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Market Dominance in Indonesia's Islamic Banking: Critical Analysis From an Industrial Organisation Perspective

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Abstract

The merger of Bank Syariah Indonesia (BSI) has resulted in the formation of a substantial Islamic bank capable of effectively competing with large conventional banks. Despite this, concerns have been raised that BSI might eliminate smaller Islamic banks. This study aims to critically analyze the characteristics of market dominance in Indonesia's Islamic banking industry before and after the merger of BSI from an industrial organization perspective. We utilized several indicators, including the Concentration Ratio (CR), Herfindahl–Hirschman Index (HHI), and Melnik ratio. The findings strongly indicate market dominance in the Islamic banking industry following the BSI merger. However, we argue that the market dominance achieved by BSI fosters a positive environment by reducing fragmentation within the industry. This merger has also prompted other conventional banks to optimize their support for Islamic banks. Additionally, BSI has the potential to drive the Islamic banking industry forward. Therefore, the BSI merger represents a viable option for the government to support the development of the Islamic banking sector, while competition within the industry remains dynamic. Based on our findings, we recommend that State-Owned Banks provide further support for the development of BSI, and that other conventional banks optimize their support for Islamic banks.

Keywords: Market Dominance, Islamic Banking Industry, Bank Syariah Indonesia, Industrial Organization Perspective

Introduction

On May 1, 1992, the Muamalat Indonesia Bank, the first Islamic bank in Indonesia, commenced operations. This event marked the establishment of the Islamic banking industry in Indonesia (Antonio, 2017; Zaini et al. 2019).

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Over the course of 30 years, the Islamic banking sector in Indonesia has experienced growth, with the presence of 13 Islamic full-filled banks, 20 Islamic Windows, and 208 Islamic Rural Banks (Financial Services Authority, 2022b). Despite its three-decade existence, Islamic banking holds only a 6.96% market share in the national banking industry, which is disappointing, given Indonesia's majority Muslim population and its status as home to the largest number of Muslims worldwide (Siregar & Sissah, 2021).

To support the development of the Islamic banking industry in Indonesia, the Government of Indonesia, through the Ministry of State-Owned Enterprises, decided to merge three subsidiaries of state-owned banks: Bank Syariah Mandiri, BNI Syariah Bank, and BRI Syariah Bank. This merger led to the establishment of Bank Syariah Indonesia (BSI), which commenced operations on February 1, 2021(Rantemangiling et al. 2022). By the end of 2021, the BSI recorded assets worth IDR 265.3 trillion and positioned itself among the top 10 largest national banks in Indonesia (Bank Syariah Indonesia, 2022; Sultoni & Mardiana, 2021). Islamic banks have historically faced challenges owing to their limited capital, making it difficult for them to compete with conventional banks. With substantial capital, BSI is expected to engage in direct competition with conventional banks (Sultoni & Mardiana, 2021).

The merger of BSI is anticipated to have several positive impacts. By leveraging significant assets and resources, the BSI can achieve greater economies of scale and efficiency. Furthermore, BSI will have the capacity to invest substantially in technology, research, and marketing, enhancing its ability to compete with large conventional banks in Indonesia, such as BCA Bank, BNI, BRI, and Mandiri. The BSI is also poised to diversify its business and provide financing for major projects and companies in Indonesia. As a leading Islamic bank, BSI boasts a strong reputation, effective risk management practices, and a pool of highly skilled professionals within the Islamic banking industry (Maulida et al., 2022; Wiyono, 2021). These capabilities position BSI to seize opportunities among unbanked community and conventional bank customers, as Islamic banks have traditionally faced challenges in reaching the unbanked population and offering services of equal quality to those of conventional banks (Sultoni & Mardiana, 2021). Moreover, the BSI has the potential to expand globally and establish a significant presence as an Islamic bank (Rantemangiling et al. 2022). As such, BSI could serve as a catalyst for the growth of Indonesia's relatively stagnant Islamic banking industry (Wiyono 2021).

Although the merger between BSI has had several positive impacts on the Islamic banking industry, there have also been concerns and objections raised. This is because of the significant market share controlled by the BSI, accounting for approximately 40% of the Islamic banking market in Indonesia (Anika et al., 2021; Wiyono, 2021). In comparison, CIMB Niaga Bank, the second-largest Islamic bank, controls only 8.76% of the market. Among the 33 national Islamic banks, including both Full-Fledged Banks and Islamic Windows, only a few have a market share of above 1%. These figures indicate that BSI has a dominant position and effectively monopolizes the Islamic banking industry in Indonesia, leaving smaller banks unable to compete on an equal footing (Anika et al., 2021; Melnik et al., 2008; Wiyono, 2021). Consequently, there are fears that the BSI will squeeze out smaller banks (Siregar & Sissah, 2021). These concerns have led the Business Competition Supervisory Commission to file an objection to the BSI merger, citing the presence of market dominance, indications of a monopoly, and the possibility of unhealthy business competition that could eliminate smaller Islamic banks (Alit & Sumiyati, 2021).

