# EMPIRICAL STUDY: QUALITY OF ISLAMIC BANKING IN MEDAN CITY

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**Abstrak**
However, the problem in Sharia Banking that affects the quality of Islamic banks is various things, including the absence of product differentiation and literation. Of course, this reality is a challenge for Islamic banks to improve and develop both internally and externally. This reality is the idea of the idea of making a new paradigm for Islamic banks as also conveyed in the Sharia Banking Development Road Map issued by the OJK for 2022-2025. This study aims to analyze the factors that affect the quality of Sharia Banking due to the current reality of Sharia Banking that does not support the quality in Islamic banks, so that it can be improved both in terms of products, community paradigms, and Islamic financial literacy which has increased, especially in Medan City by using variable testing techniques that affect the quality of Sharia Banking in Medan City. The results of this study show that the quality of Sharia Banking has an effect. The results of this study show that the quality of Sharia Banking has a significant effect on the quality of Islamic banks in Medan City from customer perceptions generated through product differentiation and literacy.

**Kata kunci**: Product differentiation, Literacy, Quality, Islamic Banking

## 1. Introduction

The increasing need for various services and infrastructure available in the banking industry, especially Sharia Banking in Indonesia, has increased. However, on the other hand, Sharia Banking must also face the ups and downs of various challenges in facing governance in improving the quality of Islamic bank services in the community. Based on the Sharia Banking Transformation Study published by the Financial Services Authority (OJK) in 2022-2025, there are issues that hinder the growth of Sharia Banking, including the absence of product differentiation, technology systems that are not up-to-date, the quality of Human Resources (HR), and the paradigm of society towards profit-oriented Islamic banks.

Based on Sharia Banking Statistics (SPS) data as of October 2021, the number of Sharia banks in North Sumatra is 31 banks with details of 24 Sharia Commercial Banks (BUS) and 7 Sharia Business Units (UUS). From the rapid development of assets and the number of offices is a good progress towards the popularity of banking. However, Sharia Banking currently does not have any characteristics in terms of the type of business. According to Heru Kristiyana as the chief executive of the banking supervisory of the Financial Services Authority (OJK), sharia banking needs to have differentiation or differences in doing business. Sharia Bank products are still not varied so that they become a difficult choice for the public(Uly, 2020).

As a country with a Muslim majority, Islamic financial literacy is an interesting thing to study, where logically, with a high level of Muslim population, the level of Islamic financial literacy should show a good number (Sihotang et al., 2021) and based on demographic factors (Setiawan, 2015). The Islamic financial literacy index in Indonesia was first conducted by the OJK in 2016 through the National Survey on Financial Literacy and Inclusion (SNLIK).

The results of the survey show that the Literacy level of Islamic finance is at the level of 8.11%. This means that out of every 100 inhabitants in Indonesia, only 8 people know and understand the Islamic financial industry. This is much lower than the financial Literacy index which is at 29.7%. This phenomenon is a dilemma, considering that the majority of Indonesia's population is Muslim. The following is an overview of the Islamic financial Literacy index and Islamic financial inclusion in Indonesia:

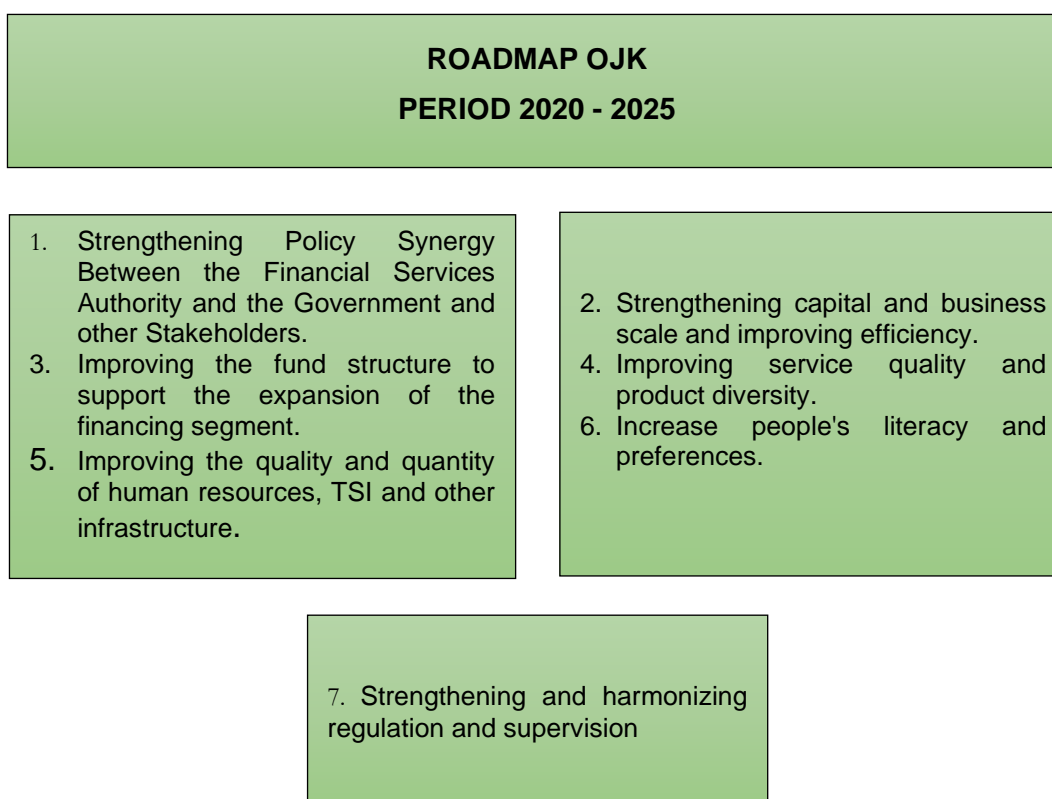**Figure 1. Islamic Financial Literacy Index and Provincial Islamic Financial Inclusion**
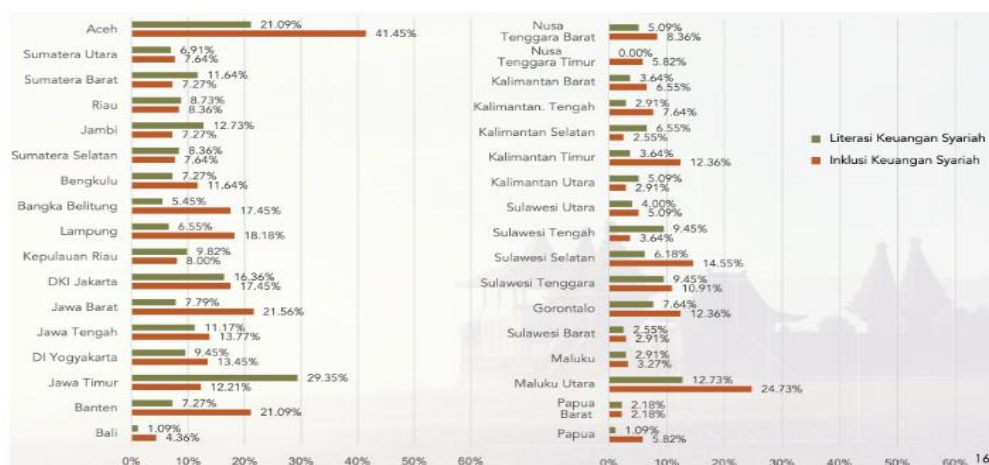


Data Source: **www.ojk.go.id, 2016**

Figure 1 shows that the average Islamic financial inclusion index is higher than the Islamic financial literacy index, meaning that the use of Islamic financial products and services by the public is not balanced by knowledge and understanding of these products and services. Figure 1 also shows that North

Sumatra Province is one of the provinces with a minimal Islamic financial literacy index and Islamic financial inclusion with a Sharia financial literacy rate of 6.91% and a Sharia financial inclusion rate of 7.64%. Even though the Muslim population in North Sumatra is as many as 10.06 million people or 66.3% are Muslims (Kusnandar, 2021).

Product differentiation is an attempt by a company to distinguish its products from competing products in a property that makes it more desirable (Madura, 2001). Some products are distinguished by competitors by their quality. Whereas in research (J. Sahetapy, 2013) defines product differentiation as the act of modifying the product to be attractive. and one of the key strategies to lock in customers so that the actualization of the purchases made only leads to one point, namely our product (Khasanah & Muamar, 2020) Product differentiation is the main component because the main products in banks, namely credit, are an offer that is not different, therefore competition will be greatly influenced by the bank's ability to improve its quality. Especially in Sharia Banks that must have product differentiation so that the public can enjoy services and products at Sharia Banks so as to improve the quality of services in Sharia Banks. Through product differentiation as in the OJK roadmap, namely:

**Figure. 2 Roadmap OJK  Period 2020 – 2025**

**ROADMAP OJK**

**PERIOD 2020 - 2025**

1. Strengthening Policy Synergy Between the Financial Services Authority and the Government and other Stakeholders.
3. Improving the fund structure to support the expansion of the financing segment.
5. Improving the quality and quantity of human resources, TSI and other infrastructure.

