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Displaced Commercial Risk (DCR) Mitigation Analysis in Temporary Syirkah Fund Management in Islamic Banks

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Abstract

This study presents an in-depth conceptual analysis of Displaced Commercial Risk (DCR) mitigation strategies, one of the most fundamental and unique risks faced by Islamic banks in a dual banking system. DCR, as the risk that Islamic banks are forced to pay returns to investment depositors that do not reflect the performance of the underlying assets in order to maintain competitiveness, inherently threatens the essential principle of profit-loss sharing (PLS). Using a critical analysis approach and literature synthesis, this study deconstructs the limitations of the conventional mitigation paradigm that relies too heavily on reactive instruments such as the Profit Equalization Reserve (PER). This study argues that this approach is merely a symptomatic treatment that fails to address the root cause and potentially creates moral hazard. As a novel finding, this study formulates a Dynamic Capability Framework for DCR Mitigation. Rather than viewing DCR mitigation as a technical function, this framework conceptualizes it as a core organizational capability that must be built. This framework consists of three capability pillars: (1) Sensing Capacity to identify market volatility and asset risks, (2) Seizing Capacity to respond through proactive asset-liability management and adaptive reserve management, and (3) Transforming Capacity to build long-term resilience through product innovation and stakeholder expectation management. These findings imply a strategic paradigm shift for practitioners and regulators, from static risk management to building dynamic organizational capabilities to maintain the sustainability and sharia integrity of Islamic banking.

Keywords: Displaced Commercial Risk (DCR), Temporary Syirkah Fund, Profit Equalization Reserve (PER), Dynamic Capabilities, Risk Management, Islamic Bank

INTRODUCTION

The existence and growth of the global Islamic banking industry is based on a unique and fundamental value proposition: operating based on the principles of fairness, transparency, and profit and loss sharing (PLS). This principle, in theory, distinguishes it diametrically from the conventional interest-based banking model. However, in practice, Islamic banks do not operate in a vacuum. They exist and compete within a dual banking ecosystem, where market metrics, expectations, and behavior are still largely shaped by conventional banking logic and instruments(Roziq & Ilma Ahmad, 2024).

This situation has given rise to a strategic trilemma for every Islamic bank: a constant struggle to balance three often-conflicting objectives: Sharia Compliance, Market Competitiveness, and Financial Stability. The most critical point where these three objectives collide is in the management of investment third-party funds, also known as Temporary Syirkah Funds (e.g., Mudarabah deposits). According to Sharia law, the returns on these funds should reflect the actual performance of the financed assets. However, in the market, customers tend to compare these returns to conventional deposit rates, which are fixed and predictable(Putro et al., 2022).

This tension gives rise to a unique and endemic risk for the Islamic banking industry: Displaced Commercial Risk (DCR). DCR, by definition, is "transferred" or shifted commercial risk. The risk of declining asset performance, which should be part of the risk shared by the investment fund owners (IAH), is instead absorbed and borne by the bank (and its shareholders) in order to maintain competitive returns (Archer & Karim, 2007). This practice, while often unavoidable due to competitive pressures, is a dangerous anomaly. It not only threatens financial stability through potential capital erosion but also gradually erodes the philosophical essence of Islamic banking itself, rendering it merely conventional banking with a Sharia label. Although DCR has been widely recognized as an inherent risk—as reflected in the standards issued by the AAOIFI—academic and practical discourse is often too narrow, focusing on the single most popular mitigation instrument, the Profit Equalization Reserve (PER). Much of the literature discusses the accounting aspects or the sharia-compliant nature of PER, but very little critically analyzes its effectiveness and limitations as a long-term strategy. There is a gap in the literature that addresses DCR from a strategic management perspective: as a complex organizational challenge that requires a response that goes beyond technical-accounting tools(Habibi et al., 2024).

This study aims to fill this gap by presenting an in-depth and multidisciplinary analysis. The novelty of this study lies in three main aspects. First, analytically, this study critically deconstructs the PER-centered DCR mitigation paradigm, identifying its fundamental limitations and potential inherent risks, such as moral hazard. Second, theoretically, this study introduces and adapts the Dynamic Capabilities View from the strategic management literature (Teece, Pisano, & Shuen, 1997) as a new lens for understanding and formulating DCR mitigation strategies. This represents a conceptual leap from viewing mitigation as a static function to a dynamic organizational capability. Third, as a culminating contribution, this study formulates a novel finding in the form of a capabilities-based Integrated DCR Mitigation Framework. This framework offers a holistic, proactive, and strategic model, transcending the currently dominant reactive and symptomatic approaches(Syahni & Husen, 2022).