The BSI merger has given rise to a classic debate between the Harvard and Chicago schools of thought on business competition. According to Harvard, the existence of a company with market dominance, such as a BSI, is unfavorable. This concentration of power in the Islamic banking industry has led to monopolistic practices and unfair competition. Furthermore, there is concern that BSI may engage in monopoly pricing that disregards market mechanisms and is detrimental to consumers (Hellmer & Wårell, 2009). In contrast, the Chicago School of Thought supports the idea that a company with market dominance can be beneficial as it eliminates inefficient small firms. This increased efficiency within the industry is expected to improve consumer services (Hellmer and Wårell, 2009).

Analyzing market dominance in Indonesia's Islamic banking sector post-BSI mergers is essential for understanding its economic impact, ensuring fair competition, and protecting consumer interests. It also helps regulators maintain a healthy financial environment that upholds Shariah compliance and promotes financial inclusion. This analysis is crucial for evaluating the market power of Islamic banks, identifying any potential monopolistic or anticompetitive practices, and ensuring that the benefits of Islamic banking are equally distributed among SMEs and the broader community. The merger of Indonesia's three state-owned Islamic banks–BRI Syariah, BNI Syariah, and BSM–to form Bank Syariah Indonesia (BSI) is a significant event that has the potential to reshape the country's Islamic finance landscape (Nawawi et al., 2023; Utari et al., 2022; Qibtiyah & Wicaksono, 2022; Apit et al., 2022). The merger is expected to create a stronger and more efficient Islamic banking entity that can better compete on the global stage and drive the growth of Indonesia's Islamic economy. However, the concentration of market power within BSI also raises concerns about the potential for reduced competition, limited product diversity, and higher costs for SMEs and consumers. The

Indonesian government and regulators must closely monitor market dynamics and ensure that the merger's benefits are equally distributed and do not result in the exploitation of SMEs or consumers (Qibtiyah & Wicaksono, 2022; Apit et al., 2022).

Before the merger, the sector comprised approximately 14 Islamic commercial banks of varying sizes, with major players including Bank Syariah Mandiri, Bank Muamalat Indonesia, and BNI Syariah, which collectively held a significant market share. Major trends, such as increasing consumer demand for Shariah-compliant products, digital transformation, and regulatory support for Islamic finance, were shaping the sector. The BSI merger consolidates these major players, potentially reducing competition and posing challenges for smaller banks, which may struggle to compete with the BSI's scale and resources, leading to reduced market diversity and innovation.

Thus far, research on the merger of BSI has primarily focused on its effects on BSI performance and efficiency (Maulida et al., 2022; Yusuf & Ichsan, 2021). The existing literature also adopts a descriptive qualitative approach that examines mergers through the lens of business, juridical, or Islamic law (Alit & Sumiyati, 2021; Anika et al., 2021; Fiqri et al., 2021; Rantemangiling et al., 2022; Siregar & Sissah, 2021; Sultoni & Mardiana, 2021; Ulfa, 2021; Wiyono, 2021). However, studies exploring the potential monopoly of BSI have been restricted to analyzing market share data, and have primarily relied on juridical or Islamic law perspectives. Consequently, these studies have hastily concluded that BSI possesses a monopoly potential, thereby failing to provide comprehensive and well-substantiated insights (Alit & Sumiyati, 2021; Anika et al., 2021; Wiyono, 2021).

This is primarily due to the omission of perspectives grounded in the field of industrial organization, a discipline that encompasses concepts of market dominance and monopoly. Additionally, prior research has solely employed market share data as an indicator, disregarding other commonly used indicators, such as the Concentration Ratio (CR), Herfindahl–Hirschman Index (HHI), and Melnik ratio, when discussing market dominance and monopoly. Therefore, there is a need for research that examines BSI mergers from an industrial organization perspective, employing more comprehensive indicators (i.e., CR, HHI, and Melnik ratio). This study analyzes market dominance within the Islamic banking industry by comparing the pre- and post-merger conditions.

