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Strategic Agility Diversification Investment: Islamic Financial Inclusion on the Financial Performance of Sharia Banks

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Abstract:

This study aims to conceptualize new variables as an intervention on the relationship between Islamic financial inclusion and the financial performance of Islamic banks. This variable is the strategic agility diversification investment (SADI) which is an integration of the resource-based and portfolio theories. The methodology is to derive the two theories, which are integrated based on a logical connection. SADI is used to mediate Islamic financial inclusion (challenges facing financial inclusion, benefits of financial inclusion, and realization of financial inclusion) in predicting the financial performance (activities, operations, products, and services) of Islamic banks. The result is that the conceptual SADI can be an intervention for improving the financial performance of Islamic banks in conditions where Islamic financial inclusion does not directly support the performance of Islamic banks.

Keywords: Islamic Financial Inclusion; Strategic Agility Diversification Investment; Islamic Financial Performance.

Introduction

The Islamic financial system is a “"muamalah” for mankind in running the economy. Opromolla (2012) states that Islamic finance uses a financial system that is free of interest. However, the inclusion of Islamic finance in financing investments such as mudharabah and musyarakah contracts for Islamic banks has a greater risk than other contracts (Hoston, 2010; Antara et al. 2017). This agreement contains the losses that must be borne by the bank from the money they have invested in customers. In the provisions of Islamic law, an Islamic bank (*shahibul mall*) will bear the losses from the customer's business-financing contract (*mudharib*). This is what causes the exclusion of various accesses, conditions, prices, marketing, and all aspects related to financial services (Carbo et al., 2005). Lamb (2016) stated that this refusal put the banking sector in a rather disadvantageous position, which clearly had an impact on the financial performance of banks and the global economy. According to Akhtar and Pearce (2010), and Demirgüç-Kunt et al. (2014), financial inclusion (FI) for some member countries of the Islamic Cooperation Organization can be an important aspect of global financial performance. Shinkafi et al. (2019) states that Islamic FI (IFI) can be developed through facing FI, benefits of FI, and realization of FI to improve aspects of financial performance in the Islamic financial system.

1. Literature Review / State–of–Arts / Research Background

Jacobson (1988), Hansen and Wernerfelt (1989), and Rumelt (1991) refer to a resource-based theory on competencies and abilities to build organizational performance. This will have an impact on the company's competitive advantage (Selznick, 1957; Ansoff, 1965; Andrews, 1971; Hofer & Schendel, 1978; Irvin & Michaels, 1989; Wernerfelt, 1989; Prahalad &

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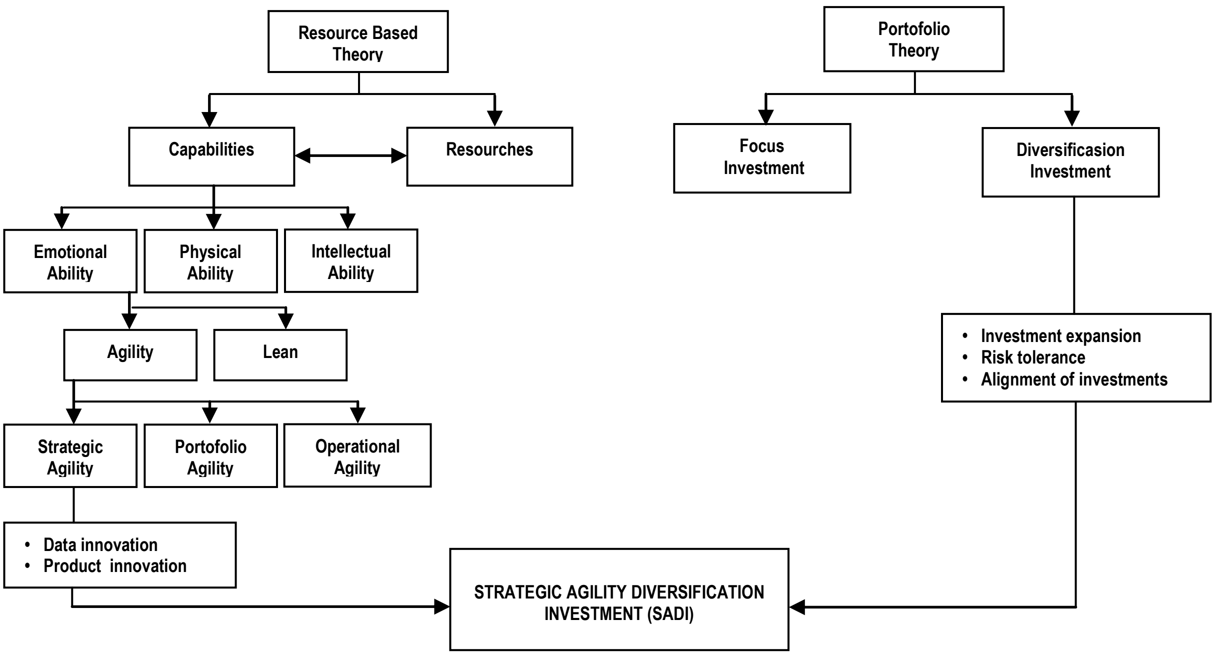
Hamel, 1990; Grant, 1991; Stalk et al., 1992). Amit and Schoemaker (1993) build resources on abilities requiring physical, emotional, and intellectual capabilities (Colquitt et al., 2009). Physical ability is greatly influenced by leanness and agility. Eriksson (2010) states that leanness pertains to a collection of companies with interrelated flow of products, services, finance, and information to operate efficiently and effectively. Meanwhile, Basu and Wright (2008) assess agility as an agile supply chain, which means fast and precise. In the agile dimension, Kuilboer et al. (2016) revealed three things, namely: 1) strategic agility; 2) agility portfolio; and 3) operational agility. Meanwhile, Kasali (2005) stated that strategic agility has two dimensions: data innovation and product innovation.

