ABSTRACT

This research is conducted to analyze the relationship between efficiency (pure technical efficiency), credit risk (non-performing loan) and competition (lerner index). The empirical analysis covered the period from 2013 to 2017. Using purposive sampling method, the sample in this study are 19 conventional commercial bank which accounted for more than 60% of the Indonesian banking industry's assets.

The data for the study were obtained from secondary sources including the annual reports and financial statements of the selected banks. Banking efficiency will be measured with Data Envelopment Approach (DEA) and banking competition will be measured with Lerner Index. The analysis methods are Granger Causality test, Vector Auto-Regressive model (VAR) and Vector Error Correlation Model (VECM) using econometric analysis tool, Eviews10.

The results show that there is a bi-directional causality relationship between efficiency and bank competition, which means competition affects efficiency and vice versa. Furthermore, the results of the study also explained that the causal relationship between efficiency and competition is negative and significant. This result is consistent with the efficient structure hypothesis and competition-inefficiency hypothesis. The bi-directional causality relationship is not found between efficiency and credit risk but there is only unidirectional causality relationship from credit risk to efficiency. The effect of credit risk on efficiency is positive and significant. And, there is no causal relationship (neutrality) between credit risk and bank competition.

Keywords: Efficiency, Credit Risk (NPL), Competition, VECM, Granger Causality