Methods

This study employed a quantitative and descriptive methodology (Moskoviez, 2019). Therefore, the objective of this research is to provide a description of the characteristics of market dominance in the Islamic banking industry, both prior to and following the merger of BSI in 2020 and 2021. Notably, this research aims to scrutinize the market share of Islamic banks in terms of assets, third-party funds, and financing, providing a nuanced understanding of their dominance in the industry (Widarjono et al., 2023). Overall, this study aims to provide a comprehensive and accurate analysis of the market dominance characteristics of the Islamic banking industry in Indonesia, particularly before and after the merger of BSI. This study utilizes secondary data obtained from the annual financial reports of Islamic banks as well as Islamic banking statistics issued by the Financial Services Authority from 2020 and 2021. In terms of sampling, data are gathered from the entire Indonesian Islamic banking industry population, which consists of Full-Fledged Islamic Banks and Islamic Windows (34 banks in 2020 and 33 banks in 2021). The Islamic Rural Bank is excluded from the sample, as our analysis only focuses on Full-Fledged Islamic Banks and Islamic Windows. Data are collected from the annual reports of 2020 (before the BSI merger) and 2021 (following the BSI merger), thus enabling a comparison of the market dominance conditions in the Islamic banking industry.

Descriptive statistical methods were employed for data analysis, with the Concentration Ratio (CR), Herfindahl–Hirschman Index (HHI), and Melnik ratio serving as the study's indicators for market dominance. To ensure comprehensiveness, this study examines Islamic banks' market share in terms of assets, third-party funds, and financing for calculating the CR, HHI, and Melnik ratios during 2020 and 2021 period. Employing descriptive statistical methods and utilizing these 3 indicators enables a comprehensive analysis of market dominance characteristics. Moreover, these indicators are utilized since these indicators were used by prominent bodies around the world, such as the United States Department of Justice, the United States Federal Trade Commission, and the European Commission for determining the presence of market dominance (Besanko et al., 2013; Hellmer & Wårell, 2009). In addition, these indicators were also utilized in several research in market dominance, such as Hellmer & Wårell (2009). The concentration ratio measures the combined market share, customer base, and assets of the largest companies in the industry, which is then compared to the total market share, customer base, and assets in the industry (Besanko et al., 2013). The concentration ratio was calculated as follows:

$$CRn = C1 + C2 + ... + Cn$$

Where:

Cn represents the market share of the nth largest firm in the industry as a percentage of the total industry market share

n represents the number of firms included in the concentration ratio calculation

The commonly used concentration ratios were CR4 (the concentration ratio of the four largest firms in the industry) and CR8 (the concentration ratio of the eight largest firms). A higher concentration ratio indicates a more concentrated industry. A concentration ratio between 40% and 70% suggests an oligopoly, whereas a concentration ratio above 70% indicates a monopoly (Besanko et al., 2013). The Herfindahl–Hirschman Index (HHI) is an important metric used to assess industry concentration. It is calculated by squaring the market share percentage of each company in the industry and summing them. Unlike the Concentration Ratio (CR), the HHI considers changes in the size of the largest firms operating in the industry (Besanko et al., 2013; Hellmer & Wårell, 2009; Melnik et al., 2008). The HHI formula is as follows:

$HHI = s_1^2 + s_2^2 + s_3^2 + \ldots sn^2$

Where:

HHI is Herfindahl–Hirschman Index

sn defines the market share percentage of firms *n*

Melnik et al. (2008) also proposed an indicator to determine market dominance in an industry, by looking at the size of the market share of the two largest companies in the industry. This is because an increase in the Herfindahl-Hirschman index (HHI) does not always signify the presence of market dominance (Hellmer & Wårell, 2009). The Melnik ratio was calculated as follows:

$S^D = 0.5[1 - \Upsilon(s_1^2 - s_2^2)]$

Where:

S^D is defined as the market threshold, where a lower threshold indicates a higher risk of market dominance.

Υ is a market-specific variable that serves as a proxy for several factors that act as barriers to entry, such as regulation, barriers to entry, and influential buyers. The value of Υ is usually assumed to be 0.5, 1, or 2. The higher the value of Υ, the greater the barriers to entry into the industry.

s1 represents the market share of the largest company in an industry.

s2 represents the market share of the second-largest company in the industry.

After the calculation of these indicators, the value of the CR, HHI, and Melnik ratios were then compared between the value of these indicators in 2020 (before the BSI merger) and 2021 (following the BSI merger). Thus, from this comparison, it could be determined the presence of market dominance before the BSI merger and following the BSI merger.

