

The Effect of Bank Syariah Indonesia Merger on Financing in Indonesia

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This study aims to examine the impact of the merger of three state-owned Islamic banks on financing in Indonesia's Islamic banking sector, while also analyzing the role of macroeconomic and bank-specific factors. The study employs time-series data and applies the Auto-Regressive Distributed Lag (ARDL) bounds testing approach to analyze short- and long-term relationships between financing and various macroeconomic and bank-specific variables. The results show that in the short run, the merger did not have an immediate effect on financing, with key variables such as asset size, non-performing financing (NPF), exchange rates, and the unemployment rate significantly influencing financing. In the long run, asset size and NPF positively and negatively impacted financing, respectively, while the exchange rate negatively influenced financing. The merger itself showed no significant long-term effect, likely due to the bank focusing on internal consolidation rather than expanding financing or market share. This study provides insights into the immediate and long-term impacts of bank mergers in the context of Islamic banking, emphasizing the role of macroeconomic factors and internal consolidation processes. The findings offer valuable guidance for policymakers, regulators, banks, and stakeholders in the Islamic banking industry.

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INTRODUCTION

The global Islamic banking sector has demonstrated strong growth and resilience despite facing substantial global challenges. Over the past five years, its assets have grown at a compound annual growth rate (CAGR) of 10.72% (IFSB, 2024). This growth is driven by increased demand for Shari'ah-compliant products, significant funding from oil-exporting countries, and the expansion of Islamic

banking assets, which outpaced conventional banking. According to IFSB (2024), Islamic banking asset is concentrated in the GCC with over

1400 billion USD in 2024. When it comes to year-on-year growth, European and Central Asia region slightly overcomes the GCC region. The Sub-Saharan region is recorded with the least market share of Islamic banking assets compared to other regions, experiencing a decreased year on year total assets as well.

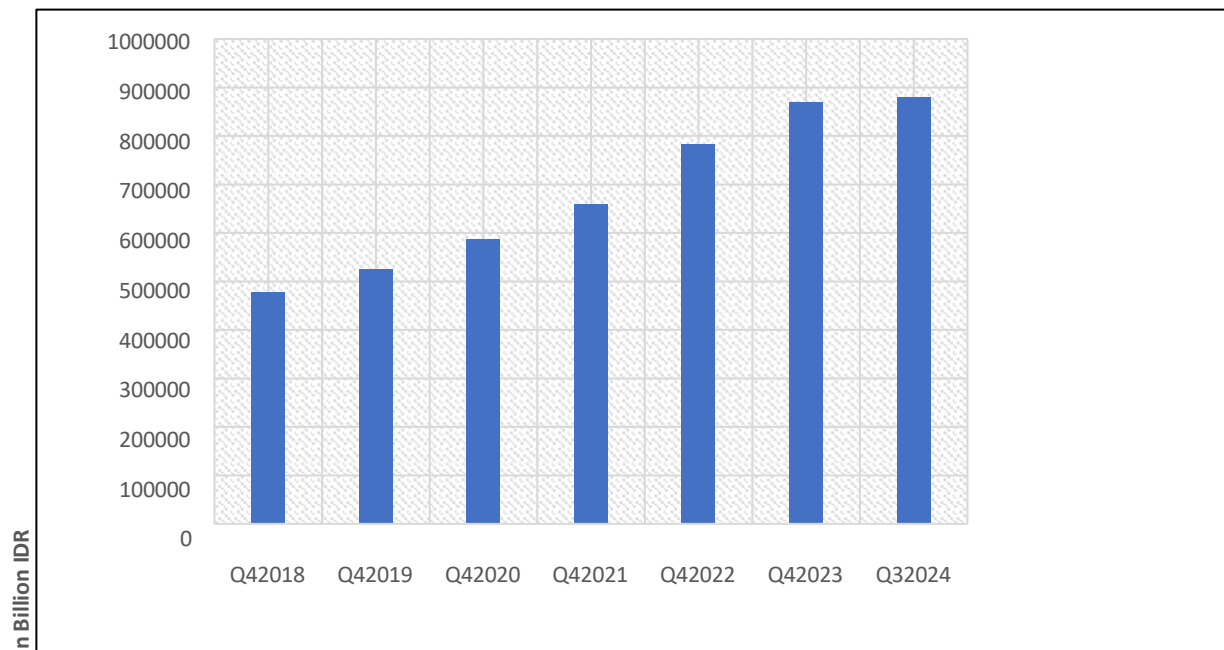


Figure 1. Indonesian Islamic Banking Asset 2018 - 2024

Source: (OJK, 2024)

