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CONVERSION INTO FULL-FLEDGE ISLAMIC BANKS AND IT'S IMPACT ON ASSET: EVIDENCE FROM INDONESIAN ISLAMIC BANKING INDUSTRY

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ABSTRACT

Objective: This study aims to analyze whether the number of assets differs before and after conversion to an Islamic bank.

Theoretical Framework: The theoretical framework provides relevant information on Islamic banking and market structure, which forms the basis for the development of hypothesis.

Method: Using regression analysis with dummy variables, the study found differences in assets between the pre and post-conversion periods.

Results and Discussion: The findings suggest that conversion could be a recommended approach for the Islamic banking industry in Indonesia to accelerate asset growth. Additionally, it offers an optimal solution for smaller-sized conventional banks as an alternative to spin-offs or mergers.

Research Implications: This research provides significant contributions to the study of Islamic banking. This research has the implication that conversion can be an alternative strategy for small parent banks.

Originality/Value: Several conventional banks in Indonesia have chosen full conversion into Islamic banks as an exit strategy. This decision is in addition to the spin-off option. Bank of Aceh, Bank of NTB and Bank of Riau Kepri completed the full conversion in 2016, 2018 and 2022, respectively. However, research on Islamic bank conversion is still limited.

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CONVERSÃO EM BANCOS ISLÂMICOS COMPLETOS E SEU IMPACTO NOS ATIVOS: EVIDÊNCIAS DA INDÚSTRIA BANCÁRIA ISLÂMICA DA INDONÉSIA

RESUMO

Objetivo: Este estudo tem como objetivo analisar se o número de ativos difere antes e depois da conversão para um banco islâmico.

Referencial Teórico: O enquadramento teórico fornece informações relevantes sobre a estrutura bancária e de mercado islâmica, que constitui a base para o desenvolvimento de hipóteses.

Método: Utilizando análise de regressão com variáveis dummy, o estudo encontrou diferenças nos ativos entre os períodos pré e pós-conversão.

Resultados e Discussão: As conclusões sugerem que a conversão poderia ser uma abordagem recomendada para o setor bancário islâmico na Indonésia acelerar o crescimento dos ativos. Além disso, oferece uma solução ideal para bancos convencionais de menor porte, como alternativa a cisões ou fusões.

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Implicações de Pesquisa: Esta pesquisa fornece contribuições significativas para o estudo da atividade bancária islâmica. Esta investigação tem a implicação de que a conversão pode ser uma estratégia alternativa para pequenos bancos-mãe.
Originalidade/Valor: Vários bancos convencionais na Indonésia escolheram a conversão total em bancos islâmicos como estratégia de saída. Esta decisão é adicional à opção de spin-off. O Banco de Aceh, o Banco de NTB e o Banco de Riau Kepri concluíram a conversão total em 2016, 2018 e 2022, respectivamente. No entanto, a investigação sobre a conversão bancária islâmica ainda é limitada.

Palavras-chave: Conversão, Ativo, Bancos Islâmicos, Bancos Convencionais, Unidade de Negócios Islâmica.

LA CONVERSIÓN EN BANCOS ISLÁMICOS DE PLENO DERECHO Y SU IMPACTO EN LOS ACTIVOS: EVIDENCIA DE LA INDUSTRIA BANCARIA ISLÁMICA DE INDONESIA

RESUMEN
Objetivo: Este estudio tiene como objetivo analizar si el número de activos difiere antes y después de la conversión a un banco islámico.
Marco Teórico: El marco teórico proporciona información relevante sobre la banca islámica y la estructura del mercado, que forma la base para el desarrollo de hipótesis.
Método: Utilizando análisis de regresión con variables ficticias, el estudio encontró diferencias en los activos entre los períodos previo y posterior a la conversión.
Resultados y Discusión: Los hallazgos sugieren que la conversión podría ser un enfoque recomendado para que la industria bancaria islámica en Indonesia acelere el crecimiento de activos. Además, ofrece una solución óptima para bancos convencionales de menor tamaño como alternativa a escisiones o fusiones.
Implicaciones de la Investigación: esta investigación proporciona contribuciones significativas al estudio de la banca islámica. Esta investigación implica que la conversión puede ser una estrategia alternativa para los bancos matrices pequeños.
Originalidad/Valor: Varios bancos convencionales en Indonesia han elegido la conversión total a bancos islámicos como estrategia de salida. Esta decisión se suma a la opción de escisión. Bank of Aceh, Bank of NTB y Bank of Riau Kepri completaron la conversión total en 2016, 2018 y 2022, respectivamente. Sin embargo, la investigación sobre la conversión de los bancos islámicos es todavía limitada.

