

Partnership Implementation in Banking Industry: Parent-Subsidiary Bank Policy in Indonesia

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Abstract

Indonesia has a partnership policy as a prerequisite for foreign parties who wish to open a bank in Indonesia. This partnership policy has been known since the allowance for foreigners to own banks with a 99% stake which continues to this day in today's era of financial industry consolidation. This paper will elaborate on the idea of implementing a partnership policy through the concept of parent-subsidiary bank between Commercial Bank with Foreign Ownership and Local Banks in Indonesia such as Regional Development Banks and People's Economic Banks. This idea will examine the possibility, procedure, and impact of the implementation of the concept on the consolidation of the national banking industry, especially the strengthening of local banks as an effort to improve the welfare of the people as a whole. This research is normative legal research with a statutory and conceptual approach. Based on the analysis conducted in this paper, the implementation of the parent-subsidiary bank concept is in line with the positive regulations prevailing in Indonesia around strengthening the capital of Regional Development Banks and People's Economic Banks as well as having an impact on strengthening capital and transferring technology to these local banks which have an impact on improving the services and capacity of local banks in competing in the banking industry.

Keywords: *Commercial Banks; Foreign Shareholding; Local Banks; Partnership.*

1. INTRODUCTION

In order to support and realize efforts to develop and strengthen the financial sector in Indonesia, the government in early 2023 has made new arrangements and adjustments to various regulations into one comprehensive law¹ namely Law Number 4 of 2023 concerning Financial Sector Development (P2SK Law). The P2SK Law is a new milestone of financial sector regulatory reform in Indonesia with the basic motivation is to encourage the financial sector to be more developed, more inclusive, and more stable. The P2SK Law is very important for the author to study in order to get a clearer understanding of policies related to foreign ownership² in Commercial Banks, especially Conventional Commercial

¹ Indonesia, Financial Sector Development and Strengthening Law (P2SK Law), Law No. 4 of 2023, State Gazette of the Republic of Indonesia No. 4 of 2023, Supplement to the State Gazette of the Republic of Indonesia No. 6845, consideration section.

² Foreign ownership in this case is an investment made by foreign investors, either individually as foreign citizens, foreign business entities and / or foreign governments in the form of share ownership in

Banks³ and their impact on the development and strengthening of the national banking industry.

The development of the number of Commercial Banks and Commercial Bank Offices from 2019 to December 2022 is as follows⁴ :

Table 1. Grouping of Banks by Number of Offices

Bank Group	2019	2020	2021	2022
Persero Bank				
Number of Banks	4	4	4	4
Number of Of-fices	17.621	17.307	18.182	13.023
BPD				
Number of Banks	27	27	27	27
Number of Of-fices	4.396	4.421	5.127	4.038
National Private Bank				
Number of Banks	71	70	68	68
Number of Of-fices	9.074	8.969	9.030	8.293
Branch Office of an Overseas Bank				
Number of Banks	8	8	8	7
Number of Of-fices	36	36	27	23
Total				
Number of Banks	110	109	107	106
Number of Of-fices	31.127	30.733	32.366	25.377

(Source: Processed From Various Sources)

Commercial Banks in the form of limited liability companies in the territory of the Republic of Indonesia.

3 Based on the provisions of Article 1 Point 1, Regulation of the Financial Services Authority of the Republic of Indonesia Number 12/POJK.03/2021, dated July 30, 2021, concerning Commercial Banks, State Gazette of the Republic of Indonesia of 2021 Number 163 (POJK 12/2021) is a bank that carries out business activities conventionally, which in its activities provide services in payment traffic. The author deliberately includes the phrase 'Conventional Commercial Bank' to emphasize the focus of the research so that it is not interpreted to include Islamic banking activities.

4 The development of the number of branch offices of the Bank by location is spread across West Java to West Irian Jaya and others can be seen in Table 2 of the Appendix to this Dissertation.

