

ABSTRACT

In recent years, Indonesian banking sector has become increasingly concentrated in large bank, which has led to less competition. This condition may affect cost efficiency, particularly for smaller banks that must adapt their operational strategies to maintain their position in the market. This study aims to examines the state of competition and cost efficiency in the Indonesian banking sector from 2015 to 2025 and to analyze the relationship between the two.

The study employs a Stochastic Frontier Analysis (SFA) approach to estimate the cost efficiency scores of individual banks, while market competition is proxied by the Lerner Index. In addition, to estimate the impact of competition and efficiency, this study uses dynamic panel analysis method with Generalize Method of Moments (GMM) technique to control the endogeneity caused by reverse causality between the two.

The findings reveal that both competition and cost efficiency in Indonesia's banking sector have fluctuated over the observed period. The average of cost efficiency score exceeds 0.8, indicating a relatively high level of efficiency, while the average Lerner Index value above 0.6 suggests a low degree of competition. Moreover, the results indicate that increased competition has a negative effect on cost efficiency, supporting the Efficient Structure Hypothesis. Under heightened market pressure, banks are compelled to allocate more resources which ultimately raises operational costs and reduces efficiency.

Keywords: Cost Efficiency, Bank Competition, Quiet Life Hypothesis, Efficient Structure Hypothesis