METHODOLOGY

This research adopts a qualitative-conceptual methodology with a critical analysis and theory-building approach(Nasiruddin & Hidayati, 2022). This approach was chosen because the purpose of the research is not to statistically test hypotheses, but rather to critically deconstruct existing paradigms and build a new, more robust conceptual framework. The research process is carried out through three stages: (1) Critical Literature Review and Synthesis, which involves an in-depth review of existing literature on DCR, PER, and sharia risk management, with a focus on identifying assumptions, debates, and limitations; (2) Cross-Disciplinary Theoretical Integration, which consciously borrows and adapts the Dynamic Capabilities framework from strategic management literature to provide a new analytical lens; and (3) Framework Deduction and Formulation, which logically derives a new model or framework (research findings) from the results of the synthesis and critical analysis(Maulana & Al Azhar, 2023).

RESULTS AND DISCUSSIONS

Results

An In-Depth Analysis of DCR Dynamics and Mitigation Strategies

This discussion will elaborate on the argument in depth, beginning with a critique of the conventional paradigm, then building on and elaborating on new findings in the form of a dynamic capabilities-based framework.

4.1. Limitations of the Conventional Mitigation Paradigm: A Critical Analysis of Reliance on PER

The current dominant paradigm in DCR mitigation can be likened to a "shock absorber management" approach. PER functions as a shock absorber, cushioning the impact of "potholes" (volatile asset performance). While useful for short-term comfort, this approach has a fatal flaw: it does nothing to improve the "road" itself, or even to improve the "driver's" ability to avoid potholes. Overreliance on PER creates several organizational pathologies(Nasiruddin et al., 2022).

First, it creates the illusion of stability and masks the root of the problem. By artificially stabilizing returns, PER masks important signals that management should receive. Poor performance in a particular financing sector may not immediately impact the cost of funds, resulting in delayed corrective action on the asset side. This is like taking painkillers for a serious infection; the symptoms disappear, but the disease worsens(Shiddiq et al., 2022).