The development of global Islamic bank is followed by the development of Islamic bank in Indonesia. Figure 1 explains the total asset of Islamic banking industry in Indonesia in the period of 2018-2024. In general, the size of Islamic banking industry is increasing in every year. The total asset reached its peak in Q32024 which is about 878.60 billion IDR. However, the development of Islamic banking industry in Indonesia is not followed by significant increase of market share. After more than 20 years of operation in Indonesia, the market share of Islamic banking industry has not reached 10% of the total banking industry. Indonesian Islamic banking industry is not categorized as domestic systemically important due to the low market share (IFSB, 2024).

The government implemented a merger policy to boost the market share of Islamic banks, combining three state owned Islamic banks into one major

institution. This merger created the largest Islamic bank in the country. The merger in 2021 aimed to strengthen sharia banking across Indonesia and support the development of the country's halal economy. The merger has given positive impacts on the Islamic economy development in Indonesia at a certain level. Afnani and Suselo (2024) stated that the merger is causing Bank Syariah Indonesia to experience rapidly increasing revenue. Frestiva (2024) stated that the merger conducted by Bank BSI successfully improved the financial performance of the bank. Busnetty, Susilo, Soeharjoto, & Jayaprawira (2023) demonstrates that the merger successfully achieved its goal of creating more efficient Islamic banks. However, some studies also highlight the potential negative effects of the merger. Masrifah & Farich (2023) and Aransyah (2021) stated that the merger does not increase the market share. The merger did not affect the realization of financing

disbursement in several branches of Islamic banks (Ariadi, 2023). After the merger and the initial phase of its establishment, Bank Syariah Indonesia was considered inefficient (Hanifah & Suseno, 2022).

In order to grow the asset of Islamic banking industry, financing needs to be highlighted. In this context, the financing portfolio is essential for Islamic banks to grow its asset. According to Federal Deposit Insurance Corporation (2022), loans in conventional banks typically comprise a majority of a bank's assets and carry the greatest amount of risk to their capital. Islamic banks in the other hand need to focus on Sharia-compliant financing products. In the subprime mortgage crisis, troubled asset relief program is released as an intervention from the U.S. government by injecting billions of dollars into banks to prevent further economic meltdown. Troubled Asset Relief Program (TARP) was a lending program that would increase liquidity by encouraging the flow of credit between the banks and from banks to customers (Ghosh & Mohamed, 2010). One of the key goals of this program was to restore credit flow in the U.S. economy, which had come to a near halt during the 2008 financial crisis. Similar to how TARP worked to restore credit flow for economic recovery, an Islamic bank seeking growth of market share should focus on growing its financing.

Most studies focus on the effect of the merger on performance indicators such profitability, efficiency, and non-performing financing. Limited studies such as Rosmati (2023) and Ariadi (2023) discussed about the effect of merger on financing with a small scope or a general viewpoint. This study aims to examine the effect of merger of three state owned Islamic banks on financing of Islamic banking in Indonesia. Furthermore, this study will evaluate the role of various macroeconomic variables and bank specific variables in shaping the financing performance of the Islamic banking sector. The research aims to contribute to the understanding of how consolidation through mergers impacts financing dynamics in Islamic banking, particularly in a market characterized by Islamic financial products targeted at specific consumer groups. It will also seek to explain the slow increase in the market share of Islamic banks relative to conventional banks within Indonesia's dual banking system.

LITERATURE REVIEW

Corporate consolidation theories, particularly those focusing on mergers and acquisitions (M&As),

have been essential in understanding the key drivers and outcomes of such processes. These theories explore factors such as efficiency gains, economies of scale, and market expansion, which are central to the success of mergers. One of the key theoretical frameworks in this area is the Resource-Based View (RBV), which argues that mergers enable firms to combine and leverage resources, such as capital, human resources, and technological capabilities, to create a competitive advantage (Barney, 1991). This view highlights how mergers allow firms to harness complementary resources, leading to enhanced operational performance and market positioning.

