SUMMARY

ARUDDY. Four Essays on Competition, Efficiency and Bank Soundness in the Indonesian Banking Sector. Supervised by NOER AZAM ACHSANI, HARI WIJAYANTO and BAGUS SARTONO.

The role of banking sector to sustain economic growth is critical. Banking provides support in the form of facilitating financial services/transactions and as one source of funding to finance productive or consumptive activities of economic actors. Support from banking can be maximized if the sector is in good condition in terms of stability and soundness. The banking stability and soundness is influenced by the resilience and soundness of each individual bank. If banking sector is disturbed which causes intermediation role is not functioning well then it will disrupt the activities of bank lending, will hamper economic activities and slow down economic growth as a consequence.

This study aims to examine the relationship between managing efficiency, exploiting competitive position and risk-taking decision in the context of Indonesian banking sector during period 2002-2016 and evaluate the impact of efficiency and/or competitive position on bank soundness. The relationship between efficiency, competitive position and risk-taking decision will be analyzed by taking into account relevant information related to macroeconomic data and bank specific data. The sample used in this study consists of data for 4 state-owned banks and 24 private-owned foreign exchange commercial banks. Quarterly financial statements for all banks are retrieved from OJK website.

The study employed data envelopment analysis (DEA) with input orientation under variable return to scale (VRS) nature to estimate X-efficiency and Lerner index as a proxy for competitive position indicator for commercial banks in Indonesian banking sector. The Z-score used as an indicator for overall bank risks or bank soundness. The β-convergence and σ-convergence analysis were applied to identify the existence of convergence in level of efficiency. Partial Adjustment Model (PAM) identified speed of efficiency adjustment. In order to account for heteroskedasticity and endogeneity, generalized method of moment (GMM) employed to estimate the dynamic model.

Result of the study showed small decrease in the efficiency due to global financial crisis (GFC) in 2007/2008, and the existence of convergence in banking efficiency, however the GFC slowed down the acceleration of convergence. The findings confirmed that consolidation policy was successful in strengthening the fundamental of Indonesian banking sector post Asian Financial Crisis (AFC) in 1997/1998. The relationship between level of efficiency and competitive position is a positive one-way relationship from efficiency to competitive position. The more efficient is, the stronger competitive position. The higher efficiency will increase market share and profit. These indicate that efficiency-structure hypothesis (ESH) supported by Indonesian commercial banks with pricing power as a channel, besides that the “quiet-life” hypothesis (QLH) was rejected.

Larger pricing power (measured by Lerner index) potentially has a negative impact on soundness of a bank and banks support competition-fragility hypothesis in the context of competitive position or support competition-stability hypothesis in the context of market situation. The execution of pricing power by a bank will be very likely to increase credit risk which will endanger bank soundness if not accompanied by a corresponding improvement in the quality of implemented risk management. In relation with the implementation of Basel 3, the increase of net stable funding ratio (NSFR) for banks that have not reached the minimum NSFR level will reduce their returns and then may deliver negative impact on banking stability. When off-balance sheet transactions included, the relationship between level of efficiency and competitive position remains positive one-way from efficiency to competitive position. And also, the competitive position remains negatively affect soundness of the bank through an increasing portfolio of credit risk resulting from risk-taking behavior.

Keywords: Competitive Position, Efficiency, Efficiency-Structure Hypothesis, NSFR, Risk Taking