In this case, the reason for the opening of foreign bank branch offices and banks with foreign ownership in Indonesia is motivated by Indonesia's need for foreign capital.⁵ With the presence of foreign banks operating later, it is expected to encourage the development of banking and the national economy. The advantages gained by Indonesia with the presence of foreign banks, including banks with foreign ownership, include being a channel for *capital inflows* to the Indonesian economy, increasing competition between banks, and introducing more varied products.⁶ However, there are disadvantages, especially in times of crisis, because foreign banks can act as a place or means to move capital (*capital flight*), and in addition because the incoming foreign funds can be more temporary and only to seek momentary profits (*capital inflow during good times capital outflow during bad times*).⁷

Foreign banks operating in Indonesia are clearly commercial banks. The activities of foreign banks have the same duties as other commercial banks, what distinguishes their activities from Indonesian commercial banks is that they are more specialized in certain fields and there are certain restrictions on their activities. Foreign investment in banking refers to the process by which foreign individuals, companies, or institutions inject capital or funds into a country's banking sector. These investments may take the form of stocks, bonds, or other forms of financial instruments. Foreign investment in banking can benefit both the recipient country and the investor country. Indonesia as a developing country with a large population and significant economic potential, attracts a lot of attention from foreign investors, including those interested in investing in the banking sector.

The sector has evolved through a process of consolidation, modernization, and liberalization, all aimed at making the banking industry more efficient, stable, and competitive.⁸ As a result of these processes, Indonesia's banking sector today consists of a variety of banks that vary in size, ownership, and market focus. Foreign investment in Indonesian banking provides several benefits to the country. *First*, it can increase the amount of capital available to Indonesian banks, which in turn can increase their capacity to lend and support economic growth.⁹ *Second*, foreign investment can bring technology and management expertise that can help improve the efficiency and quality of banking services in Indonesia. *Third*, foreign investment can help increase competition in the banking sector, which can encourage innovation and improved customer service. *Fourth*, foreign investment can also serve as a *lender of last resort* in the event of a crisis experienced by commercial banks while preventing a domino effect on other banks in Indonesia.

5 Sabrina, F. N., & Muharam, H. (2015). Analysis of the effect of government ownership, foreign ownership, liquidity risk and credit risk on bank financial performance. *Diponegoro Journal of Management*, 224-236.

6 Tambunan, K. F., & Fauzie, S. "The Effect of Capital Inflow and Capital Outflow in Indonesia on the Rupiah Exchange Rate." *Journal of Economics and Finance*, 2 (2014).

7 Dwi Puspitarini, "Efficiency Analysis of Domestic and Foreign Banks: A Case Study in Indonesia Using the Data envelopment Analysis Method," *FEB Student Scientific Journal*, Vol. 4.2 (2019), pp. 30.

8 Ray Farandy, "Regulation of Foreign Investors in Indonesian Banking," <https://www.pajakku.com/read/b1523119-8c63-4331-9918-eb5240442132/Regulasi-Investor-Asing-di-Perbankan-Indonesia>, accessed on April 25, 2024.

9 Koran TEMPO, "The Important Role of International Banks in Carving Indonesia's Economic Resilience," <https://koran.tempo.co/read/info-tempo/484845/peran-penting-bank-internasional-dalam-carving-economic-resilience-indonesia>, accessed on April 25, 2024.

To date, there are 39 banks operating in Indonesia controlled by foreign investors with a total set of Rp2,944.14 trillion.¹⁰ Of this figure, 32 banks are national private banks and 7 other banks are branch offices of foreign banks. According to OJK Regulation No. 12 of 2021 concerning Commercial Banks, OJK opens space for foreigners to control 99 % of bank share ownership in Indonesia. In addition, OJK also requires foreign investors to provide support and contribution to the Indonesian economy whatever the deal. Foreign investment in Indonesian banking has far-reaching implications, not only for the banking industry but also for the economy as a whole. These investments can help strengthen the banking sector, improve efficiency and service quality, and boost economic growth.¹¹

Ultimately, foreign investment in Indonesian banks is an important component of financial globalization and can provide benefits to both recipient countries and foreign investors. However, it is important for both parties to understand the risks and challenges associated with such investments and to take appropriate measures to mitigate such risks.¹² In this case, when referring to Law 10/1998, the terms ‘mixed bank’ or ‘foreign bank’ can no longer be found. Therefore, the form is included in commercial banks whose ownership is held by Indonesian citizens and Indonesian legal entities with foreign citizens (WNA) or foreign legal entities in partnership.¹³ The form of partnership is not further explained in the applicable laws and regulations. However, this actually means that there is no distinction between the provisions of commercial banks of local and mixed origin.