The agility strategy can be applied to an investment approach, which is related to the quick response of a company in taking action on investment risk at a rate of return in the future. Markowitz (1952), in his portfolio theory, explains that the risk and return of investors must be statistically measurable to make investment decisions on portfolio returns. There are two methods of approach: focus on investment and investment diversification. Hagstrom (1999) posits that an investment focus can be applied to clients by providing welfare and helping them work toward financial success. Meanwhile, investment diversification is the formation of a portfolio investment by selecting a combination of a number of assets so that risks can be minimized. The way to diversify is to organize the contents of the portfolio with financial instruments such as stocks, bonds, among others, the results of which are called portfolios. Diversification can also be done by using stocks from various companies, so that the portfolio formed does not only consist of one type of financial instrument. In the diversification method, Fahmi (2018) shows investment objectives as investment expansion, risk tolerance, and investment alignment.

Figure 1 explains the derivation of the resource-based and portfolio theories. The logic of the connection leads to the integration of the strategic application of agility in building investment diversification.

Figure 1. Resource Based Theory and PortofolioTheory Integration



Source:developed for this research

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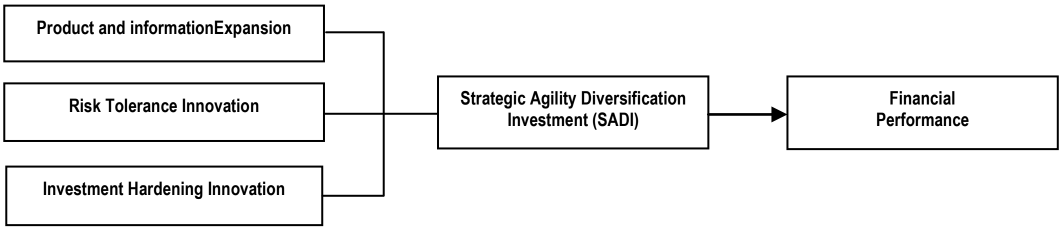
Based on the integration of the dimensions of the resource-based and portfolio theories, one proposition of strategic agility diversification investment (SADI) can be formulated as follows:

Proposition 1: A product and information expansion strategy that leads to risk-tolerant innovation so that it can be used in realigning investment, as an effort to improve financial services.

In this approach, SADI is used as a proxy for the relationship between the financial performance of Islamic banks. Abdullah and Adnan (2012) revealed that the measurement of the financial performance of Islamic banks can be done through three methods: investment, buying and selling, and leasing. Meanwhile, Antonio (2001) assesses the financial performance of Islamic banks through their investment activities in the form of profit sharing. SADI can be a proxy for the financial performance of Islamic banks by expanding products and information tailored to customer conditions. This will relate to risk tolerance innovation from investments that Islamic banks are attempting to run. Therefore, when there are problems with the investment, this risk can be aligned with handling to overcome investment losses. Consequently, it will open up access to the widest possible range of financial services, which will have an impact on improving the financial performance of Islamic banks in terms of activities, operations, products, and services.

Proposition 2: Implementation of SADI in improving Islamic banking financial services, which will open access for customers and trigger the financial performance of Islamic banks.