Palabras clave: Conversión, Activo, Bancos Islámicos, Bancos Convencionales, Unidad de Negocio Islámica.

1 INTRODUCTION

Regulations in Indonesia's Islamic banking sector allow conventional banks to establish Islamic units, creating numerous Sharia units to tap into new markets. However, many conventional parent banks must still show adequate commitment to developing these Islamic business units. In response, Law No. 21 of 2008 introduced a spin-off policy to compel conventional banks to prioritize the growth of their Sharia units. Despite six banks undergoing spin-offs since the law's enactment, the policy has yet to succeed in boosting Islamic banking's market share beyond 5 percent. This milestone was only reached after the Bank of Aceh fully converted to full-fledged Islamic banking in 2016.

Since enacting Law No. 21 of 2008, regulatory authorities have pressed conventional parent banks to swiftly separate their Islamic business units (Yusuf et al., 2023). Several studies suggest that adopting spin-off strategies could have negative consequences for smaller Islamic banks. According to Al Arif et al. (2020), spin-off policies might risk smaller banks, resulting in lower efficiency levels than non-spinoff banks (Al Arif & Nabilah, 2022). This adverse impact is particularly evident in regional banks, as Haribowo (2017) emphasized. Hasan and Risfandy (2021) argue that Islamic windows demonstrate more stability than fully-fledged banks. Abimanyu & At Tamimi (2024) also suggest that the financial performance of Islamic business units is better than full-fledged Islamic banks. However, the spin-off strategy mandates a core capital of IDR 3 trillion for conventional holding banks, while a spin-off Islamic bank must maintain a capital of IDR 1 trillion. This condition presents a significant challenge for regional banks in meeting these rigorous capital requirements.

In 2016, the Bank of Aceh chose a complete transformation, transitioning from a conventional bank to a Full-fledged Islamic bank instead of opting for a spin-off policy for its Islamic business unit. Following this successful conversion, the market share of the Islamic banking industry finally exceeded the 5 percent threshold. Subsequently, the Bank of NTB converted thoroughly, becoming a full-fledged Islamic bank in 2018. In August 2022, the Bank of Riau Kepri received approval from the financial service authority to convert into an Islamic bank. Another conventional bank, Bank Nagari, is preparing for conversion into a full-fledged Islamic bank.

The trend of complete conversion to Islamic banking is observable across various nations, propelled by various factors. For instance, Libya underwent a comprehensive transition to Sharia banking in 2013 but faced challenges due to the absence of conversion guidelines (El-Brassi et al., 2018). Alani and Yaacob (2012) assert that the Middle East region views the shift to Islamic banking as driven by the low-risk nature and high profitability of Islamic banks. In Bangladesh, the appeal of reduced reserve requirements incentivizes conventional banks to transition to Islamic banking (Suzuki et al., 2020). Similarly, Al Harbi (2020) suggests that conversion can improve the performance of Islamic banks in Gulf Cooperation Council (GCC) countries.

Several research studies have explored the transition to Islamic banking in Indonesia. Al Arif et al. (2023) found that banks the converted banks successfully expanded their market share. Ramdan et al. (2020) demonstrated that after the Bank of NTB Sharia fully converted, there was a 40 percent annual increase in deposit funds. The promising opportunities within the Islamic banking market are influential, prompting many banks to convert conventional banks into Islamic commercial banks (Damanuri, 2012). Yoesoef and Khairisma (2020) stressed that the conversion of the Bank of Aceh into a full-fledged Islamic bank had implications for the welfare of the Acehnese people. Full conversion into an Islamic commercial bank is viewed as a way to mitigate financing risk (Al Kautsar et al., 2019; Pambuko & Pramesti, 2020). Notably, there is an expected variation in financial performance before and after the conversion to a full-fledged Islamic bank at the Bank of Aceh (Budianto & Sofyan, 2021).