Additionally, the Synergy Theory suggests that mergers can result in improved profitability and operational performance due to the synergies created between the merged entities (Dyer et al., 2004). These synergies can arise from various factors such as cost savings, expanded market reach, and the ability to offer a broader range of products or services. The theory posits that when two firms merge, the combined entity may be more efficient than the sum of the individual parts, as they can achieve economies of scale and optimize operations.

Further studies have expanded on these theories, demonstrating that mergers can lead to significant restructuring and operational improvements, particularly in the context of market consolidation. For instance, in the banking sector, mergers often aim to achieve greater financial stability, increase market share, and enhance competitive positioning. Merging banks can combine their customer bases, expand product offerings, and streamline operations to realize cost efficiencies. The outcome of such mergers, however, depends on the strategic alignment of the firms involved, the integration process, and the effective utilization of the combined resources.

The literature on the impact of mergers and acquisitions (M&As) in the banking sector broadly emphasizes that while such transactions generally enhance profitability, efficiency, and financial stability in the long term, their short-term effects often include challenges in operational integration and market growth. Studies such as those by Johnson and Lee (2023), Patel et al. (2024), and Singh and Kumar (2023) highlight that the initial stages of a merger are primarily focused on internal restructuring, including the consolidation of operations, harmonization of policies, and alignment of organizational cultures. This focus on integration often diverts resources away from immediate expansion in

lending activities and market share growth. Moreover, challenges such as aligning corporate cultures and addressing employee redundancies are frequently reported in the literature as key hurdles during the post-merger phase (Meyer and Tanaka, 2023).

In the long term, however, mergers are found to contribute significantly to improved cost efficiencies, better risk management, and enhanced competitiveness. Research by Chen et al. (2023), Oliveira and Santos (2024), and Gupta and Mehta (2023) demonstrate that larger, consolidated entities benefit from economies of scale and scope, enabling them to optimize capital allocation and strengthen their market position. Nevertheless, these studies also underscore the complexity of integrating diverse banking systems, regulatory compliance requirements, and customer bases, which can delay the realization of these synergies. Despite these difficulties, the consensus across multiple studies is that the strategic benefits of M&As—such as increased financial stability, improved shareholder value, and enhanced operational resilience—materialize gradually over time. Overall, the research underscores a recurring theme: while M&As in the banking sector offer substantial long-term advantages, the initial phase is marked by integration-focused efforts that can temporarily constrain growth in lending and market outreach.

The literature on the impact of mergers and acquisitions (M&As) in the Islamic banking sector, particularly in the context of Bank Syariah Indonesia (BSI), consistently highlights that while mergers generally lead to improvements in profitability, capital strength, and financial stability, the short-term effects on financing growth and market expansion are often limited. Studies by Afnani and Suselo (2024), Annisa et al. (2024), and Putri and Ningtyas (2022, 2023) all point to a delayed effect on financing growth, with the initial phase of the merger focusing on internal consolidation, integration, and policy harmonization. This internal focus often detracts from the immediate expansion of market share and financing activities. In contrast, long-term benefits such as enhanced operational efficiencies, risk management, and market positioning emerge more gradually, as seen in the findings of Frestiva and Sholahuddin (2024), Rusli (2024), and Budiantoro et al. (2024). These studies argue that mergers foster capital strength and competitive positioning, but the process of reorganization tends to limit rapid financing growth. Additionally, the integration of Sharia-compliant financial products and alignment of corporate cultures

in Islamic banks introduce unique challenges that may further delay the realization of merger synergies (Rosmiati et al., 2023). Overall, while these studies agree on the positive long-term outcomes of mergers in Islamic banking, they collectively emphasize that the immediate post-merger period is characterized by internal adjustments that constrain financing and market expansion, underscoring the gradual nature of the benefits derived from mergers in this sector.

Overall, the literature emphasizes the complex nature of mergers in Islamic banking. While the benefits of mergers are evident in terms of operational efficiency and profitability, the immediate impact on financing and market expansion is often limited by the integration process. These findings contribute to understanding the factors that influence the financial performance of Islamic banks post-merger and the time required for the full effects of consolidation to be realized.