Findings and Discussions

Prior to the merger, eight prominent Islamic banks had noteworthy assets, third-party funds, and financing. These Islamic banks were Mandiri Syariah Bank, BRI Syariah Bank, BNI Syariah Bank, Muamalat Indonesia Bank, Islamic window of CIMB Niaga Bank, Islamic window of Maybank Indonesia, Islamic window of BTN Bank and Aceh Syariah Bank. On February 1, 2021, the three largest Islamic banks in Indonesia, Mandiri Syariah Bank, BRI Syariah Bank, and BNI Syariah Bank, officially merged to form the BSI. Consequently, the composition of the eight largest Islamic banks underwent notable transformation. Several banks have been incorporated into this group in terms of their assets and financing. These banks include the BSI, Islamic window of CIMB Niaga Bank, Muamalat Indonesia Bank, Islamic window of Maybank Indonesia, Islamic window of BTN Bank, Islamic window of Permata Bank, Aceh Syariah Bank, BTPN Syariah Bank, Mega Syariah Indonesia Bank and Panin Syariah Bank. Tables 3 and 4 present the eight largest Islamic banks in Indonesia both before and after the BSI merger.

Table 3: Islamic Banks with the Largest Market Share Before the Merger of BSI

No	Bank Name	Market Share in Terms of Asset (%)
1	Syariah Mandiri Bank	21.35
2	BRI Syariah Bank	9.71
3	BNI Syariah Bank	9.25
4	Muamalat Indonesia Bank	8.62
5	Islamic Window of CIMB Niaga	7.53
6	Islamic Window of Maybank Indonesia	5.93
7	Islamic Window of BTN	5.55
8	Aceh Syariah Bank	4.28
No	**Bank Name**	**Market Share in Terms of Third-Party Funds (%)**
1	Syariah Mandiri Bank	24.12
2	BRI Syariah Bank	10.58
3	BNI Syariah Bank	10.28
4	Muamalat Indonesia Bank	8.87

5	Islamic Window of CIMB Niaga Bank	6.39
6	Islamic Window of Maybank Indonesia	5.88
7	Islamic Window of BTN	5.1
8	Aceh Syariah Bank	4.62
No	**Bank Name**	**Market Share in Terms of Financing (%)**
1	Syariah Mandiri Bank	22.82
2	BRI Syariah Bank	10.98
3	BNI Syariah Bank	9.06
4	Muamalat Indonesia Bank	7.97
5	Islamic Window of CIMB Niaga Bank	8.75
6	Islamic Window of Maybank Indonesia	7.19
7	Aceh Syariah Bank	4.19
8	Islamic Window of BTN	1.27

Source: Annual Reports of Islamic Banks in 2020

Table 4: Islamic Banks with the Largest Asset Market Share After the Merger of BSI

No	Bank Name	Market Share in Terms of Asset (%)
1	Syariah Indonesia Bank	39.2
2	Islamic Window of CIMB Niaga Bank	8.76
3	Muamalat Indonesia Bank	8.71
4	Islamic Window of Maybank Indonesia	5.79
5	Islamic Window of BTN	5.67
6	Islamic Window of Permata Bank	4.19
7	Aceh Syariah Bank	4.16
8	BTPN Syariah Bank	2.74
No	**Bank Name**	**Market Share in Terms of Third-Party Funds (%)**
1	Syariah Indonesia Bank	43.45
2	Muamalat Indonesia Bank	8.73

3	Islamic Window of CIMB Niaga Bank	7.73
4	Islamic Window of Maybank Indonesia	5.78
5	Islamic Window of BTN	5.45
6	Islamic Window of Permata Bank	4.48
7	Aceh Syariah Bank	4.47
8	Mega Syariah Indonesia Bank	2.18
No	**Bank Name**	**Market Share in Terms of Financing (%)**
1	Syariah Indonesia Bank	43.96
2	Islamic Window of CIMB Niaga Bank	9.48
3	Islamic Window of Maybank Indonesia	6.57
4	Muamalat Indonesia Bank	4.63
5	Islamic Window of Permata Bank	4,24
6	Aceh Syariah Bank	4.19
7	BTPN Syariah Bank	2.68
8	Panin Syariah Bank	2.15

Source: Annual Reports of Islamic Banks in 2021

Several indicators are employed in the analysis of market dominance conditions preceding and ensuing the merger of BSI, specifically the concentration ratio, Herfindahl–Hirschman Index (HHI), and Melnik ratio. The concentration ratios used in this study were 4 and 8. Following the merger of the BSI, there was a substantial increase in CR 4 and CR 8 in terms of assets, third-party funds and financing. Prior to the merger, CR 4 ranged from 48% to 53%, whereas post-merger CR 4 increased to a range between 62% and 65%. Regarding CR 8, the pre-merger value was between 72% and 75%, whereas the post-merger value increased from 77% to 82%. A comparison of the CR 4 and CR 8 values before and after the merger indicates a significant augmentation in the dominance of the four largest Islamic banks and the eight largest Islamic banks after the BSI merger. Consequently, the Islamic banking sector is marked by much greater concentration and is moving towards heightened consolidation. The values of CR 4 and CR 8 are presented in Table 5.