However, transitioning conventional commercial banks into Islamic commercial banks can pose governance-related hurdles. Conventional banks converting into Islamic banks must comply with Sharia law (Ahmed & Hussainey, 2015). Shafii (2016) identified low-quality and unreliable human resources as challenges emerging during this conversion process. Additionally, problems may arise regarding regulations and Islamic banking products. Adha et al. (2020) observed a similar trend: the effectiveness of corporate governance may decrease after converting conventional commercial banks into Islamic ones. Furthermore, challenges related to the efficiency and stability of assets and the inadequate qualifications of human resources are common in this conversion process.

Given the preceding discussion, while numerous studies have scrutinized the conversion of Islamic commercial banks, there still needs to be more research examining the effects of transitioning into full-fledged Islamic banks on assets. This paper focuses on parent conventional banks that completely shift to Islamic banks rather than opting for spin-offs for their Islamic business units. The objective of this study is to comprehensively investigate the conversion process of two Islamic banks in Indonesia, specifically Bank of Aceh and Bank of NTB. The research will analyze how the conversion of these Islamic commercial banks impacts their assets.

2 THEORETICAL FRAMEWORK

The shift towards an Islamic banking model is not just limited to Indonesia, but it is also being observed in several other countries across the globe. Some nations have completely restructured their banking systems to follow Islamic principles, while others have allowed conventional banks to undergo a complete conversion. For example, Iran successfully executed a comprehensive conversion of its banking system to Islamic banking. Similarly, Libya underwent a thorough transformation of its banking system in 2013 (El-Brassi et al., 2018). Moreover, many banks in Middle Eastern countries have embraced the shift towards Islamic banking (Alani & Yaacob, 2012). Additionally, certain banks in Bangladesh have decided to convert into Islamic banks (Suzuki et al., 2020).

According to Adha et al. (2020), commercial banks in Indonesia are transitioning to Islamic banking as a way to establish Islamic banks. There is a growing trend towards Islamic banking in Indonesia, with small banks choosing to convert completely rather than establishing separate Islamic business units. This is because creating separate units would require the parent bank to provide IDR 3 trillion in capital, plus IDR 1 trillion for the resulting bank, which is a significant financial challenge for small regional banks. Therefore, the complete conversion to Islamic banking is seen as the most strategic option for them. In addition, the fact that the majority of the population in the region is Muslim also plays a significant role in this trend

The Bank of Aceh and Bank of NTB have chosen a different approach to conversion than the conventional spin-off process that is typically used to establish Islamic business units within parent banks. However, the conversion procedures they have undertaken are similar to those of other banks. The Bank of Aceh's decision to transform into a full-fledged Islamic bank is driven by a desire to serve the Acehnese people better, in accordance with Islamic law (Rohman, 2019; Rahmawati & Putriana, 2020; Yoefoef & Khairisma, 2020; Alamsyah & Amri, 2021). Similarly, the Bank of NTB's decision to fully convert into an Islamic bank is motivated by the significant Muslim population in NTB, with the aim of meeting the increasing demand for Islamic banking services (Trisnawati & Wagian, 2021). The provinces in which these banks are located have predominantly Muslim populations. Therefore, it's understandable that the primary factor considered when transitioning to a Sharia-compliant bank is adherence to Islamic principles. Moreover, Aceh province is the only province in Indonesia that implements Islamic Qanun. This Qanun regulates that financial institutions that can operate in Aceh are sharia financial institutions.

Pambuko and Pramesti (2020) have suggested that the conversion of Bank of Aceh has significantly increased the level of non-performing financing. However, it has resulted in a corresponding decrease in profitability. Bank of NTB's financial performance has improved since its transition to a full-fledged Islamic bank, but it has not yet reached its full potential (Fahdiansyah, 2021). This situation is attributable to the ongoing economic challenges faced by the people of NTB following the 2018 earthquake when the conversion occurred. Consequently, intensified efforts are required to further enhance the financial performance of Bank of NTB Sharia post-conversion.