METHODOLOGY

This study used time series data from *Otoritas Jasa Keuangan* as the financial services authority in Indonesia for the bank specific variables, Bank Indonesia as the monetary authority for the exchange rate data and national Central Bureau of Statistics for the unemployment data. This paper examines the effect of merger on financing of Indonesian Islamic bank and establishes the short- and long-run causal effect using auto-regressive distributed lag (ARDL) as the method. In comparison to traditional co-integration approaches of full maximum likelihood (Johansen and Juselius, 1990) and the residual-based method (Engle and Granger, 1987), the ARDL bounds test approach has some key distinctive features; (1) the ARDL approach used ordinary least square (OLS) for estimating co-integration relationship which is done by selecting respective lag order from the model considered, (2) this technique is found to be statistically significant for all types of variables with I(1), I(0) or jointly integrated (3) the ARDL model tracks the long-run relationship with dependent variables (Shrestha and Chowdhury, 2007; Antonio et al., 2021). The error correction model (ECM) without dropping the long-run evidence assimilates the short run with long run (Collier and Goderis, 2012). The variables for macroeconomic indicators and economic growth were chosen based on data availability for the period 2003–2024 using quarterly data.

1. Model specification

Corporate consolidation theories, particularly

those focusing on mergers and acquisitions, highlight several key drivers and outcomes of such processes, including efficiency gains, economies of scale, and market expansion. The Resource-Based View (RBV) theory suggests that mergers enable firms to combine resources, such as capital, human resources, and technological capabilities, thereby enhancing their competitive advantage (Barney, 1991). Furthermore, the Synergy Theory posits that the merger of firms can lead to improved operational performance and profitability due to the synergies created between the merged entities (Dyer et al., 2004). Following prior studies on the relationship between macroeconomic variables and Islamic bank financing, such as Adebola et al. (2011), and to capture the dynamic nature of the financing process, the econometric model employed in this study is the Autoregressive Distributed Lag (ARDL) model. Hence, the econometric model is specified as:

$$LNFINANCING_t = \beta_0 + \beta_1 LNASSET_t + \beta_2 NPF_t + \beta_3 LNXCHANGERATE_t + \beta_4 UNEMPLOYMENT_t + \beta_5 DummyMerger_t + \varepsilon_t \quad (1)$$

where, Dependent Variable

$LNFINANCING_t$ = the total amount of financing disbursed by the Islamic bank (IDR) at time t .

Explanatory Variables

$LNASSET_t$ = the total asset of islamic banking industry in Indonesia (IDR) at time t . NPF_t = Non-Performing Financing (% of total financing) at time t

$LNXCHANGERATE_t$ = the exchange rate between the Indonesian Rupiah and the US Dollar at t

$LNUNEMPLOYMENTRATE_t$ = the unemployment rate (% of the total labor force that is unemployed but actively seeking work) of Indonesia at t ,

$MERGER_t$ = dummy variable to represent the occurrence of a merger of three state-owned banks in Indonesia at time t . This variable takes the value of 0 when the merger has not yet taken place, and 1 when the merger has occurred.

RESULT AND DISCUSSION

Descriptive statistics of selected variables

Table 1. Descriptive statistics

	<i>FIN</i>	<i>AST</i>	<i>NPF</i>	<i>EXR</i>	<i>UR</i>	<i>MER</i>
Mean	198395,47	291985,85	3,68	11770,94	7,06	0,17
Median	184122,12	240914,64	3,55	11613,00	6,26	0,00
Standard Deviation	174331,64	269684,67	1,07	2566,12	1,87	0,38
Kurtosis	-0,63	-0,67	-0,43	-1,61	-0,87	1,14
Skewness	0,65	0,72	0,47	0,15	0,72	1,77
Minimum	3662,59	4632,24	2,04	8250,00	4,82	0,00
Maximum	601953,00	878604,00	6,63	16367,00	11,24	1,00
Sum	17260405,7	25402768,9	319,87	1024072,0	614,45	15,00
Observations	87,00	87,00	87,00	87,00	87,00	87,00
Correlation						
	<i>TOTAL ASET</i>	<i>NPF_NEW</i>	<i>EXRATE</i>	<i>UR</i>	<i>Merger</i>	
TOTAL ASET	1					
NPF_NEW	-0,44	1				
EXRATE	0,79	-0,21	1			
UR	-0,75	0,21	-0,76	1		
Merger	0,78	-0,50	0,59	-0,34	1	

Table 1 shows that financing has an average value of 198395 with a standard deviation of 174331 and having a maximum value of 601953 and a minimum value of 3662. Asset has an average value of 291985 and

a standard error of 269684 ranging from 878604 maximum to 4632 minimum values. Non performing financing has an average value of 3.68 and a standard error of 1.07 ranging from 6.63 maximum to 2.04

minimum values. Exchange rate has an average value of 11770 and a standard error of 2566 ranging from 16367 maximum to 8250 minimum values. Unemployment rate has an average value of 7.06 and a standard error of 1.87 ranging from 11.24 maximum to 4,82 minimum values. Merger has an average value of 0.17 and a standard error of 0.38 ranging from 1 maximum to 0 minimum values.

