Indonesian Banking: Challenges and Opportunities Ahead

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EY Parthenon
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Contents

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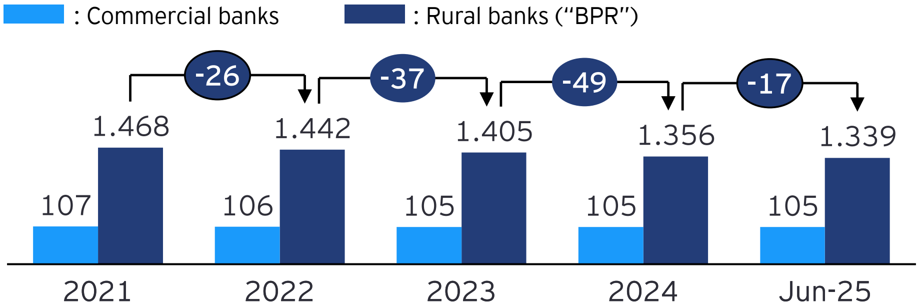
Banking Landscape in Indonesia

Banking consolidation continues despite slowing pace

Over the past five years, the number of commercial and rural banks has steadily declined, reflecting OJK's broader push for consolidation to strengthen industry structure and resilience.

Figure 1.1. Number of commercial and rural banks in Indonesia



Source: Source: OJK (Dec 2021 - June 2025)

Following the issuance of Otoritas Jasa Keuangan (OJK) Regulation No. 12/POJK.03/2020, which set a minimum core capital of IDR 3 trillion by end-2022, commercial banks moved quickly to comply through capital injections, mergers, and Kelompok Usaha Bank (KUB) arrangements. As a result, the number of commercial banks fell only slightly – from 107 in 2021 to 105 by mid-2025[1] – since most Mergers and Acquisitions activity involved foreign investors acquiring existing banks rather than reducing the total count.

Meanwhile, rural banks saw a much steeper decline, driven by stricter supervision, license revocations, and consolidation to meet higher capital requirements and single-presence rules.

Foreign investors have become a major force in Indonesia's banking consolidation, attracted by a large population, low banking penetration, strong profitability, and supportive regulation. Despite this, foreign-invested banks still account for only about 25% of the market[2], leaving significant room for further entry.

Challenging year for banks due to weakening economic conditions

Banks ended 2024 with strong capital and 10.4% Year-over-Year loan growth[3]. **For 2025–2026, OJK expects continued resilience amid an economic slowdown[4]** shaped by Rupiah volatility, policy transitions, middle-class pressure, and global trade uncertainty.

Bank Indonesia maintains a Gross Domestic Product growth outlook of around 5% for 2025, with a stronger recovery expected in the second half after the policy adjustment period.

Externally, while the United States (U.S.) tariff raise on Indonesian goods is anticipated to have limited impact on the negligible contribution of exports to the U.S., the broader U.S. – China tensions may disrupt supply chains and intensify competitive pressures on export-oriented sectors. These factors are expected to temper credit growth, weaken loan quality, tighten liquidity, and increase investor caution, contributing to capital outflows and currency pressure.

From a socioeconomic perspective in Indonesia, a contracting middle class, job insecurity, and low consumer confidence continue to weigh on consumption and retail loan demand.

Banking industry sets sail toward ambitious growth targets

National Priority 3 under Indonesia's Government Rencana Pembangunan Jangka Menengah Nasional 2025-2029 outlines ambitious goals for the banking sector: increasing total banking assets from 57.2% of GDP in 2023 to 77.2% by 2029 and raising banking loans from 33.9% of GDP in 2023 to 46.8% by 2029[5].

While Indonesia's banking sector rebounded post-COVID—reflected in asset and loan growth of 7.9% and 9.3% Compound Annual Growth Rate[6] driven by stronger credit demand and digitalization—structural gaps remain, including high funding costs, intermediation concentrated on Java, and limited alignment with priority sectors.

To address them, key priorities have been identified:

- Improving industry efficiency by accelerating consolidation;
- Diversifying banking offerings;
- Enhancing credit distribution; and
- Advancing digitalization.

These efforts are currently underway and aligned with OJK's banking roadmap.

In recent years, the Loan Deposit Ratio levels of Indonesia's banks have increased as loan balance grew faster than Third Party Fund (TPF), with loans primarily directed toward the mining, processing, trade, and financial intermediary sectors, as well as mortgage financing. Meanwhile, Indonesia's banking Capital Adequacy Ratio maintained a stable and upward trend, reaching 26.7%—the highest in Southeast Asia[7]—reflecting strong capital buffers and resilience.

New bank classification under OJK roadmap to strengthen the industry

OJK introduced OJK Regulation No. 12/POJK.03/2021, replacing the Bank Umum berdasarkan Kegiatan Usaha (BUKU) classification with the new bank grouping based on core capital/Kelompok Bank Berdasarkan Modal Inti (KBMI) framework to enhance prudential oversight by enabling more accurate peer grouping based on core capital.

As the case in the previous BUKU classification era, banks in the highest category remains to be the leading contributors across key metrics in terms of loan balance, TPF, net income, and Net Interest Margin (NIM).

Figure 1.2. Number of commercial banks by KBMI

Source: OJK (Dec 2024)

The top four banks hold over half of Indonesia's total banking assets, and most customers rely on them for daily banking needs. Their dominance is likely to continue, strengthened by OJK's push for further consolidation.

Going forward, OJK aims to see six banks move up from KBMI 3 to KBMI 4 by 2027[8].

Modern Digital Banking

Ecosystem-driven growth and profitability divergence

After a wave of license acquisitions in 2020–2022—accelerated by COVID—Indonesia's digital banks expanded rapidly, especially in raising deposits and growing loans. Many attracted customers by offering rates above the market (and often above Lembaga Penjamin Simpanan (LPS) limits), enabled by lean, branch-light operating models and support from broader digital ecosystems.