Al Kautsar et al. (2019) expects the stability of the bank to exceed its previous status as a conventional commercial bank after its conversion. Budianto and Sofyan (2021) summarize significant differences in financial performance before and after Bank of Aceh's conversion. Additionally, the decision to convert leads to an increase in market share and profitability for the converted banks and the Islamic banking sector as a whole (Al Arif et al., 2023; 2024). At Bank NTB, profitability experienced a minor decline a few years following the conversion. Nonetheless, this decrease can be attributed to an error in tax calculation that occurred prior to the conversion.

The parent bank should adequately prepare for the full conversion into Islamic banks. Bank Aceh prepared the conversion process for one year, while Bank NTB took two years to prepare the conversion process. It is crucial to prioritize enhancing the motivation of personnel at each stage of the conversion process. This will ensure that the conversion positively impacts the development of human resources within Bank of NTB (Ramdan et al., 2020). When transitioning to a full-fledged Islamic bank, the conversion procedure should be tailored to align with the characteristics of the customers and regions served. Neglecting this aspect of the conversion may lead to increased complexity when addressing issues (Shafii et al., 2016; Afrida et al., 2020). Banks must also provide education and outreach to customers. If a customer wants to move to another bank, the bank must facilitate the transfer process.

The selected approach for conversion and the competencies of bank management plays pivotal roles in determining the success of the conversion process (Al Harbi, 2020). Management must form a strong transition team, where they can oversee the conversion process from conventional to full-fledge Islamic banks. Dalhatu et al. (2023) present a model aimed at transitioning conventional banks into fully Islamic ones. They propose the "4Quadrants Conversion (4-QC) framework" as a regulatory tool for central banks to oversee this transition. Their research indicates that this suggested regulatory framework could efficiently facilitate the conversion process, facilitating the creation of new Sharia-compliant institutions while gradually phasing out non-compliant ones

3 METHODS

To address the research objective of this manuscript, the study will employ the panel regression technique. The selected timeframe for this investigation spans from 2014 to 2023. The focus of the research includes two banks that have undergone conversion, namely the Bank of Aceh and Bank of NTB. One converted bank -Bank of Riau Kepri- is excluded from the model as its conversion decision is anticipated to occur in 2022. Various techniques will be applied to estimate the model parameters in regression with panel data. These techniques encompass ordinary least square, fixed-effect model, and random effect model. The proposed mathematical equation is as follows:

Ln_Assetit = a + b1 D_Convit + b2 NPFit + b3 ROAit + b4 BOPOit + b5 CARit + eit

Where:

Asset: Log natural of asset
D_Conversion is dummy variable for conversion policy
where: 0 = before conversion; 1 = post conversion
NPF: non performing financing
ROA: profitability ratio measured by return on asset
BOPO: operational efficiency ratio
CAR: capital adequacy ratio

4 RESULTS AND DISCUSSION

This study revealed a substantial disparity in the assets of the converted bank before and after the conversion. Table 1 demonstrates that the transition of conventional commercial banks into Islamic commercial banks, exemplified by Bank of Aceh Sharia and Bank of NTB Sharia, results in a significant increase in the assets of the converted banks. These results are consistent across all three models, namely Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM). Based on the Chow and Hausman test results, the best model used in this study is the fixed effect model.

Table 1

The Empirical Result

	CEM	FEM*	REM
C	8.884677	11.13879	8.884677
	0.371648***	0.546756***	0258535***
D_conversion	0.761411	0.477662	0.761411
	0.131831***	0.174902***	0.091707***
NPF	0.360603	1.350258	0.360603
	0.0101**	0.143328***	0.094998***
ROA	-0.000251	-0.000509	-0.000251
	0.9319	0.002929	0.002036
BOPO	0.012564	-0.000814	0.012564
	0.0223**	0.006143	0.003742***
CAR	-0.040770	-0.111215	-0.040770
	0.0000***	0.010405***	0.006108***
R-square	0.450148	0.878045	0.450148
Adj R-square	0.411964	0.715437	0.411964
F-stat	11.7887***	5.399790***	11.78887***