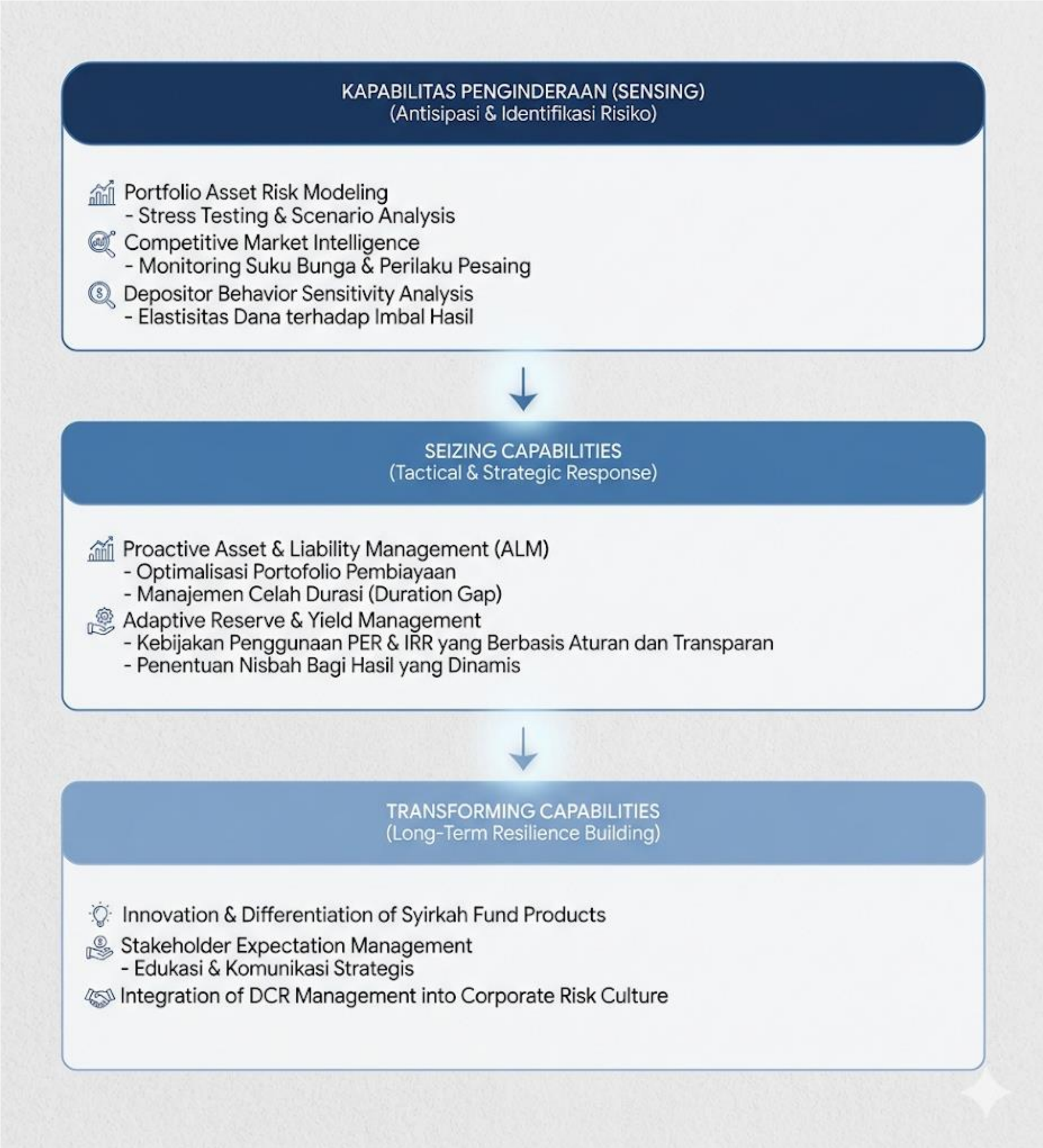
Second, it creates a double moral hazard. For bank management, the PER can reduce pressure to conduct prudent asset management. The awareness of a "cushion" available can reduce discipline in selecting and monitoring financing. For customers, consistently stable returns will create the expectation that temporary syirkah funds are essentially risk-free products. This fundamentally distorts customers' understanding of the PLS principle and hinders long-term market education efforts. Customers never learn to "share in the risk" because they rarely experience it(Budi Santoso et al., 2024).

Third, the PER is a limited resource. This reserve can only be built up during times of good performance. In a prolonged period of poor performance (for example, during an economic crisis), the PER can be completely depleted. Banks that rely too heavily on this instrument will find themselves highly vulnerable when this cushion disappears, lacking other established defense mechanisms(Roziq & Ilma Ahmad, 2024)zakiyya.

Building Dynamic Capabilities for DCR Management

Recognizing the limitations above, a fundamental paradigm shift is required: from DCR mitigation as a technical-reactive function to DCR management as a core dynamic capability. This capability is not about having a single tool (PER), but rather about having an integrated organizational process to continuously manage the trilemma between Sharia compliance, competitiveness, and stability. Based on an adaptation of the Dynamic Capabilities framework, we formulated a new finding: the Dynamic Capabilities Framework for DCR Mitigation(Abidin & Ilma Ahmad, 2023).

Chart 1. Dynamic Capabilities Framework for DCR Mitigation



4.3. In-Depth Elaboration of Each Capability Pillar

Pillar 1: Sensing Capabilities

This represents the bank's capacity to "look ahead." Banks that excel in this capability do not merely wait for Displaced Commercial Risk (DCR) to materialize; instead, they proactively anticipate it. This entails building a sophisticated risk intelligence system.

- **Portfolio Asset Risk Modeling** goes beyond the analysis of historical Non-Performing Financing (NPF); it involves comprehensive stress testing to determine how portfolio performance will react to macroeconomic shocks (e.g., surging inflation or GDP deceleration).

- **Competitive Market Intelligence** is not just about knowing competitors' deposit rates, but rather about understanding their underlying strategies and predicting their next moves(Umam, 2022).
- **Depositor Behavior Sensitivity Analysis** is a quantitative effort to understand how elastic temporary *syirkah* fund depositors are to changes in yield spreads. Finding the definitive answer to the question, *"At what basis-point spread will our depositors begin migrating their funds?"* serves as a crucial input for strategic decision-making(Habibi et al., 2022).

Pillar 2: Seizing Capabilities

This is the ability to act effectively based on the insights gained from sensing capabilities. It serves as the core of DCR mitigation.