Choosing the ideal legal form for a foreign bank that wants to do business in a country is not so easy. Various options are available such as *international banking facilities (offshore banking)*, *representative office*, *agency*, *branch office* or *subsidiary*. These options reflect the level of depth of intervention into the receiving country’s market. A representative office, for example, has limited powers and may not accept deposits, extend credit or make transfers. A branch office offers full banking services and the head office is responsible for its obligations. Meanwhile, *subsidiaries* are established separately from the parent company. A subsidiary is an independent legal entity that conducts complete banking activities and operates as a separate company from the parent company but is owned or controlled by the parent company.

When referring to the definition that a foreign bank is a branch of a bank established abroad, either owned by a foreign private company or a foreign government. Therefore, a foreign bank is not actually a national bank. The main difference between a foreign bank and a ‘mixed’ bank is in its legal form. A foreign bank remains incorporated following its overseas headquarters and is an essential part of its headquarters’ organization. Consequently, all financial policies of a foreign bank are highly dependent on its head

10 Tasya Natalia, “Latest Data on Japan Starting to Master Indonesian Banking,” <https://www.cnbcindonesia.com/market/20230724132921-17-456764/data-terbaru-jepang-mulai-kuasai-perbankan-ri>, accessed on April 25, 2024.

11 Winata, A. S. (2018). “Protection of Foreign Investors in Foreign Investment Activities and its Implications for the State”. *Adjudication: Journal of Legal Science*, 2(2), 127.

12 Hikmah Dwi Astuti, “Comparative Analysis of the Performance of Foreign Banks and National Banks Using Financial Ratios,” *Journal of Master of Management*, Vol.01, No.1 (2015).

13 Dicky Eko Prasetyo, “Ius Constituendum Legal Standing Bagi WNA Terkait Proses Judicial Review Di Mahkamah Konstitusi Dalam Perspektif HAM,” *Hunila* 2, no. 1 (2023): 125–38.

office, and lending is generally provided to large companies, just as is the case with foreign banks in Indonesia whose lending.¹⁴

However, with regard to the partnership mechanism as accommodated in the Banking Law, Job Creation Law, and P2SK Law, it is now possible for foreign investment in the shares of conventional commercial banks incorporated in Indonesia, so that the foreign presence can strengthen the capital structure of conventional commercial banks in Indonesia.¹⁵ This shows that the term foreign bank in Indonesia is no longer supported and limited to KCBLN. The partnership mechanism allows foreigners to enter and join as shareholders in national banks and Indonesian private banks. This has helped to increase capital capacity and strengthen Indonesian conventional commercial banks themselves.

In addition, the opportunity for foreigners to own shares in Indonesian conventional commercial banks also gave birth to the concept of *parent banks* in national banking. Although not recognized and mentioned in the laws and regulations in Indonesia, Indonesia has indirectly agreed to the concept. This is indicated by the existence of foreign share ownership above the majority in conventional commercial banks in Indonesia. As in Indonesia alone there are 32 banks with foreign ownership in them. The number of share compositions that exceed the majority has created the concept of *parent bank* and *parent-subsidiary bank*.

The presence of the parent bank concept in national banking can be utilized to strengthen the People's Economic Bank (BPR) and the Regional Economic Bank (REB) as part of the national banking sector. In this case, the P2SK Law changes the name of BPR from Bank Pengkreditan Rakyat to Bank Perekonomian Rakyat. This was done to increase the participation of BPRs in supporting the community's MSME business. According to the P2SK Law, People's Economic Bank (BPR) is a type of conventional bank whose activities do not provide services in chiral traffic directly. The presence of the P2SK Act is expected to overcome one of the problems faced by BPR so far, namely regarding the expansion of its functions in the *payment system* and capital market. In line with this, the concept of partnership as launched by the government can be directed to then be able to contribute to the capital of BPR.

Meanwhile, BPR as stipulated in the Regulation of the Minister of Home Affairs No. 8 of 1992 concerning Adjustment of the Regulation on the Establishment of Regional Development Banks with Law No. 7 of 1992 concerning Banking, there are adjustments to the BPD institution so that it is a bank with the type and business activities of a commercial bank with a focus on improving the economy and regional development. In this case, difficulties are also still a complicated problem within BPD. Therefore, the concept of *parent banks* accessed through partnership mechanisms should also be utilized by BPD to strengthen its capital.