2. Strengthening capital and business scale and improving efficiency.
4. Improving service quality and product diversity.
6. Increase people's literacy and preferences.

7. Strengthening and harmonizing regulation and supervision

**Source**: www.ojk.go.id, 2021

This research is important and interesting to be researched because it is based on several factors and considerations, namely that many Islamic banks that have developed in Medan cities certainly need strategies to be able to maintain their quality. That way Sharia Banking will continue to update and create new products that are more innovative, creative in line with the state of society and the current development of the times (Sukmajati, 2019a).

Sharia Banking in its governance is also presented in the banking system in general, which is profit-oriented. This has given rise to the public perception that there is no difference between Islamic and conventional banking. However, Sharia Banking is not only profit-oriented but also the goal of getting benefits and peace and blessings.

## 2. Literature Review
### Differenciacy Product

Some products are distinguished by competitors by quality as an act of modifying the product to make it attractive. Product differentiation usually only slightly changes product characteristics, including packaging and promotional themes without changing the physical specifications of the product (Handida & Sholeh, 2018). So, product differentiation is making a difference in a product by developing and modifying a product (J. P. Sahetapy, 2013). The differentiation strategy is implemented by creating the customer's perception that the products or services produced by the company are unique with higher quality. This perception causes companies to set higher prices and be competitive (Sukmajati, 2019b). Differentiation must be the reason customers choose our products. Differentiation must be able to answer the customer's question why he should choose our product compared to similar products on the market (Sulistyawati et al., 2019). Therefore, differentiation is one of the key strategies for locking in customers so that actual purchases are made only to one point, namely the product (Khasanah & Muamar, 2020). Product differentiation indicators include: (1) Important, which must be of value to consumers; (2) Distinctive, namely the differentiation that has been made has never existed so far; (3) Superior, namely providing product advantages over competitors' products; (4) Communicable, namely the differentiation can be communicated and observed by consumers; (5) Pre-emptive, which is difficult for competitors to imitate; (6) Affordable, namely the buyer can pay the price with the differentiation; (7) Profitable, that is, the company will profit if it introduces the differentiation (Tho'in, 2011), (Yusuf, 2018).

### Literacy

Individuals with a high level of understanding of financial literacy are able to determine financial products and services that suit their needs, correctly understand the benefits and levels of risks, understand their rights and obligations and believe in what is the decision to use financial products and services that can

improve their welfare. Gunawan et al., 2019). The goal of financial literacy according to the Financial Services Authority (OJK) (Financial Services Authority, 2021) is to be able to increase individual literacy from low literacy (Less literate) (Isrowiyah, 2019) or not literate (Not Literate) to be well literate (Cahyono et al., 2017) and increase the number of users of financial service products (Setiawati, 2015). There are several principles for increasing Islamic financial literacy so that it can run well, namely: (a) Universal and Inclusive; (b) Systematic and Measurable; (c) Ease of Access; (d) Benefit; (e) Collaboration (Eliza, 2019); (Ruwaidah, 2020).

**Quality**

Quality is equality between requirements and suitability for users, renewal continuously, free from damage, to meet customer needs from the start and at any time, to do everything right, and this thing is meant to make customers happy (Fathan Budiman, 2016) . Quality means keeping promises to customers for the services to be provided (Suhir & Duri, 2008), so that those served are satisfied (Handida & Sholeh, 2018). Quality is one of the determining aspects of performance in a company and as a benchmark for determining the absolute goodness of a product, quality is also a major factor that ensures performance in a company. Quality goods and services are goods and services that are in sync with what customers want (Razak, 2019). Thus, a company must understand its customers or consumers and understand their needs and desires, which includes quality including marketing, engineering, manufacture, and maintenance (Romadhani & Wahyudi, 2015), where the goods and services in use will be in accordance with the needs and customer desires (Nigtyas, 2018). In terms of the quality of a healthy Islamic banking industry, it is necessary to have encouragement from various parties, be it business operators or carriers of other needs. In order for sharia bank business practitioners to carry out their business smoothly, it is necessary to provide preparation with understanding (knowledge), skills (skills), and behavior (attitude) in sync with instructions and obligations (Ashal, 2015).