Table 5: Comparison of the Concentration Ratio of the Islamic Banking Industry Before and After the Merger of BSI

Concentration Ratio	Value	Concentration Ratio	Value
CR 4 Asset 2020	48,9	CR 4 Asset 2021	62,5
CR 8 Asset 2020	72,2	CR 8 Asset 2021	79,27
CR 4 Third-Party Funds 2020	53,8	CR 4 Third-Party Funds 2021	65,7
CR 8 Third-Party Funds 2020	75,8	CR 8 Third-Party Funds 2021	82,29
CR 4 Financing 2020	50,8	CR 4 Financing 2021	64,65
CR 8 Financing 2020	72,2	CR 8 Financing 2021	77,92

Source: Annual Reports of Islamic Banks in 2020 and 2021

In terms of the Herfindahl-Hirschman Index (HHI), the HHI value pertaining to assets, third-party funds, and financing stood within the range of 904–1043 prior to the merger of BSI. However, following the merger, a significant increase in the HHI value was observed, ranging from 1825 to 2164. According to the United States Department of Justice and Federal Trade Commission, an HHI value above 1800 signifies market dominance (Hellmer & Wårell, 2009). Therefore, it can be concluded that the merger of BSI resulted in market dominance in the Islamic banking industry.

Table 6: Comparison of the HHI of the Islamic Banking Industry Before and After the Merger of BSI

HHI	Value	HHI	Value
HHI Asset 2020	904,8	HHI Asset 2021	1825,7
HHI Third-Party Funds 2020	1043,7	HHI Third-Party Funds 2021	2152,3
HHI Financing 2020	986,8	HHI Financing 2021	2164,3

Source: Annual Reports of Islamic Banks in 2020 and 2021

In relation to the Melnik ratio, an analysis is conducted by considering multiple ϒ values (ϒ being a market-specific variable that serves as a proxy for various factors acting as barriers to entry, such as regulation, barriers to entry, and influential buyers). A higher ϒ value indicates a greater level of difficulty for new entrants in the industry (Hellmer & Wårell, 2009; Melnik et al., 2008). The assumed ϒ values are 0.5, 1, and 2. The Melnik ratio signifies that if a company possesses a market share that surpasses the value of the ratio, market dominance is present within that industry. Prior to the merger of the BSI, the Melnik ratio values ranged from 0.46 to 0.49, with no Islamic banks exceeding this range in terms of market share (Mandiri Syariah Bank, the most prominent

Islamic bank prior to the merger, held a market share of 21.35% in assets, 24.12% in third-party funds, and 22.82% in financing). Following the merger of the BSI, Melnik ratio values ranged from 0.39 0.48. Assuming a ϒ value of 2, it can be concluded that market dominance exists within the Islamic banking industry, particularly about third-party funds and financing. This is because BSI has a market share of 43.45% in third-party funds (exceeding Melnik's ratio of 39.8%) and 43.96% in financing (surpassing Melnik's ratio of 40%).

Table 7: The Melnik Ratio of the Islamic Banking Industry in the Islamic Banking Industry Before and After the Merger of BSI

ϒ	**Asset**	**Third-Party Funds**	**Financing**	**ϒ**	**Asset**	**Third-Party Funds**	**Financing**
	Asset 2020	Third-Party Funds 2020	Financing 2020		Asset 2021	Third-Party Funds 2021	Financing 2021
ϒ=0,5	0,49	0,488	0,489	ϒ=0,5	0,483	0,474	0,475
	Asset 2020	Third-Party Funds 2020	Financing 2020		Asset 2021	Third-Party Funds 2021	Financing 2021
ϒ=1	0,481	0,476	0,479	ϒ=1	0,466	0,449	0,45
	Asset 2020	Third-Party Funds 2020	Financing 2020		Asset 2021	Third-Party Funds 2021	Financing 2021
ϒ=2	0,463	0,452	0,459	ϒ=2	0,433	0,398	0,4

Source: Annual Reports of Islamic Banks in 2020 and 2021

Among the indicators used, namely, the CR, HHI, and Melnik ratio, strong evidence of market dominance in the Islamic banking industry can be observed after the BSI merger. It is also noteworthy that the BSI holds market dominance in the Islamic banking industry. However, it should be emphasized that this does not imply any wrongdoing in the context of the Islamic banking industry. Moreover, we argue that the market dominance of BSIsat has positive implications. First, the merger of the BSI played a significant role in consolidating the fragmented Islamic banking industry (Barney, 2007). The number of Islamic banks in Indonesia experienced rapid growth during the 2000s, with various banks, including state-owned banks, regional development banks, and large private banks competing to establish both full-fledged Islamic banks and windows.