***Figure 2**. Strategic Agility Diversification Investment Proposition*



***Source:** developed for this research*

In this conceptual study, IFI is an antecedent for SADI in proxies for the financial performance of Bank Syraiah. Antara et al. (2017) view IFI as a way for financial institutions to limit certain financial transactions, because this is considered to have a detrimental impact on bank financial performance or a large risk of loss. In the practice of syraiah banking, this risk is contained in two financing contracts (mudharabah and musyarakah). In the provisions of Islamic law, the two contracts do have a law on the risk of loss that must be borne by banks for investment funds channeled by banks to customers. With the intervention role of SADI, it is hoped that banks can open the widest possible access for all layers to be able to access the two financing contracts, so that the relationship between IFI and the financial performance of Islamic banking can be maintained consistently.

Figure 3. Basic Theoretical Model of Strategic Agility Diversification Investment

Source: developed for this research.

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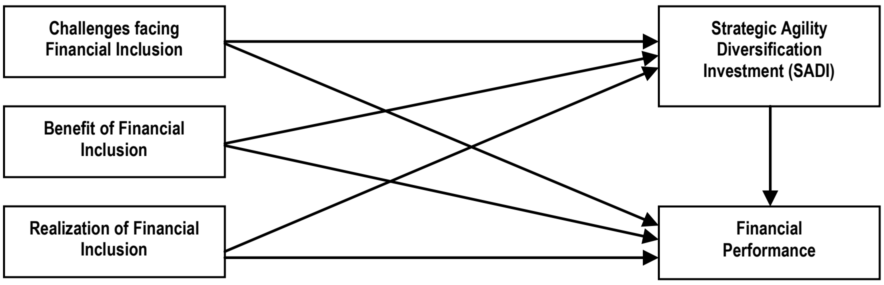
2. Methodology

This conceptual research uses a derivation methodology from two basic theories (resource-based theory and portfolio theory) to form new variables(e.g. Anum & Apriyanto, 2019; Apriyanto & Anum, 2020; Apriyanto & Nurhayaty, 2019; Hidayat et al., 2019). The derivation of the resource-based theory begins with integrating two derived dimensions: resources and capabilities(Kerr et al., 2018). Capabilities have three dimensional aspects: emotional abilities, physical abilities, and intellectual abilities, while in this path, the derivation is through physical abilities. Physical ability has two aspects: lean and agility, in this path, derivation is through the agility pathway. Agility has three derivative aspects: strategic agility, portfolio agility, and operational agility, in this path, derivation is through the strategic ability path. The portfolio theory is divided into two approaches: diversification investment and focus investment, while the derivatives are through investment diversification. The integration of these two theories forms SADI, and is used to intervene in the relationship between natural FI: challenges facing FI, benefits of FI, and realization of FI on the financial performance of Islamic banks.

Figure 4. Empirical Research Model



Source: developed for this research.

3. Case studies/experiments/ demonstrations/ application functionality

Challenges Facing Financial Inclusion on Strategic Agility Diversification Investment

The World Bank (2016) reports that there are still more than two billion people in the world, especially the poor, who do not have access to financial services. This condition is a challenge for FI, where access to finance is a very important component that can be used in presenting data as a source of information needed in the segmentation of banking financial services. Limited access to financial services is a challenge for financial organizations to be able to create an agility strategy in investment diversification. An agility strategy that can be used to exploit the challenges facing FI is to create information expansion for investment diversification in Islamic banking financial service products. As we know, the challenges facing FI are the limitations that a person has in obtaining financial services due to the absence of collateral, access to accounts, business informality, inadequate financing, difficult access, gender gaps, lack of infrastructure, and social isolation that can make “them” unable to develop economically, even though they have good personal characteristics. This information expansion is aimed at obtaining information about personal characteristics rather than financial requirements for someone who is said to be eligible for financial services from the banking sector. This is in line with the function of Islamic banks, which prioritizes achieving the benefit of the economy along with Islamic banking products in accordance with these principles.

Benefits of Financial Inclusion on Strategic Agility Diversification Investment

The benefits of FI related to financial services for the poor are reduced costs, efficient allocation, productivity, business facilitation, family facilitation, poverty reduction,

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supporting capital, financial services, and reducing income inequality. This can be used in empowering the value of financial resources for the benefit of the wider community. Benefit of FI is also in line with the challenge facing FI, which is developed through an agility strategy in the aspect of expansion of personal characteristics assessment information. This development will be in line with the wishes of the community, with the exception of financial services, to benefit from FI. Islamic banks can cut all aspects, especially those related to the costs they have to spend to get financial services in the application of operational acceleration. Islamic banks are considered relevant and competitive in adjusting the form of financial services according to the conditions at every level of society. This is because, in the Islamic banking system, the main objective is to fulfill social expectations through equal access to financial services for mutual welfare. Benefit of FI, especially in its agility strategy, is to be able to adjust to conditions of income inequality, inequality of benefits, partiality of financial regulations, and financial contracts to the lower classes of society. Islamic banks can carry out an agility strategy based on the benefits facing FI by opening every opportunity for the untouched layer. This is intended so that the untouched layer gets services on investment tolerance innovations carried out by Islamic banks to expand financial services, expand business opportunities, manage risks, overcome financial shocks, invest, and advance the superiority of “their” life.