- **Proactive Asset & Liability Management (ALM)** acts as the true first line of defense. It is about consciously shaping an asset portfolio that generates a risk-return profile aligned with competitive funding costs. For instance, a bank can strategically scale up its financing allocation in sectors proven to yield high returns with well-controlled volatility.
- **Adaptive Reserve & Yield Management** serves as the second line of defense. This is where the Profit Equalization Reserve (PER) and Investment Risk Reserve (IRR) come into play—not as a knee-jerk reaction, but as a structured response. Their utilization must be governed by a pre-approved, rule-based policy (such as a "traffic light" model) that clearly defines when, how much, and under what specific conditions these reserves can be deployed. This transforms the utilization of PER from an arbitrary managerial decision into a structured organizational response(Nasiruddin et al., 2022).

Pillar 3: Transforming Capabilities

This is the capacity to drive fundamental change and build long-term organizational resilience. This capability is fundamentally about rewriting the "rules of the game."

- **Product Innovation & Differentiation** is the ultimate key to breaking free from the trap of direct comparison with conventional deposits. A prime example is designing tiered *Mudharabah* savings products, allowing depositors to choose varying risk profiles (e.g., *"Mudharabah Amanah"* for low risk-moderate yield, and *"Mudharabah Bertumbuh"* for higher risk-higher potential yield)(Hidayati et al., 2024).
- **Stakeholder Expectation Management** is a strategic, ongoing effort to educate depositors and the broader market on the true essence of Profit-and-Loss Sharing (PLS). This goes far beyond mere brochures; it demands an integrated

communication program that transparently elucidates asset performance and the underlying logic behind yield fluctuations. The ultimate goal is to gradually cultivate a loyal customer segment—one that chooses Islamic banks not because their yields "mimic" conventional ones, but precisely because of their distinct differences(Hidayati & Ahmad, 2025).

CONCLUSION AND RECOMMENDATION

Conclusion

This study concludes that Displaced Commercial Risk (DCR) is a strategic challenge that is far more complex than a mere technical-accounting issue. The currently dominant mitigation paradigm, which relies too heavily on reactive instruments such as the Profit Equalization Reserve (PER), has proven to be unsustainable and has the potential to erode Shariah integrity. The main finding and most significant contribution of this research is the formulation of the Dynamic Capabilities Framework for DCR Mitigation. This framework advocates for a fundamental paradigm shift: moving from DCR mitigation as an isolated technical function toward an integrated, proactive, and dynamic core organizational capability. To effectively manage DCR, Islamic banks must excel in sensing market risks, seizing opportunities through sophisticated Asset and Liability Management (ALM), and transforming their business models through innovation and market education.

Implications

The implications of these findings are multi-dimensional and demand action across various levels:

- **Managerial Implications:** Top management of Islamic banks must view DCR as the number-one strategic risk and make the construction of these dynamic capabilities a top corporate priority. This entails allocating significant resources toward risk intelligence systems, recruiting top-tier ALM talent, and driving product innovation initiatives. DCR must become a standing agenda item at the board of directors level, rather than being confined solely to the treasury committee.
- **Policy Implications for Regulators (OJK & DSN-MUI):** Regulators need to evolve from merely regulating the utilization of PER to encouraging and supervising the development of comprehensive DCR risk management capabilities. The Financial Services Authority (OJK) could consider incorporating the assessment of DCR mitigation capabilities as part of the Bank Soundness Rating (*Penilaian Tingkat Kesehatan Bank*). Meanwhile, the National Shariah Board - Indonesian Ulema Council (DSN-MUI) could issue more detailed fatwas or guidelines regarding the

boundaries of yield-smoothing instruments to safeguard the essence of Profit-and-Loss Sharing (PLS) contracts.

- **Theoretical and Academic Implications:** This study opens a new research agenda that bridges the literature of strategic management with Islamic finance. Future quantitative research could attempt to operationalize and measure the levels of these dynamic capabilities, as well as statistically test their empirical impact on the financial stability and profitability of Islamic banks.

Research Limitations

As a conceptual-theoretical study, the primary limitation lies in the lack of direct empirical validation. The proposed framework is built upon logical deduction and literature synthesis rather than direct field observations of industry practices. Consequently, the relative strengths and weaknesses of each proposed strategy need to be further tested through in-depth empirical case studies or quantitative surveys in future research

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