Consequently, numerous Islamic banks have been established with relatively small assets, resulting in their fragmentation within the Islamic banking industry. As a result, Islamic banks have no significant market share. The largest Mandiri Syariah Bank held a market share of 21%–24% in terms of assets, third-party funds, and financing. The other eight largest Islamic banks only had a market share between 4% and 11%. Meanwhile, 11 Islamic banks held a market share of approximately 1%, while 14 other banks held a market share below 1%. Consequently, the Islamic banking industry was served by numerous players (34 Islamic banks), but none had a substantial presence, preventing economies of scale or the ability to compete with conventional banks. Consequently, developing the Islamic banking industry has become a challenge considering the difficulty of competing with the well-established conventional banking industry dominated by large banks. Therefore, by consolidating the Islamic banking industry through the merger of BSI, despite granting market dominance to BSI, fragmentation within the Islamic banking industry has been eliminated, and an Islamic bank capable of competing head-to-head with conventional banks has been established (Barney, 2007).

Second, because many Islamic banks are affiliated with conventional banks (28 or 84.8% of the total Islamic banks), support from parent banks is crucial (Nugroho & Anisa, 2018). However, these parent banks provided minimal support to their full-fledged Islamic banks and windows. This is evident when comparing the size of the assets of several Islamic banks and their parent banks (see Table 8). Numerous Islamic banks have parent banks with assets worth hundreds of trillions of rupiah (BJB Bank, Mega Bank, Panin Bank, BCA Bank, BTPN Bank, Danamon Bank, Permata Bank, Maybank Indonesia, CIMB Niaga Bank, and OCBC NISP Bank).

However, the Full-Fledged Islamic Banks or Islamic windows affiliated with these banks only possess assets ranging from 8 trillion to 60 trillion rupiahs (excluding BSI), with Islamic banks holding only 10.66% of assets compared to their parent banks. Several Full-Fledged Islamic Banks or windows have assets of approximately 10 trillion rupiahs or less, even though their parent banks possess assets worth hundreds of trillions of rupiahs (BJB Syariah Bank, BCA Syariah Bank, Islamic Window of Danamon, and Islamic Window of the OCBC NISP Bank). The merger of BSI resulted in the bank being associated with three major banks in Indonesia (Mandiri Bank, BRI Bank, and BNI Bank), marking the first time an Islamic bank in Indonesia received support from more than one major bank. This development is expected to serve as a wake-up call for other parent banks with the hope that this merger will encourage other conventional banks to provide optimal support to their Full-Fledged Islamic Banks or Islamic windows. With improved support, the Islamic banking industry is expected to experience more rapid development.

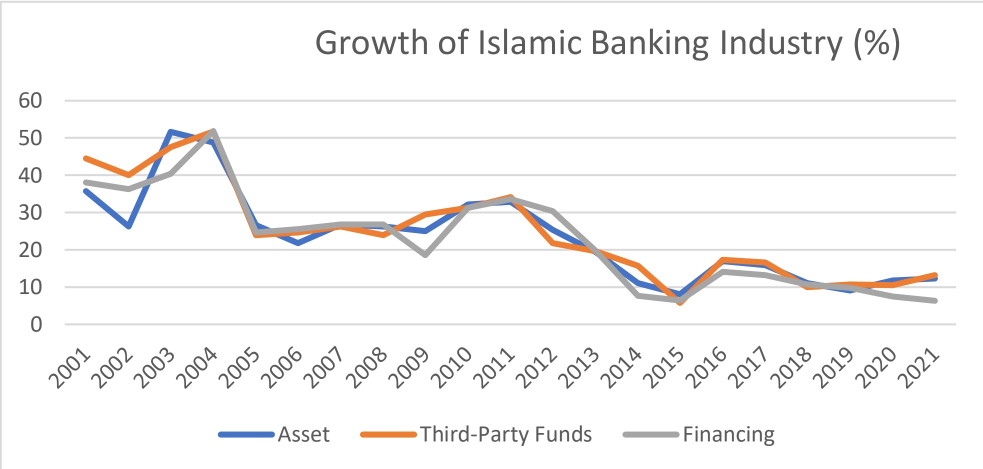
Table 8: Asset of Islamic Banks Compared to Parent Banks in 2021