Source: Data processed

The empirical results in Table 1 also show that apart from conversion, what influences the total assets of the converted bank is the level of non-performing financing (NPF) and the level of capital adequacy (CAR). Meanwhile, the other variables, profitability (ROA) and operational efficiency (BOPO) do not affect the number of assets. The efficiency level will generally decrease during the transition process from conventional banks to full-fledged Islamic banks. Banks will incur many costs, such as human resource training, administrative, customer outreach, and other operational costs. This condition will, of course, also have an impact on the level of profitability.

Assets serve as a key metric of progress within the banking sector, including Islamic banks, as they are used to gauge a bank's market share. Market share, in turn, determines a bank's competitive position relative to its peers (Adenan et al., 2021). Previous studies have consistently shown a significant increase in market share following the full conversion to a Sharia bank (Ribowo & Nurdin, 2022; Al Arif et al., 2023). Prior study shows that Islamic banks have better asset quality and more stable than the conventional banks (Sakti & Mohamad, 2018). Opting for full conversion can be a strategic choice for smaller conventional parent banks compared to spinning off their Islamic business units. When a small bank opts for a spin-off, it must consider the capital adequacy of both the parent bank and the spin-off bank. Regulators are currently encouraging banks, including Sharia banks, to bolster their capital reserves.

Table 2

Asset of Islamic Banking Industry

Year	Total Asset (in billion IDR)	Market share (%)
2014	272,343	4.85
2015	296,262	4.86
2016	356,504	5.29
2017	424,181	5.74
2018	477,327	5.92
2019	524,564	6.13
2020	593,948	6.47
2021	676,735	6.69
2022	782,100	7.04
2023	868,986	7.38

Source: Islamic banking statistics, financial service authority

Table 2 shows the development of assets in the sharia banking industry in Indonesia. In general, Islamic banking industry assets increase every year. A significant increase in assets occurred in 2016, when the conversion process occurred at Bank of Aceh. This development signifies that the Islamic banking sector has finally surpassed the targeted 5% market share, which was expected to be achieved by the end of 2008. The asset increase continues along with the conversion of Bank of NTB in 2018 and Bank of Riau Kepri in 2022. By the end of 2023, the market share of the Islamic banking industry has reached 7.38% (see Table 2). However, because the three banks that have decided to convert are small regional banks, the increase in total industrial assets is still not able to increase market share to 10%. The government may be able to encourage conventional holding banks of medium or large size to convert. If this happens, the market share of Islamic banks in Indonesia could reach above 10%.

The results of research conducted by Al Arif et al. (2023) shows that there has been an increase in market share in converted banks. Bank of Aceh was able to increase its market share from 0.94% to 7.38% in 2016 after deciding on the conversion. Likewise, Bank of NTB was able to increase its market share from 0.49% to 2.22% in 2018 after conversion. This fact shows that full conversion to an Islamic bank is one of the options that can be taken by conventional parent banks with a small size compared to those carrying out spin-offs. The banks' size positively impact on the performance of Islamic banks (Chowdhury & Rasid, 2016).

A contradictory situation actually occurred when the government decided to merge 3 state-owned bank subsidiaries, namely Bank of BRI Sharia, Bank of BNI Sharia, and Bank of Sharia Mandiri. The government took this merger decision in October 2020. The merger decision taken by the government apparently did not have any impact on the total assets of the sharia banking industry. The current situation is that there is one Islamic bank that has very large assets reaching IDR 354 trillion at the end of 2023, while other Islamic banks are still below IDR 70 trillion. This inequality in terms of the number of assets triggers a market structure that tends to be monopolistic. Despite a study showing that mergers will be able to increase the business valuation of Islamic banks (Ahdizia et al., 2018).