Furthermore, the descriptive statistics revealed that, Financing, Asset, NPF, exchange rate, Unemployment rate, and merger were positively skewed meaning that, their mean are peaked to the right of the distribution while GOVEXP, TOP and M2 were negatively skewed meaning that their mean were peaked to the left. The kurtosis coefficients of the variables were below 3.000, showing that they are *platokurtic* which means they have fewer extreme outliers than the normal distribution. The kurtosis coefficient of the variables is above 3.000, meaning that they are leptokurtic relative

to the normal, meaning that their distribution produces more extreme outliers than the mesokurtic distribution. According to [Gujarati \(2004\)](#) when the coefficients between the variables exist within certain thresholds, it signals weak, moderate and strong correlation in positive or negative directions. If the coefficients lie below 0.5(-0.5), it is weak correlation like human capital development, foreign aids trade openness, foreign direct investment, official exchange rate and inflation, when it is between 0.5(-0.5) and 0.8(-0.8), it is moderate correlation like gross capital formation, broad money and if it is above 0.8(-0.8), indicates strong multicollinearity. From the correlation section, the presence of multicollinearity can be inferred. Since the correlation coefficients presented only scenario of weak and moderate across all the variables.

Stationarity test and bound test results

Table 2. Stationarity Test Result

Variables	Stationarity Check	
	Level	1st Difference
Financing	0,00	0,03
Asset	0,97	0,00
NPF	0,05	0,00
Exchange Rate	0,23	0,00
Unemployment Rate	0,19	0,00
Merger	0,81	0,00

Table 2 shows the stationarity properties of variables using the [Augmented Dickey–Fuller \(1979\)](#) and [Phillips–Perron \(1988\)](#). Some variables were stationary at level I(0), while others at difference I(1). [Gujarati \(2003\)](#) proposed the ARDL approach to co-integration to determine how dependent variables react to changes in independent variables in the long and short runs. This approach by Pesaran and Shin (1999) has

many advantages over the Johansen co- integration approach. It is used whether the data are strictly I(0), purely I(1) or mixed integrated. The asset, exchange rate, unemployment rate, and merger are stationary at first difference while financing and non-performing financing are stationary at level, thus bounds checks is used to investigate a co-integration relationship ([Pesaran et al., 2001](#)).

Table 3. Bound Test Result

F-statistic	5,73	
Critical value	Lower bound I(0)	Upper Bound I(1)
1% significant level	3,91	5,04
5% significant level	2,92	3,84
10% significant level	2,47	3,31

Table 3 shows the Bound test result. It shows that at 1% and 5% significance levels, the F- statistics is 5.73, higher than the lower bound of 3,91 at 1% and 2,92 at 5% significance level as well as the upper bound of 5,04 at 1% and 3.84 at 5% significance level. The results reject

the null hypothesis of no co-integration. A long-run co-integration exists between Islamic bank financing as the dependent variable and the independent variables in the model.

Table 4. Diagnostic Test Result

Statistic Test	F-Statistics	p-Value	Interpretation
Heteroscedasticity test: Breusch-Pagan-Godfrey	1,84	0,27	No heteroskedasticity
Jacque-Bera Test	0,46	0,80	Normal distribution
Breusch-Godfrey Serial Correlation LM Test	1,39	0,26	No autocorrelation

Diagnostic test for serial autocorrelation, heteroskedasticity and normality test of the residual are undertaken for model's robustness highlighted in Table 4. The Breusch-Pagan-Godfrey correlation test, Breusch-Pagan-Godfrey heteroskedasticity test, Jacque-Bera normality test and Ramsey RESET test were used. The results show that the model accepts the null hypothesis of no autocorrelation, homoscedasticity and normal distribution. The relationship between the dependent and independent variables is correctly defined as the *p*-values are greater than 5% significance level. The CUSUM and CUMSUMQ tests results in Figure 2 reveal that all the parameters exhibit long-run stability at the 5% significance level. The diagnostic tests conducted in the study suggests the errors are not

correlated over time, ensures accurate coefficient estimates, and meet the assumption of normality. Overall, these results suggest that the model is well-specified, stable, and suitable for drawing valid inferences.