No	Islamic Bank Name	Asset Compared To Parent Bank (%)
1	Victoria Syariah Bank	7.01
2	BSI (Compared To Mandiri Bank)	15.37
3	BSI (Compared To BRI Bank)	15.8
4	BSI (Compared To BNI Bank)	27.4
5	BJB Syariah Bank	6.54
6	Mega Syariah Indonesia Bank	10.56
7	Panin Syariah Bank	7.05
8	Bukopin Syariah Bank	6.97
9	BCA Syariah Bank	0.86
10	BTPN Syariah Bank	9.66
11	Islamic Window of Danamon Bank	4.51
12	Islamic Window of Permata Bank	12.1
13	Islamic Window of Maybank Indonesia	23.24
14	Islamic Window of CIMB Niaga Bank	19.06
15	Islamic Window of OCBC NISP Bank	2.35
16	Islamic Window of Sinarmas Bank	14.01
17	Islamic Window of BTN	10.31
18	Islamic Window of BPD DKI	10.11
19	Islamic Window of BPD DIY	9.94
20	Islamic Window of Jateng Bank	6.65
21	Islamic Window of Jatim Bank	3.8
22	Islamic Window of Sumut Bank	8.66
23	Islamic Window of Jambi Bank	11.2
24	Islamic Window of Nagari Bank	8.12
25	Islamic Window of Sumsel Babel Bank	12,31
26	Islamic Window of Kalsel Bank	15,12
27	Islamic Window of Kalbar Bank	8,07
28	Islamic Window of Kaltimtara Bank	7,69
29	Islamic Window of Sulselbar Bank	8,06
30	Islamic Window of Jago Bank	17,5
	Average	10.66

Source: Annual Reports of Islamic Banks and Parent Banks in 2021

Third, the Islamic banking industry has experienced a decline in its growth rate due to excessive fragmentation and a lack of support from conventional parent banks. In the 2000s, the industry witnessed an annual growth rate of 20% to 50% in assets, third-party funds, and financing. However, by the 2010s, this growth rate had dropped to below 20% annually. To address this issue, the merger of the BSI has provided the industry with a major bank that can serve as a catalyst for revitalizing the stagnant Islamic banking sector, which has experienced limited progress over the past decade.

Figure 2: Growth of the Islamic Banking Industry (2001-2021)
Source: (Financial Services Authority, 2022b).



Fourth, the merger of BSI presents a practical option for the Government of Indonesia to contribute to the development of the Islamic banking industry. Thus far, the Government of Indonesia, along with regulators such as Bank Indonesia and the Financial Services Authority, has actively promoted the growth of the Islamic banking sector through favorable regulations and marketing campaigns for Islamic banks. The merger of BSI represents a significant step towards government support for the Islamic banking industry, as it creates a large Islamic bank that can potentially become a global leader. Nevertheless, some researchers have proposed more radical policies to expedite the expansion of the Islamic banking industry, such as establishing a massive Islamic bank from scratch, or converting existing state-owned banks into Islamic banks (Anika et al., 2021; Siregar & Sissah, 2021). However, these proposals may be deemed unrealistic because of the substantial capital requirement of hundreds of trillions, which cannot be fulfilled by the state budget alone. Additionally, the conversion of state-owned banks to Islamic banks may lead to controversy and opposition. Hence, it can be argued that from an economic and political standpoint, it is more feasible for the government to establish a substantial Islamic bank through the merger of existing state-owned Islamic banks.

Fifth, despite the existence of BSI, the competition in the Islamic banking industry remains vibrant. Other Islamic banks have thrived and expanded their operations. This is evident in the growth of several Islamic digital banks, such as Aladin Bank and the Islamic window of Jago Bank. Aladin Bank, which did not disburse any financing in 2021, manages to distribute financing of 1.3 trillion rupiahs in 2022. Similarly, the Islamic window of Jago Bank disbursed the financing of 2.26 trillion rupiahs in 2022, despite being established for only a year (Fadillah, 2023). These examples demonstrate that other Islamic banks maintain a positive outlook and that concerns regarding BSI overshadowing and eliminating other Islamic banks appear exaggerated.

