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Technical Efficiency and Interest Rate Spread in the Indonesian Banking Industry

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Abstract

This research investigates the effect of technical efficiency on the interest rate spread in the Indonesian banking sector. This research uses the sample of banks listed in the Indonesian Stock Exchange Market during the period from 2003 until 2012. Technical efficieny is estimated using the data envelopment analysis (DEA) with bootstrapping approach. Regarding the role of bank, the technical efficiency is estimated using the intermediation approach in the DEA. The effect of technical efficiency on the banks' spread is estimated using panel data regression. This research finds that the banks listed in the Indonesian Stok Exchange Market are moderately efficient with the average technical efficiency of 0.89. The interest rate spread is relatively high during the period of estimation with the spread of 6.66%, on average. This research also finds that the technical efficiency does not affect the banks' spread indicating that the Indonesian banking sector may not be competitive.

Keywords: technical efficiency, banking pricing, interest rate spread, Indonesian banking sector, data envelopment analysis.

1. Introduction

Banking sector has a significant role in the Indonesian economy. This sector provided funding to run the Indonesian businesess with the banking credit reached about 2706 Trillion Rupiah in 2012. During the period from 2002 to 2012, the growth of the banking credit was about 25% with the highest increase in 2012. Therefore, the performance of the banking sector will affect the performance of the Indonesian economy.

Despite the importance of Indonesian banking sector, it may limit the investment and economic growth because of the banking pricing problems i.e. setting high interest rate of borrowing and low