CUSUM (Cumulative Sum) is a diagnostic test often used in the context of ARDL (Autoregressive Distributed Lag) models to assess the stability of the regression coefficients over time. The CUSUM test checks whether the parameters of the regression model remain stable over the sample period. It does this by plotting the cumulative sum of recursive residuals and comparing it to critical bounds. If the CUSUM plot stays within the 5% significance level bounds, the coefficients are considered stable.

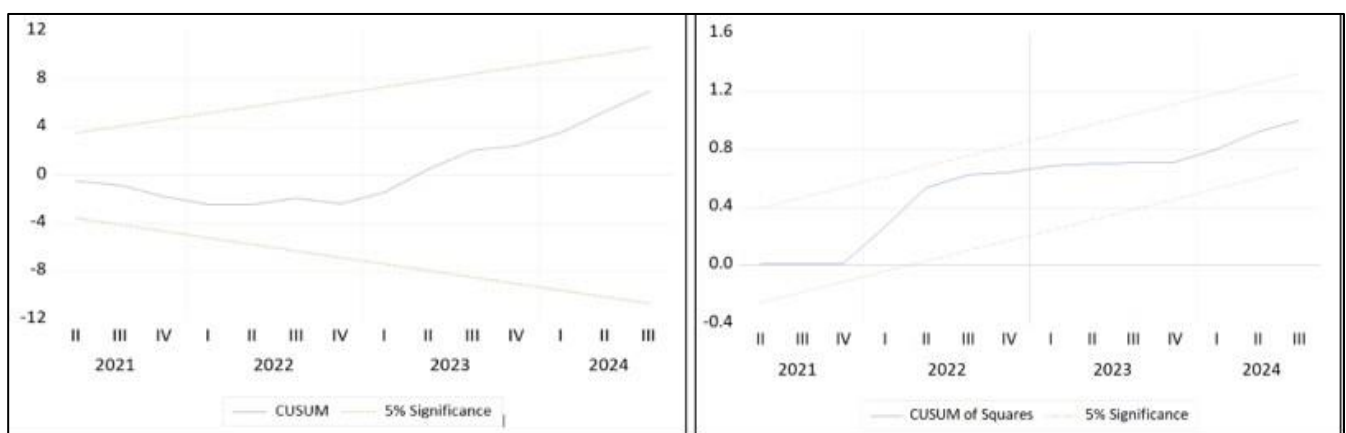


Figure 2. Graphical representation of cumulative sum of square recursive residual (CUSUM) and cumulative sum of recursive residual (CUSUM).

ARDL short-run and long-run coefficient

Table 5. Short-run ARDL test

Dependent Variable: D(LN_FINANCING)				
Selected model: ARDL(2,0,4,2,1,2)				
Deterministics: Restricted constant and no trend (Case 2)				
Variable	Coefficient	Std. Error	t-Statistic	Prob.*
D(LN_FINANCING(- 1))	0.809693	0.100097	8.089067	0.0000***
D(LN_FINANCING(- 2))	-0.231905	0.095237	- 2.435026	0.0176**
D(MERGER)	0.009534	0.013344	0.714486	0.4774
D(LN_EXCHANGE)	-0.071486	0.059085	- 1.209882	0.2306
D(LN_EXCHANGE(- 1))	0.029324	0.069150	0.424068	0.6729
D(LN_EXCHANGE(- 2))	-0.095659	0.068502	- 1.396438	0.1673
D(LN_EXCHANGE(- 3))	0.159187	0.068775	2.314620	0.0238**
D(LN_EXCHANGE(- 4))	-0.156470	0.051618	- 3.031287	0.0035***
D(LN_ASSET)	0.258983	0.079677	3.250424	0.0018***
D(LN_ASSET(-1))	-0.081130	0.108635	- 0.746816	0.4578
D(LN_ASSET(-2))	0.198996	0.092546	2.150238	0.0352**
D(NPF)	0.001320	0.007401	0.178367	0.8590
D(NPF(-1))	-0.023385	0.008231	- 2.840969	0.0060***
D(UR)	-0.002551	0.006422	- 0.397181	0.6925
D(UR(-1))	0.015064	0.007808	1.929295	0.0580*
D(UR(-2))	-0.013974	0.006005	- 2.326838	0.0231**
C	1.868399	0.363304	5.142803	0.0000***
R-squared	0.999773	Durbin-Watson stat		2.131823
Adjusted R-squared	0.999718	S.D. dependent var		1.266693
F-statistic	18199.15	Prob(F-statistic)		0.000000

