SUMMARY

SAPTO JUMONO. The Dynamic of Profitability in Indonesian Banking Industry (Empirical Study in the Period of 2001-2014). Supervised by NOER AZAM ACHSANI, DEDI BUDIMAN HAKIM, dan MUHAMMAD FIRDAUS

The main objective of this research is to find out whether the management behavior in Indonesian banking industry is efficient or in the collusive condition. Meanwhile, the minor objective of this research is to find out the factors affecting the dynamics of profitability in Indonesian banking during 2001-2014. The research background is based on the observation of real phenomena occurred in Indonesian banking industry both in microeconomics and macroeconomics point of view. The report from the high class international surveys such as Asia Pacific Equity Research Financials (2014), Status Report on the Philippine Financial System (2013), Standard and Poor Rating System (2013), and World Bank (2001-2014) stated that return on total assets (ROTA) of Indonesian banking had the highest position in ASEAN and Asia-Pasific ranking in the period of 2001-2014.

The profitability of Indonesian banking industry was relatively high because the assets, credits, and deposits also remained high. This is an interesting phenomenon because the profitability increment occurred in the tighter competition of banking industry. The tighter competition indicator is shown by decline of the number of bank which is 145 banks (in 2001) to 119 banks (in 2014). Meanwhile, the number of branch offices strangely increased from 6,765 units (2001) to 19,307 units (2014).

Based on aggregate economic system point of view, the banking profitability is related to the basic conditions of the economy, market structure, and behavior of bank management. The important thing is Indonesian economy was affected by financial crisis (2008-2010), while Bank Indonesia (BI) imposed API (Architect Banking Indonesia) regulation during 2004-2012. The crisis and the new regulation surely will affect Indonesian profitability during the research period (2001-2014)

Therefore, the research questions arose from the real phenomenon are stated below:

1) Does Indonesian banking profitability is related to conduct, structure, and economy basic condition?
2) What are the factors affecting profitability based on internal and external factors?

To answer the questions, this study uses SCP theory (structure conduct performance) as a grand theory. The advantages of SCP theory is it can simplify the analysis and research synthesis because SCP theory contains about the relationship between structure, conduct, and performance of an industry. Several previous studies that included SCP theory on their researches are Bhatti and Hussain (2010) in Pakistan banking; Gajurel and Pradhan (2011) in Nepalese banking. To solidify basic theory as a basic premise in the process of developing hypotheses and, this research includes ALMA (assets, liability, management) du Pont model as the supporting theory.

This study uses purposive sampling technique which results 97 banks during 2001-2014 as the sample. This study also uses dynamic panel data, Regression-

Arelanno Bond GMM, as the regression technique. There are three main results regarding the main significant factors affecting profitability in Indonesian banking industry:

1) Profitability of prior year (ROTA- lag_1 and ROE-lag_1)
2) Market concentration index of HHI (Herfindahl-Hirschman Index)
3) Efficiency of operational expense management

The prior year profitability (ROTA- lag_1 and ROE-lag_1) has positive and significant effect on current year profitability, which means Indonsian banking market is increasingly competitive. Meanwhile the positive influence of the concentration index HHI on profitability and the positive influence of the market share shows the condition of the banking market is still indicated collusion, yet efficient in managing market share through product differentiation (Smirlock, 1985). Based on per variable, the research results are stated below:

1) The significant factors increasing profitability are prior year profitability, index of the use of ICT- Internet, money supply, exchange rate of Rp/USD, concentration index of deposit and credit, profit structure or the ratio of NII/OC, interest income and non-interest income, LAR (loan to asset ratio), and TETA (equity to assets).
2) The significant factors decreasing profitability are economic growth, market share of deposits and loans, interaction between market concentration and firm size, interest expense and overhead), a minimum requirement ratio and loan to deposit ratio, debt to asses ratio, sensitivity, duus (dummy Islamic business units)

The implications of the research results are stated below:
1) NII (*net interest income*) can be increased by raising the credits volume
2) OC (*overhead cost*) can be increased by cutting the prodigality and the mistakes of working operational system
3) FBI (*fee based income*) can be increased by raising banking product variances using the competitive price
4) The low cost funds in financial structure should be increased in order to suppress cost of funds
5) Doing assets and credit portfolio optimization to improve the quality of the assets to achieve optimal return
6) In the future, the internal factors will be the determinant of market structure which is conduct and performance
7) AEC (ASEAN Economics Society) will make the competition of banking industry tighter
8) The local or international banks should make a strategy to increase the customers
9) The efficiency is the main key of banking industry management. The banking industry should be intensive in capital and technology area in order to accelerate the improvement of the quality of performance, conduct, and market structure.

Keyword: bank, profitability, basic earning power, return on equity, efficiency, alma, du pont market structure, and market concentration