## 3. Research Method

This research was aimed at two sharia bank customers in Medan, namely Bank Sumut Syariah and Bank Muamalat with a total of 200 respondents and interviews with Sharia bank employees and customers for other information. The sampling method is carried out with a purposive sampling technique, which is a sample selected from one population using certain criteria or considerations(Azwar, 2007). The respondents selected as a sample met the criteria, namely; customers of third party funds and financing at Bank Sumut Syariah and Bank Muamalat; already working or having their own income and having an account or customer at one of the Islamic banks. In this study, the number of indicators was 20, so using calculations (number of indicators x 10) the number of samples needed was 200 people. According to (Azwar, 2007) for better results, it is necessary to get a good

benchmark, namely with the number of participants is 100 – 200. The analysis tool uses the SPSS program with the regression method.

## 4. Result and Discussion

**Classic Assumption Test**

**Normality Test**

The results of the normality test using the Kolmogorov – smirnov (K – S) method at a significant level of 0.05. The full results of the normality test can be seen in table 1. the teble:

**Table 1.**
**Normality Test**
**One-Sample Kolmogorov-Smirnov Test**

| | | Unstandardized Residual |
|---|---|---|
| N | | 200 |
| Normal Parameters[a,b] | Mean | .0000000 |
| | Std. Deviation | 5.18273101 |
| Most Extreme Differences | Absolute | .056 |
| | Positive | .040 |
| | Negative | -.056 |
| Test Statistic | | .056 |
| Asymp. Sig. (2-tailed)[c] | | .200[d] |
| Monte Carlo Sig. (2-tailed)[e] | Sig. | .120 |
| | 99% Confidence Interval Lower Bound | .112 |
| | Upper Bound | .129 |

a. Test distribution is Normal.

b. Calculated from data.

c. Lilliefors Significance Correction.

d. This is a lower bound of the true significance.

e. Lilliefors' method based on 10000 Monte Carlo samples with starting seed 1535910591.

*Source: Processed data, 2022*

From table 1 above it can be seen that the grade of Asymp.Sig. (2- tailed) is 0.200 where the value > α = 0.05. that way it can be concluded that the data is distributed normally.

**Multikolinearity Test**

Multikolinearity test is a test to determine whether or not there is a significant correlation between variables – free variables in a multiple linear regression model. This test is needed to determine the similarity between free variables and other variables in a model. Similarities between variables in a model can lead to a strong colleration between free variables and other variables. The results of the Multikolinearity test can be seen in table 2 below:

**Table 2. Multicollinearity Test**

| Model | Colinearity Statistics | |
|---|---|---|
| | Tolerance | VIF |
| 1        (Constant) | | |
| Product Differentiation | ,857 | 1.166 |
| Literacy | ,857 | 1.166 |

a. Dependent Variable: Quality of Islamic Banks

**Source: Processed data SPSS, 2022**

When viewed from table 2, it can be concluded that the Tolerance value in the Product Differentiation and Literacy variables is 0.857 which means < 1, then the Variance Inflation Factor (VIF) value in the Product Differentiation and Literacy variables is 1.166 which means that > of 1 based on these results, the model can be said to be free from multicolinearity.

**Heteroscedasticity Test**

Heteroscedasticity test aims to test whether in the regression model there is an inequality of variants from the residual of one observation to the observation of another.

**Table. 3 Heteroscedasticity Test**

Coefficientsᵃ

| Model | Sig. | Collinearity Statistics Tolerance | Collinearity Statistics VIF |
|---|---|---|---|
| 1 (Constant) | ,001 | | |
| Product Differentioation | .084 | .857 | 1.166 |
| Literacy | .057 | .857 | 1.166 |

a. Dependent Variable: ABS_RESIDUAL

From the table above, it can be seen that the value of Sig. in the Product Differentiation variable is 0.084 which means that the value of Sig. 0.084 > 0.05 can be declared heteroskedasticity-free, as well as in the Literacy variable with a value of Sig. 0.57 > 0.05. So it can be concluded that the regression model of the Effect of Product Differentiation and Literacy on the Quality of Sharia Banks in Medan City. Does not occur heteroskedasticity so that the test of the classical assumption of heteroskedasticity can be met. In this case it can be continued at the stage of multiple linear regression tests.