(***), (**) and (*) denote 1%, 5% and 10% significance level

Table 5 indicates the short-run relationship using an ARDL model. The R^2 value is 0.999773 with the adjusted R^2 value being 0.999718, implying that the independent variables account for 99.9% of variations Indonesia's Islamic banking financing. This demonstrates that the model substantially explains the variation in the financing of Islamic banking industry in Indonesia with a good match. The null hypothesis is rejected because the F-statistics (18199.15) indicates the model's overall importance at 1% level because the likelihood value (0.00000) is below 0.05 critical values. The Dublin Watson statistic (2.131823) is within the appropriate bound, indicating no serial autocorrelation.

The lag value of financing is integrated into the model to capture 2 previous quarters' effects. Financing in the previous quarter positive affect the current year's financing but negatively affect it in the second lag. Exchange rate did not affect financing in the first two lags, but affects significantly positive in the third lag and

significantly negative in the fourth lag. Asset affects financing significantly in a positive relationship in the current quarter and third quarter while non-performing financing affects financing significantly in a negative relationship in the first lag. Unemployment rate affects financing significantly in the first and second lag with a positive and negative relationship respectively. The merger of three state-owned bank did not affect financing significantly in the short term.

The short run ARDL result indicate that all the independent variables except merger have a significant influence on financing. In the immediate term, the effect of assets, NPF, exchange rate, and unemployment rate on financing remains significant and impactful. However, the merger variable, which represents the consolidation of the three largest state-owned Islamic banks does not have a significant effect on financing in the short run.

Table 6. Long-run ARDL test

Variable *	Coefficient	Std. Error	t-Statistic	Prob.
MERGER	0.022581	0.034312	0.658107	0.5124
LN_EXCHANGE(- 1)	-0.319988	0.101123	-3.164343	0.0022***
LN_ASSET(-1)	0.892557	0.032636	2.734858	0.0000***
NPF(-1)	-0.052260	0.017111	-3.054165	0.0031***
UR(-1)	-0.003458	0.008539	-0.404933	0.6866
C	4.425259	1.262719	3.504549	0.0008***

(***), (**), and (*) denote 1%, 5% and 10% significance level

In the long run, only three out of five independent variables affect financing significantly, which is exchange rate, asset, and non-performing financing. Merger as the main independent variable and unemployment did not affect financing significantly. Exchange rate affects financing significantly in a negative relationship. This result indicates that financing increases when there is an appreciation in the exchange rate which is a signal of a healthy economy. Financing increases when the economy is good. This result is in line with Ibrahim (2006) where exchange rate appears indirectly through its effect on stock prices and real output. This is contrary to studies such as Adebola, Yusoff, & Dahalan (2011) and Mbutor (2010) where exchange rate did not affect financing significantly. Asset affects financing significantly in a positive relationship. Larger banks are viewed more stable and solvent which are more likely to be trusted by investors compared to smaller banks. This is in line with majority of the study. Larger banks tend to provide more loans due to more diversified and larger pool of fund to support higher demand from the public in normal time (Adzis, Sheng, & Bakar, 2018). A banking sector with strong asset base is desirable for credit growth and financial stability (Akinlo, Enisan, & Oni, 2015). Non-performing financing affects financing significantly in a negative relationship. This is in line with studies such as Ivanovic (2016). Increase in non-performing loan force banks to re-examine their strategies concerning asset quality. However, banks in Malaysia might have a different strategy regarding evaluation of loan application where non-performing loan did not affect financing significantly (Adzis, Sheng, & Bakar, 2018). Unemployment did not affect financing in significantly. During periods of high unemployment, governments may implement stimulus measures that encourage financing such as Direct Cash Assistance program.

