

ABSTRACT

The Indonesian banking industry is developing in line with economic developments. The role of banking is not only as an intermediary for financial institution, but has become a support system of national transactions as well as agents of monetary policy. The large potential of the banking industry attracts foreign banks to compete with domestic banks. The Indonesian Banking Architecture Policy (API) which was launched in 2004 to realize a strong and efficient banking structure has a direct influence on Indonesia's banking industry structure. This study aims to analyze the impact of foreign bank penetration on the concentration level of the banking industry in Indonesia, precisely after the implementation of the Indonesian Banking Architecture (API) policy and the influence of its determinants.

The method used in this study is the Engle-Granger Error Correction Model (ECM) estimation to determine the short-term relationship and the Ordinary Least Square to determine the long-term relationship. The effect of foreign bank penetration can be observed using the ratio of foreign bank assets to total assets of the banking industry. In addition, the determinant variables of industry concentration such as economies of scale, market size, strategic barriers, and market growth are also included in the research model.

The results show that the penetration of foreign banks empirically has a significant and negative effect on the concentration level of the banking industry in the short term, but not proven in the long term. Foreign bank penetration has proven to have the ability to push the industry towards being more competitive in the oligopoly nature of the Indonesian banking industry. The variables of economies of scale, industry size and strategic barriers have an empirically significant influence on the level of concentration in both the long and short term. Meanwhile, the market growth variable only has a significant effect in the long run.

Keywords: *industry concentration, foreign bank, Error Correction Model*