

Competitive Condition and Market Power of Islamic Banks in Indonesia

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Abstract : The expansion of Islamic banking industry seems to emphasize the banking competition in Indonesia where conventional and Islamic banks coexist. In addition, the 2007/2008 global financial crisis and deregulation have the effect on competitive conditions in Islamic banking market. In this context, this study aims at investigating competitive conditions and market power of Islamic banks in Indonesia using firm level data over the period 2006-2013. The study also attempts to identify the factors that represent the power of banking market to better study the degree of competition in this banking industry. Using samples of 27 Islamic commercial banks, the study uses a variety of structural and non-structural measures related to the traditional approach and the new empirical approach of the industrial organization (NEIO). The methodology is based on the set of measures of the competition and market power. The first measure is a set of concentration ratios (CR4) and Herfindahl-Hirschman index (HHI). The second measures are the Panzar and Ross H-statistic and the Lerner index based on econometric estimations with the aim of evaluating the market structure and measuring its power in terms of price setting. The results of the competition analysis suggest that the Islamic banking markets in Indonesia cannot be characterized by the bipolar cases of either perfect competition or monopoly over 2006-2013. That is, banks earned their revenues operating under conditions of monopolistic competition in that period. Overall, Islamic banks in Indonesia operate in a relatively less competitive environment or in high market power. It is also indicated that Islamic bank that hope to achieve higher returns should operate in the competitive environment.

Keywords : bank competition, islamic banks, market structure, profitability

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