Merger did not affect financing significantly as well. Bank Syariah Indonesia as the newly merged entity from three state owned Islamic banks only replace the

individual banks with larger institutional presence. It is not followed by an increase in the total amount of financing since the combined bank may continue operating similarly to how the individual banks operated before the merger. In other word, the merger is not followed by a significant expansion of market share which is the main reason of the merger. In the short term, merged bank might focus on cultural and integration. Instead of expanding to new markets, bank might focus more on harmonizing their internal policies, human resources, and IT system. At the same time, Islamic banks are focusing on niche markets which refers to a very specific and limited market segment which generally smaller compared to general market where products and services are aimed at consumer groups with preference in accordance with Islamic principles.

Low levels of Islamic financial inclusion serve as obstacles to the financing of Islamic banking in Indonesia. Without adequate access to Islamic banking services and products that are in accordance with Islamic principles in all segments, the ability to make right financial decisions which are in line with Islamic principles are limited. One of the examples is the Upland Project in Indonesia, co-financed by the Islamic Development Bank (IsDB), the Lives and Livelihood Fund (LLF), and the International Fund for Agricultural Development (IFAD). This initiative, executed by Indonesia's Ministry of Agriculture, aims to enhance agricultural productivity and rural development in upland areas. The project is designed to improve livelihoods by promoting sustainable farming practices and expanding market access for upland farmers (United Nations International Fund for Agricultural Development, 2021). Ideally, the Upland project should be Shariah-compliant from the outset, all the way through to when the project is received by the farmers. However, due to low Islamic financial inclusion and Islamic financial literacy in rural areas, this program is channeled through conventional banking. Therefore,

Islamic banking industry as a whole may continue operating at a similar stage before the merger that leads to slow increase of market share compared to conventional banks in the dual banking system in Indonesia.

Research underscores the importance of financial inclusion as a fundamental driver for the growth of Islamic banking. Studies by Karim et al. (2022) and Alam and Hassan (2023) highlight that limited access to Islamic banking services in rural and underserved regions significantly restricts the sector's ability to expand its customer base and compete with conventional banks. Furthermore, Mohamad et al. (2021) found that financial inclusion initiatives targeting accessibility to Shariah-compliant products and services play a critical role in integrating Islamic banking into broader economic development frameworks. Without targeted efforts to enhance financial inclusion—such as establishing more Islamic banking branches, digital platforms, and partnerships to reach remote areas—the industry's growth and contribution to sustainable economic development in Indonesia will remain limited.

CONCLUSION

This study examined the impact of the merger of three state-owned Islamic banks on financing in Indonesia's Islamic banking sector, while also analyzing the role of macroeconomic and bank-specific factors. The short-run results revealed that, although several variables—such as asset size, non-performing financing (NPF), exchange rates, and unemployment rate—significantly influenced financing, the merger itself did not have an immediate effect. This suggests that the newly formed Bank Syariah Indonesia focused more on internal consolidation, such as aligning systems and policies, rather than expanding financing or market share. In the long run, exchange rate, asset size, and NPF had significant effects on financing, with the exchange rate negatively impacting financing, while larger assets positively affected financing, and higher NPF levels negatively impacted financing. The merger, however, showed no significant long-term effect on financing, likely due to the continued operations of the bank in a similar manner as the individual banks before the merger.

Overall, the study found that while the merger did not immediately affect financing, key factors like assets, exchange rates, and NPF played a critical role in shaping financing outcomes. The findings suggest that the full effects of mergers may take time to materialize, particularly in markets where internal integration is

prioritized initially over market expansion. The study highlights that while the merger of three state-owned Islamic banks in Indonesia did not immediately impact financing, key factors like asset size, non-performing financing (NPF), and exchange rates played significant roles in both the short and long run. Banks, particularly post-merger, should focus on internal consolidation, risk management, and growing their asset base to enhance long-term financing outcomes. Regulators need to monitor the post-merger phase, ensuring stability and supporting banks during the integration process, while also addressing macroeconomic factors like exchange rate stability. Customers and investors should manage expectations, as the merger's effects on financing may take time to materialize. Furthermore, policymakers should create an environment conducive to the growth of large, stable banks, and encourage innovation in Islamic finance products to remain competitive.

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