Realization of Financial Inclusion on Strategic Agility Diversification Investment

Realization of FI is a form of strong technology, financial proficiency, financial literacy, political commitment, financial infrastructure, microfinance, public awareness, and legal/regulatory needs that will affect SADI. In a condition where there is the realization of FI in a poor community, this must be addressed by Islamic banking with an agility strategy in the form of innovation in adjusting to investment in accordance with conditions where the community is not supported by technology, financial knowledge, economics, and so on. The point is that the agility strategy formed is a continuation of challenges facing FI for “them” on the basis of personal characteristics, while the benefits of FI are by referring to these personal characteristics, so this can reduce costs such as additional costs for securing investment, guarantees, among others. The realization of FI can be carried out through the adjustment of investment risks through social funds provided during conditions where “they” are falling. Thus, the realization of FI is a significant factor and plays a role in the agility strategy of diversifying “their” investment.

Challenges Facing Financial Inclusion on Financial Performance

Challenges facing FI for developing countries is to eradicate poverty due to illiteracy, weak education, and the country’s infrastructure. This of course will cause distortion to the development of the financial system because infrastructure, networks, and telecommunications can affect the success of the microfinance program. Recommendations from the results of these studies for conventional and Islamic microfinance will greatly impact financial performance because the main issue is that poverty alleviation depends on the role of the government. If we compare it with developed countries that have shown the success of their government in facing FI challenges by building good infrastructure and making citizens financially literate, this will affect the income of the population per capita. The government seeks to facilitate financial institutions to provide support for infrastructure development for areas that are still lagging behind in these developed countries. Therefore, the challenges faced in FI in the form of financial access can be made available as widely as possible for all people. This increase in access will help the economy in areas that are still lagging behind and will have an impact on improving the financial performance for all financial institutions.

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Benefits of Financial Inclusion onFinancial Performance

In every country, whose government is able to change challenges facing FI into benefits of FI, it is certain that the performance of financial institutions will also improve. This is because the country can create financial facilities that make it easier for its citizens to obtain financial services, so that this will have an impact on bank performance in the country's economy. Banking financial performance as measured by gross income and return on assets is highly dependent on the conditions of the country in creating benefits for its FI. The government strives to create stability for credit for small and medium enterprises (SMEs), savings for SMEs, number of automatic teller machines (ATMs), number of ATM services, number of credit cards, and new financial services to facilitate transactions for its citizens. This can encourage an increase in the income of the population in that particular country, which will also affect the financial performance of the banks in that country.

Realization of Financial Inclusion onFinancial Performance

The realization of FI that can support the financial performance of banking institutions is in terms of: strong technology, microcredit and microfinance services, legal commitment to Islamic financial institution policies, public awareness of Islamic finance, financial literacy skills, and financial infrastructure that will affect performance. The realization of IFI can realize financial performance if the supporting aspects are inflowing information that is useful for financial institution investment decisions. Besides that, there is also the role of professionals, regulators, policy makers, stakeholders, and practitioners of Islamic financial institutions who also have a significant role in creating financial performance for these financial institutions.

Strategic Agility Diversification Investment on Financial Performance

The role of SADI for Islamic banking financial performance is when this variable can facilitate IFI. This condition cannot be separated from the challenges facing FI, the benefits of FI, and the realization of FI, which must be addressed with an agility strategy from a “personal” point of view. This is intended as a basis for the expansion of information and products that will be used in investment tolerance innovation, which in turn is useful in harmonizing investment innovation. This alignment is required when there is a risk to “their” investment, which is quite possible considering that in Islamic banks there are sources of funds that function as social facilities. This social fund is included to restructure “them” due to the impact of the global economy, which adversely affected businesses. This characteristic assessment is employed so that they are considered honest enough to manage the money invested in “them,” and Islamic banks can reduce costs as much as possible and always guarantee the sustainability of their business, which will certainly have an impact on the financial performance of Islamic banks.

Conclusions

In a correlation, IFI can affect the financial performance of Islamic banking. However, this relationship is still very dependent on the efforts of policy makers to create a stable economic condition. This economic condition will create solutions for IFI. If the stability of this condition is not established, it is certain that the financial performance of Islamic banking cannot be achieved. This is where the intervention of SADI is required, in the relationship between IFI and the financial performance of Islamic banking. This agility strategy, in the form of product and information expansion, is required to adjust the conditions of facing FI challenges, benefits of FI, and realization of FI so that Islamic banks can expand in creating risk tolerance innovations and adjust investment innovations aimed at improving their financial performance.

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