One of the objectives of converting a conventional holding bank into a full-fledged Islamic bank is to meet the financial needs of the community, both for saving and financing (Rafay & Sadiq, 2015). This reason is in accordance with the findings in several previous studies, one of the factors driving conversion is the public's desire for a bank that operates fully in accordance with sharia principles (Rohman, 2019; Rahmawati & Putriana, 2020; Yoesoef & Khairisma, 2020; Alamsyah & Amri, 2021). The people in these three provinces are communities with a high level of religiosity. This is in line with the findings of Soma et al. (2017) and Ullah et al. (2023) that one of the factors that determines customers choosing a sharia bank is the level of religiosity. Customers assume that Islamic banks will be able to meet their financial needs in accordance with sharia principles. This emotional bond increases customer loyalty to Islamic banks, including after the bank decides to convert to a full-fledged

Islamic bank (Athief & Ma'ruf, 2023). Evidence of this loyalty can be seen from the increasing amount of savings after the bank converted (Ramdan et al., 2020; Purwanto, 2018; Al Harbi, 2020). This condition shows that there will be customer flight after the conversion is not proven.

The banking sector in Indonesia is mostly dominated by conventional banks, which is surprising given that most of the country's population follows Islam. However, the Islamic banking industry only has a market share of 7.3 percent, which means that it has a relatively minor contribution to the economy. To accelerate the growth of the Islamic banking industry, all stakeholders must work together. The government could show its commitment to this cause by requiring State-Owned Enterprises (BUMN) to allocate a portion of their funds (say 30-50 percent) to Islamic banks, a policy similar to the one implemented by the Malaysian government to support its Islamic banking sector. Meanwhile, regulatory authorities like the Financial Services Authority (OJK) can encourage Islamic banks to consolidate to strengthen their capital. On the other hand, Islamic banks need to improve their products and services as their current level of product innovation is not up to the mark.

Expanding the scale of Islamic banks to attract public interest is a significant challenge that needs to be addressed (Eliana et al., 2020). Several factors contribute to the relatively small size of Islamic banks. Firstly, there is a need to enhance public awareness and understanding of Islamic banks, as many people still do not perceive any significant difference between Islamic and conventional banks. Secondly, support from religious leaders remains insufficient, with some holding misconceptions about Islamic financial institutions. Thirdly, there is a shortage of skilled professionals in Islamic economics and finance. Lastly, effective support from the government and regulators in the form of affirmative policies is necessary to accelerate the growth and development of the Islamic banking sector in Indonesia.

Hidayat and Trisanty (2020) proposed a strategy to enlarge Islamic banks which should focus on three key areas: the internal operations of Sharia banks, regulatory frameworks, and public perception. Regarding regulatory and governance aspects, there are two primary challenges that need to be addressed. The first challenge is the necessity for greater alignment of vision, and the second challenge is the absence of coordination between government bodies and authorities involved in Islamic banking development. Furthermore, regulatory oversight and supervision of the Islamic banking sector need to be enhanced. Finally, there is a need for increased government support for Islamic banking initiatives. The establishment of the National Committee for Islamic Economy and Finance (KNEKS) has positively impacted the Islamic economy and finance sector in Indonesia. The positive impact of the presence of KNEKS can be seen from the increase in Indonesia's ranking in the State of Global Economy (SGIE).

Islamic banks have an internal framework that involves enhancing and optimizing different elements such as products, capital, service office networks, information technology, human resources, and governance. The products developed by Islamic banks should be innovative rather than mere replicas of what conventional banks offer. In addition, Islamic banks should allocate more resources towards promotional activities to expedite market expansion. Studies show that the product is a primary determinant in selecting a bank, regardless of whether it is Sharia-compliant or conventional. Islamic banks face competition from other Islamic banks and conventional ones, highlighting the importance of enhancing their product offerings. However, increased competition may negatively impact bank profitability. To attract deposit funds, Islamic banks need to focus on product innovation. Religious, economic, and informational factors positively influence the intention to save at Islamic banks. Therefore, Islamic banking institutions should adopt a proactive and innovative approach to marketing their products.

