SUMMARY

PAMUJI GESANG RAHARJO. Determinants of Commercial Banks' Net Interest Margin in Indonesia. Supervised by DEDI BUDIMAN HAKIM, TUBAGUS NUR AHMAD MAULANA and ADLER HAYMANS MANURUNG.

Commercial banks are one of the economic actors who have a vital role in the economy of a country. It is especially for a country whose economy still dependent on the presence of banks as the main source of financing for economic activities.

If banks implement the financial intermediation function efficiently, they will encourage the economic growth of a country. One of the indicators that can be used in measuring the efficiency of banks is net interest margin. High net interest margin is often associated with the presence of inefficiencies in the banking system, particularly in developing countries, due to costs incurred as a result of the inefficiency which are transferred to bank customers by charging high interest rates. In contrast to the lower net interest margin, the expected social cost incurred by the public to banking intermediation activities undertaken will also be low. Efficient intermediation costs are indicated by low interest rates and reflect the effectiveness of monetary policy, well maintained financial stability, and competitive banking system. High intermediation costs would reduce the incentive for economic actors.

Interest margin is one of the indicators that can be used in assessing the profitability of banks. Thus, the higher the level of interest margin which is reflected, the higher profitability of the bank and bank stability is well-maintained. Under certain conditions, high net interest margin is indicated with a high risk premium, while the conditions of increasing competition will encourage speculative behavior of the banking system that could lead to financial instability.

In general, there are behaviors towards the commercial banks in Indonesia, which always expects to maintain a stable net interest margin at a certain level in the long term. It is intended to be able to sustain the achievement level of return that has been predetermined by the owner or ultimate shareholder of the bank. Thus, the high net interest margin is not defined as the low level of efficiency of Indonesian commercial banks, but rather reflects the high asymmetric information and the high level of profitability of the bank's management to be achieved within the framework of the capital increase in order to maintain organic growth in bank assets. It may also reflect the presence of lending practices with a high credit risk that banks should establish loan loss reserves which are large enough.

The purpose of this research is to study and analyze the determinant factors of commercial banks' interest margin in Indonesia, both internal factors (bank specific factors) and external factors. Internal factors are selected under this study consists of several aspects such as growth of the bank's assets, profitability, efficiency, capital adequacy, liquidity, and risk, meanwhile external factors are market power and interest rates.

This study applied fixed effects on a panel data regression model to a panel of Indonesian commercial banks that covers the period 2008 – 2012. The results

show that the net interest margin of Indonesian commercial banks are affected by internal and external variables on a different level of significance.

The results of this study indicate that the determinant of NIM each bank group of commercial banks in Indonesia are determined by the characteristics of business, business complexity, and sources of funding of the bank group. Commercial banks in Indonesia also indicate that they always wants to maintain NIM stable at a certain level within a certain time period.

Key words: *net interest margin, commercial bank, panel data, hausman test*