BSI mergers have the potential to significantly impact the Islamic banking sector beyond market dominance. A combined entity may leverage its increased size and resources to drive innovation, enhance customer service, promote financial inclusion, and shape competitive dynamics within the industry. The expanded scale and scope of the merged bank could enable it to invest more in R&D, leading to new products and services tailored to the unique needs of Islamic banking customers. Additionally, the enhanced customer base and geographical reach may allow the merged bank to provide more accessible and personalized banking solutions, catering to a wider range of individuals and medium-sized enterprises (SMEs).

Furthermore, the increased market presence and financial strength of the merged bank could spur competition, pushing other Islamic financial institutions to improve their offerings and explore new avenues for growth, ultimately benefiting the overall industry and its stakeholders (Utari et al., 2022; Nawawi et al., 2023). This strategic move aims to create a stronger and more competitive Islamic bank that can better serve the needs of the country's large Muslim population and contribute to the growth of the Islamic economy.

One key aspect of a BSI merger is its potential to enhance innovation within the Islamic banking industry. The combined resources and expertise of the three merged banks could enable the new entity to invest more in R&D, leading to the creation of new and more sophisticated Islamic financial products and services. This could include the development of digital banking solutions, alternative financing instruments, and tailored offerings for small and medium-sized enterprises (SMEs) and underserved segments of the population.

To ensure the healthy development of Indonesia's Islamic banking sector post-BSI merger, comprehensive policies are needed to promote fair competition, innovation, financial inclusion, customer protection, Shariah compliance, collaboration, regulatory enhancements, and support for SMEs with coordinated implementation and regular monitoring. These policies should focus on creating an enabling environment that fosters the growth and sustainability of Islamic finance, particularly among small and medium-sized enterprises (SMEs). Specific measures include providing access to affordable Shariah-compliant financing options, offering financial literacy and capacity-building programs for SMEs, and incentivizing the adoption of Shariah-based practices. Additionally, regulatory frameworks should be strengthened to ensure robust oversight, consumer safeguards, and adherence to Shariah principles while also encouraging innovation and diversity in the Islamic finance ecosystem. Coordinated efforts among government agencies, industry associations, and financial institutions are crucial to the successful implementation and monitoring of these policies, ensuring that the potential of the merged BSI entity is fully realized in supporting the growth and development of Indonesia's Shariah economy (Nurhasanah et al., 2022; Yazid et al., 2020).

Conclusion

This conclusion describes the characteristics of market dominance in the Islamic banking industry before and after the BSI merger. Various indicators were employed, including the Concentration Ratio (CR), Herfindahl–Hirschman Index (HHI), and Melnik ratio. The application of these indicators revealed strong indications of market dominance in the Islamic banking industry following the BSI merger. However, we argue that BSI's market dominance can be seen as a positive development for several reasons. First, the presence of market dominance signifies a more consolidated Islamic banking industry, signaling an end to fragmentation. Second, mergers serve as a wake-up call for conventional banks to provide stronger support to their full-fledged Islamic banks or Islamic windows. Third, BSI has the potential to act as a catalyst for the overall growth of the Islamic banking industry, which has seen limited progress over the past decade. Fourth, the BSI merger represents a practical approach adopted by the Indonesian government to promote the development of the Islamic banking industry, in contrast to alternatives such as establishing a new large-scale Islamic bank from scratch or converting existing state-owned banks into Islamic banks. Finally, competition within the Islamic banking industry remains dynamic, even in the presence of BSI, as other Islamic banks continue to thrive and expand their operations.

However, concerns and objections regarding the BSI merger have arisen. These concerns stem from the fact that BSI controls approximately 40% of the market share in the Islamic banking sector in Indonesia. Consequently, there were fears that BSI might exert market dominance and monopolize the Islamic banking industry in Indonesia. This concern was warranted because other Islamic banks in Indonesia held relatively small asset portfolios, making it unlikely for them to compete on an equal footing with BSI. This study primarily relies on secondary data obtained from annual financial reports and Islamic banking statistics issued by the Financial Services Authority. This reliance on secondary data may limit the depth of analysis and the ability to capture real-time market dynamics. Additionally, the analysis excludes Islamic Rural Banks, focusing only on full-fledged Islamic banks and windows. This exclusion may result in an incomplete picture of the overall Indonesian Islamic banking industry. Therefore, future research is suggested to employ an industrial organization approach to analyze market power within the Islamic banking industry, utilize comprehensive indicators such as the CR, HHI, and Melnik ratio, and explore the role of regulatory frameworks and market mechanisms in shaping the competitive landscape of the Islamic banking industry.

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