The Islamic banking sector is facing two significant challenges: product innovation and human resource quality. The competence of bank management plays a crucial role in the success of Islamic banks, particularly in GCC countries. Therefore, it is essential to focus on human resource competency as a primary concern in the conversion process. Currently, there is a stigma regarding bankers in Islamic banks being perceived as of lower status. Extending the duration of human resource training is necessary to ensure that the cultivated work culture aligns with that of the Islamic finance industry. Islamic banking training programs are essential to enhance the knowledge of bankers' post-conversion, and the Islamic banking sector must persist in enhancing the caliber of its human resources through educational initiatives and training programs. Augmenting human resource development is anticipated to contribute to bolstering the market share of the Islamic banking industry.

During the conversion process, a significant hurdle is the need for employees to transition from conventional business practices to Sharia-compliant ones. There are concerns from some non-Muslim employees (case at Bank of NTB) that they will be dismissed after full conversion to a sharia bank. However, this concern is not proven, because Islamic banks actually have universal values that can be enjoyed not only by Muslims but also non-Muslims. The Sharia Supervisory Board proactively disseminated information and educated all employees about this paradigm shift. Sharia compliance is a crucial factor driving the conversion process. According to research, the primary incentive for banks to undergo conversion is to enhance Sharia compliance and optimize profitability.

It's important to consider the characteristics of customers in the Sharia banking sector. These customers can be divided into two groups: religious and rational. Each group requires a different approach. Religious customers can be engaged through educational efforts about fatwas issued by the Indonesian Ulema Council. Some Islamic bank patrons prefer full-fledged Islamic banks because of their alignment with Sharia principles (Ratnasari et al., 2012). On the other hand, rational customers require approaches that focus on product and service innovation, as well as competitive pricing compared to conventional banks (Adebola et al., 2011). The malware incident that hit one of the largest Islamic banks in Indonesia must be avoided in the future. This condition will reduce the level of public trust, especially for rational customers whose satisfaction and loyalty are determined based on products and services from Islamic banks.

Alani and Yacoob (2012) examined why banks shifted from conventional to Islamic banking. They found that two primary motivators are risk and profit. Banks are moving towards Islamic banking because it is perceived to be safer and less exposed to banking risks, as it addresses customer requirements through partnership arrangements. Viverita et al. (2023) shows that Islamic banks can create more liquidity when covid-19 crisis rather than conventional banks. Additionally, customers who align with the Islamic banking system are a significant reason why banks are offering Sharia financial services to meet their demands. The contracts held by Islamic banks are more diverse compared to conventional banks which only have one type of system, namely the interest system. Islamic banks can offer products both murabahah and profit sharing based to their customers. The risk sharing contracts in Islamic banks can prevent formation of asset price bubbles (Azmat et al., 2020).

One of the biggest challenges facing the Sharia financial industry in Indonesia, including Islamic banks, is the low level of Sharia financial literacy and inclusion, which needs to be improved. Many people in society still do not fully understand Islamic finance. Some religious figures claim that Islamic banks are not much different from conventional banks, as they only replace the term "interest" with "profit sharing." It is crucial for stakeholders within the Islamic banking sector to develop a strategy to increase Islamic financial literacy. By promoting effective Islamic financial literacy, people can better understand the differences between Islamic and conventional finance. This will be the first step in accelerating the growth of Islamic banks. Secondly, promoting prudent financial attitudes and behaviors will help to build a community with strong financial resilience, capable of navigating different financial situations. Thirdly, enhancing access to finance will encourage the widespread use of financial products and services among the population (Fathony et al., 2022).

The two institutions have decided to transition into Islamic commercial banks, which aligns with their optimal corporate strategy compared to the spin-off alternative. Opting for the spin-off route requires shareholders to provide sufficient capital for both conventional and Islamic commercial banks. As per regulations, conventional parent banks must maintain a core capital of 3 trillion, while the spin-off bank must possess a minimum core capital of 500 billion, which must be increased to 1 trillion within a decade post-separation. A study conducted by Suzuki et al. (2020) supports this finding and arrived at similar conclusions in Bangladesh. The difference in reserve requirement regulations between conventional and Islamic banks provides a greater incentive for pursuing the conversion process. In Indonesia, the conversion strategy is a viable alternative in addition to segregating Sharia business units (Al Arif et al., 2020). Furthermore, the policy of complete conversion into a Sharia commercial bank represents a wise step that shareholders can take, as indicated by Damanuri (2012). The conversion policy has been shown to have a positive impact on market share and profitability, as demonstrated by studies conducted by Al Arif et al. (2023) and Al Arif et al. (2024).