**Multiple Linear Regression Analysis**

This study used multiple linear regression to prove the research hypothesis. This analysis uses inputs based on data obtained from the questionnaire. The results of data processing using SPSS Software are as follows:

**Table. 4 Multiple Linear Regression Analysis**
**Coefficientsᵃ**

| Model | Unstandardized Coefficients B | Unstandardized Coefficients Std. Error | Standardized Coefficients Beta | t | Sig. |
|---|---|---|---|---|---|
| 1 (Constant) | 47.991 | 7.034 | | 6.823 | ,001 |
| Product differentiation | .703 | .078 | .527 | 8.961 | ,001 |
| Literacy | .411 | .108 | .224 | 3.804 | ,001 |

a.Dependent Variable: Quality of Islamic Banks

From the calculation using SPSS, the following results are obtained:

a  = 47,991

b1 = 0,703

b2 = 0,411

Based on table 4.the regression equations of the results of this study are:

$$Y = 47,991 + 0,703(X1) + 0,411(X2)$$

1. A constant value of 47.991 means that if the Product Differentiation (X1) and Literacy (X2) variables in the constant or not undergoing change are equal to zero, then the Quality of Islamic Banks (Y) will be worth 47.991 units.
2. The value of the regression coefficient X1 = 0.703 indicates that if the Product Differentiation increases by one unit, it will result in an increase in the Quality of Islamic Banks by 0.703 units.
3. The value of the regression coefficient X2 = 0.411 mne shows that if Literacy increases by one unit, it will result in an increase in the Quality of Islamic Banks by 0.411 units.

**Hypothesis Determinant Test ($R^2$)**

This determinant coefficient is used to find out how large the percentage of the relationship of independent variables to dependents is. The magnitude of the percentage affects all independent variables on the value of the dependent variable can be known from the magnitude of the coefficient of determination $R^2$ of the regression equation. The determinant coefficient number is seen from the results of the SPSS calculation as follows:

**Table. 5 Determinant**

**Model Summary**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .801[a] | .528 | .517 | 5.20897 |

a.Predictors:(Constant),Literacy,Product Differentiation

Judging from table, the coefficient of determination of Adjusted R Square of 0.517 or 51.7% can be obtained, meaning that the Quality of Islamic Banks variable can be explained by the Product Differentiation and Literacy variables of 51.7%, while the remaining 48.3% can be explained from other variables outside the research variables.

**Partial Test ( t)**

Basically, the t-test shows how far the influence of one independent variable is partially in explaining the variation of the dependent variable. The basis of Quality of Islamic Banks using significant probability figures from data processing using SPSS Statistics Software can be seen as follows:

**Table 6 Partial Test (t)**

**Coefficients**[a]

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|
| | B | Std. Error | Beta | | |
| 1 stant) | 47,991 | | | 6,823 | ,001 |
| | | 7,034 | | | |
| Product Differentiation | ,703 | ,078 | ,527 | 8,961 | ,001 |
| Literacy | ,411 | ,108 | ,224 | 3,804 | ,001 |

Based on table 5, the partial test results can be known by looking at the SPSS output of the Coefficients results at the sig value. which is when the sig value. < 0.05 (5%) then the independent variable can be said to have a significant effect on the dependent. Also can be seen based on the comparison of t count with t table, it can be said to have an effect if the value of t counts > t table.

## 4. Conclusion

Based on the results of the research conducted in the previous chapter, the conclusions that can be drawn in this study are: Product Differentiation (X1) as an independent variable has a positive and significant effect on the Quality of Islamic Banks (Y) as a dependent variable. This means that the increasing Product Differentiation in Islamic Banks, the quality of Islamic Banks will increase. This is evident from the significant value of 0.001 < 0.05. Literacy (X2) as an independent variable has a positive and significant effect on the Quality of Islamic Banks (Y) as a dependent variable. This means that the higher the literacy, the more the quality of Islamic banks will increase. This is evident from the significant value of 0.001 < 0.05. Product Differentiation (X1) and Literacy (X2) simultaneously state that there is a significant influence together on the Quality of Islamic Banks (Y). This is a consideration so that these factors are able to further improve the quality of Sharia banks in Medan City.

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