with withdrawal and bankruptcy risk and discuss the financing performance. One of the major risks Indonesian banks face is the risk of withdrawal. Due to the scarcity of empirical studies dealing with the withdrawal risk in Indonesia, the author conducted a survey to examine the behavior of depositors in Indonesian Islamic banks. The general finding of the study shows that the interviewed depositors believe that the compliance of Indonesian Islamic banks with Sharīʿah is the most important factor determining the withdrawal behavior of depositors. The author advances three major reasons for this behavior; namely (*i*) if the amount of return sharing is less than the previous period, (*ii*) if the amount of return sharing is less than interest on conventional deposits, and (*iii*) the willingness of depositors to adjust the tenor of deposits. The status of these factors determines the probability of withdrawal by depositors. The implications of these findings could not be generalized not only in the South Asian countries but also in the Indonesian market itself. Indeed, the results would be different if corporate depositors such as large firms were included in the survey since the sensitivity of individual depositors is different from that of corporate depositors. Further, the withdrawal behavior of corporate depositors cannot be simulated using the behavior of individual depositors. Accordingly, a more comprehensive analysis could reflect more accurately the drivers of deposit withdrawals in Islamic banks.

Apart from these general aspects of the book, I would like to mention that there are some shortcomings. Although the author identified the lack of product development as one of the major challenges confronting the Islamic banking industry, little attention has been paid to the innovation of new Islamic financial products. Most of the studies tilt toward econometric investigations and policy implications. The author would have injected a deeper analysis of the tools that fit the needs of corporate and individual players in the sectors particularly in terms of risk allocation and capital distribution. The second critique is that the author remained silent about *Maqāṣid al-Sharīʿah* (i.e., objectives of Islamic law). The book would have been more comprehensive if it discussed the implications of the findings in terms of *Maqāṣid al-Sharīʿah* in order to assess the degree to which the Islamic banking industry is fulfilling them. I would consider them as the "compass" for Islamic bankers and policy makers in Islamic financial markets. Implementing new policies, strategies, and actions that do not fulfill them is like navigating without a compass.

In sum, the book shows that the author has a professional approach and this book testifies his ability to connect ideas and interpret them according to the specificities of the Indonesian economy.

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