Al Kautsar et al. (2019) have claimed that transitioning Bank of Aceh's business model to an Islamic bank will lead to changes in the company's financial performance and risk profile. According to their research, the conversion process resulted in a decrease in non-performing financing levels, and a lower risk of bankruptcy for Bank of Aceh. They attribute this phenomenon to the increased religiosity of Islamic bank customers, which leads to a decreased default risk. Budianto and Sofyan (2021) discovered various insights regarding performance alterations in Aceh Sharia banks following conversion. They found distinctions in the risk profile based on non-performing financing indicators before and after conversion. However, they noted contrasting results in the financing-to-deposit ratio (FDR), where no disparity was observed pre- and post-conversion. Hosen and Muhari (2017) demonstrated that Islamic banks face higher risk levels if core depositors withdraw funds abruptly, leading to defaults.

Shafii et al. (2016) conducted an extensive review of various studies on the conversion process and identified complexities associated with transitioning from conventional banks to Islamic banks. This conversion requires a shift from conventional banking practices to Islamic banking principles, necessitating a comprehensive framework for conversion policies. This framework should encompass Sharia compliance, resistance to conversion, human resources, Sharia financial products, regulations, and legal aspects of products. The recruitment of employees with technical banking expertise and a deep understanding of Islamic banking operational principles is a critical challenge in the conversion process. Additionally, the study noted several factors that influence the policy implementation of converting conventional banks to Islamic banks, including inadequately qualified and unreliable human resources in Islamic banking activities, management organizations' resistance to conversion policies, low employee support, and challenges in achieving Sharia compliance. Regulatory and legislative support, along with difficulties in developing Sharia banking products, also contribute to the complexities of the conversion process.

The execution of the conversion policy highlights the challenge of establishing an efficient corporate governance framework. Adha et al. (2020) demonstrated that converting conventional banks to Islamic banks in Indonesia does not impact corporate governance, financial structure, bank operations, performance, or human resources. Consequently, in light of these issues, it becomes essential for bank management planning to adequately prepare across various governance aspects before transitioning to Islamic banks. Budianto and Sofyan (2021) observed no significant difference in governance (GCG) aspects pre and post conversion in the Bank of Ace.

The conversion of conventional banks into Islamic banks is believed to have a positive impact on the welfare of the community. According to Yoesoef and Khairisma (2020), the conversion of Acehnese banks to Islamic commercial banks was well-received by the community and had a favorable influence on community welfare. However, there is still a need for improvement in socialization and education regarding Islamic banking. The Qanun of Islamic financial institutions number 11 of 2018 has played a positive role in the development of the Islamic banking industry, as stated by Rahmawati and Putriana (2020). After the implementation of Qanun, only Islamic finance industry including Islamic banks that can operate in Aceh.

5 CONCLUSION

Transitioning to a fully Sharia-compliant Islamic bank requires careful planning. This study examines the impact of such a transition on total assets. The results show that two regional banks that converted to Sharia-compliant banking experienced a significant increase in total assets, including those within the Sharia banking sector. This increase in assets helped the banks expand their market share in the Sharia banking industry, which may reach up to 7.3% by 2023.

However, it is important for banks to make this decision based on sound corporate strategy. The study found that full conversion to an Islamic bank is more effective in increasing market share compared to the merger of three Sharia banks, which was carried out at the end of 2020.

The research has several policy implications. Firstly, small-scale conventional holding banks may consider full conversion as a viable option to support the growth of the Islamic banking sector. Secondly, converted banks should focus on developing innovative products and services to compete effectively with conventional banks. Thirdly, regulators could provide fiscal incentives to encourage Islamic banks to opt for complete conversion. Lastly, the government is advised to enact regulations mandating state-owned or regional-owned enterprises to allocate a specific portion of their funds to Islamic banks.

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