As these digital banks mature, most have surpassed the initial growth phase and are beginning to realize economies of scale. Their Cost-to-Income ratio (CIR) has improved significantly owing to a digital-first operating model, which minimizes the need for branches, centralizes staffing, and emphasizes automation across processes.

By 2024, a few of the leading digital banks had reached profitability, supported by scale and operational leverage, though performance still varies across players.

***Quick Response Code Indonesian Standard (QRIS)*: Indonesia's digital payment revolution and its growing global footprint**

The rapid rise of digital banking led conventional banks to develop their own Quick Response-based payment systems, which created a fragmented landscape. To address this, **Bank Indonesia introduced a unified standard called QRIS**, which was launched in August 2019 and mandated for all banks and electronic wallet by January 2020.

To ensure secure transactions, QRIS employs data encryption and requires all users and providers to comply with Bank Indonesia's Know Your Customer (KYC) and Anti-Money Laundering (AML) standards. These safeguards support fast and reliable digital payments, driving QRIS adoption nationwide. **Since its mandatory implementation, QRIS has seen remarkable growth in adoption**. Transaction volume grew from 17 million in 2020[9] to 689 million in 2024[10], while transaction value rose from IDR 1.1 trillion[11] to over IDR 69.5 trillion[12].

This growth has been driven by sharp increases in both users and merchants, which expanded by over 450% and 600% respectively during the same period.

Following strong domestic uptake, QRIS also began international expansion in 2022 up to today, enabling cross-border payments with several partner countries such as in Thailand, Malaysia, Singapore, Japan, etc.

The Rise of Sharia Banking

Regulatory push to create a healthy, competitive Sharia banking landscape

To enhance Islamic financial inclusion and strengthen the national Sharia banking ecosystem, the Indonesian government has introduced several strategic initiatives. Despite Indonesia being home to the world's largest Muslim population, Sharia banking penetration in the country remains relatively low—currently under 8%—compared to other Muslim-majority countries, where penetration rates typically range between 20% and 30% (except for some countries with exceptionally high penetration such as Saudi Arabia, Sudan, Somalia and Iran)[13].

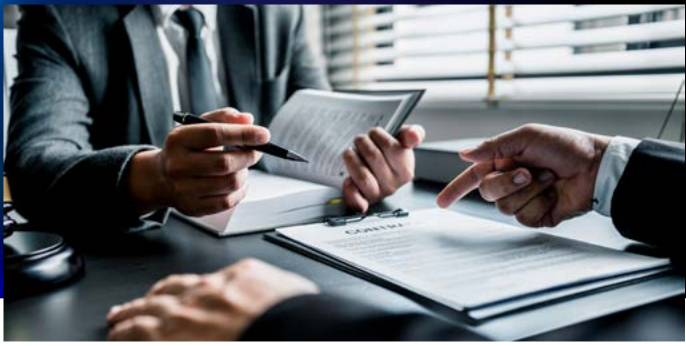
One of the most significant milestones in this effort was the merger of the Sharia banking arms of three state-owned banks. This consolidation marked a major step in creating a more competitive and sizable Islamic banking institution.

Sharia's spin-off strategies

As part of the government's efforts to strengthen the Indonesian Sharia banking landscape, OJK released OJK Regulation No. 12/POJK.03/2023 which mandates banks with Sharia business unit asset of IDR 50 trillion or accounting for 50% of the parent bank's asset to spin-off into a standalone Sharia bank. From our perspective, there are three primary approaches banks can take to comply:

- Applying for a new Sharia banking license (as part of the spin-off);
- Acquiring a standalone Sharia bank and move the Sharia business unit into the acquired Sharia bank;
- Acquiring a standalone conventional bank license and convert it into a Sharia bank;

This regulatory development signals a pivotal shift in the Indonesian Sharia banking landscape and is expected to lead to greater institutional depth, financial stability, competition, and service innovation in the Sharia sector.



Key Takeaways

The points below outline the main regulatory and market themes shaping Indonesia's banking sector, along with their implications for industry participants and investors.

1

Continued consolidation in the banking sector

OJK continues to push for a stronger, more competitive banking landscape with OJK regulation No. 12/POJK.03/2020, which mandates a minimum core capital requirement of IDR 3 trillion for commercial banks. This has triggered a wave of mergers and acquisitions, particularly among mid-sized and smaller conventional banks, as they seek to comply with the regulation.

There is a clear correlation between higher capital base and bank performance. Banks in higher KBMI tend to outperform their lower KBMI peers in terms of stability and profitability. Consolidation offers a strategic path to strengthen balance sheets and improve competitiveness.

2

Banking players to lean on digitalization trend

Digitalization continues to be a key enabler of banking growth in Indonesia. Digital-native banks are entering a more mature phase, with many reaching critical scale that allows them to start realizing cost efficiencies and operational leverage. We expect this trend to continue reshaping customer acquisition strategies, loan disbursement models, and cost structures.

3

Significant opportunities in Sharia banking

OJK is also advancing efforts to develop a more competitive Islamic banking landscape, currently dominated by Bank Syariah Indonesia (BSI). With Indonesia's large Muslim population and relatively low Islamic financial penetration, the country presents a significant untapped market. Banks that can diversify their offerings and provide tailored Sharia-compliant financial solutions stand to benefit from this growing segment.

> "The Indonesian banking sector remains as a highly attractive industry, supported by strong fundamentals, government initiatives and large untapped market. We see tremendous opportunities, particularly in Sharia banking, and digitalization. For these reasons, we expect banking M&A activities to increase in the coming years.

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