Research discussing partnerships in the banking industry has indeed been conducted by several previous researchers, namely: first, the study by Javed, et al. (2023) which

¹⁴ Henry, T. (2008). Analysis of Financial Performance Differences Between Foreign Banks and Commercial Banks in Indonesia (Doctoral dissertation, Gunadarma University Thesis). Page. 121.

¹⁵ I Gede Agus Kurniawan, "Putusan Mahkamah Konstitusi Terhadap Undang-Undang Cipta Kerja Dalam Perspektif Filsafat Utilitarianisme," *Jurnal USM Law Review* 5, no. 1 (2022).

examines the impact of partnership and non-partnership cooperation in private banking.¹⁶ The novelty of this research is the need for an effective and optimal partnership cooperation design for Islamic banking. Second, the research conducted by Edunjobi (2024) discusses strategies and models in banking to successfully achieve sustainable banking orientation.¹⁷ The novelty of this research is that banking partnerships are one of the strategies that can be pursued and optimized by the banking world. Third, the research conducted by Akbarov and Sobirjonova (2024) analyzes public-private partnerships as a strategy to succeed the financial industry, including banking.¹⁸ The novelty of this research is that partnerships have become an important orientation in the banking world, thereby contributing to the success of the banking industry. Among the three previous studies, this research is original because it has not been thoroughly examined by the three earlier studies.

Based on the above explanation, there is a need to answer the political design of Indonesian banking law in the future. Policies are needed that can accommodate the spirit of the P2SK Law, especially the strengthening of the national banking sector. In this case, it must be considered by legal political architects to develop an ideal but dynamically adaptive legal framework in the event of certain conditions such as economic crises and the provision of sanctions imposed on foreigners who do not comply with bank share ownership limits so that these restrictions are effectively adhered to. There is an urgency to create good regulations for banks that are partially foreign-owned so that these banks are optimally and actually useful and contributive to the strengthening of the banking industry as well as *sustainable* national economic development.

2. ANALYSIS AND DISCUSSION

2.1. Partnerships in Banking Shareholdings

Partnership as a condition for the establishment of a commercial bank is mentioned in Article 22 Paragraph (1) of the Banking Law¹⁹ which states that:

*“Commercial Banks may be established by a. Indonesian citizens; b. Indonesian legal entities; or c. Indonesian citizens and/or Indonesian legal entities with foreign citizens and/or foreign legal entities in partnership.”*²⁰

The Explanation of Article 22 Paragraph (1) of the Banking Law explains that included in the definition of Indonesian legal entities are the Republic of Indonesia, state-owned enterprises, regionally-owned enterprises, cooperatives, and privately-owned enterprises. Further elucidation to Article 22 Paragraph (1) letter c states that:

16 Waseemullah Muhammad Mansoor Javed, Adnan Bashir, “Impact of Partnership Based and Non-Partnership Based Shariah Complaint Products on the Financial Performance of Islamic Banks,” *Audit and Accounting Review* 3, no. 1 (2023): 78–100.

17 Tolulope Esther Edunjobi, “Sustainable Supply Chain Financing Models: Integrating Banking for Enhanced Sustainability,” *International Journal of Multidisciplinary Research Updates* 7, no. 2 (2024): 1–11.

18 Nodira Sobirjonova Gayratjon Akbarov, “The Monetary Policy in the Development of Public-Private Partnership,” *American Journal of Public Diplomacy and International Studies* 2, no. 3 (2024): 106–14.

19 Contained in the Job Creation Law that amends the provisions of the Banking Law, Paragraph 3, Banking, Article 78.

20 Law on Banking Number 10 of 1998, LN. 1998/ No. 182, TLN NO. 3790, Article 22 paragraph (1).

“Foreign legal entities establishing a Commercial Bank must first obtain a recommendation from the monetary authority of the country of origin. The recommendation shall at least contain a statement that the foreign legal entity concerned has a good reputation and has never committed misconduct in the banking sector.”²¹

According to the provisions of the P2SK Law, Chapter IV, Article 14, Number 20, which amends Article 21 Paragraph (1) of the Banking Law, states that Commercial Banks are limited liability companies. Article 21 Paragraph (2) regulates that People's Economic Banks can take the form of limited liability companies or cooperatives.²²

Based on the wording of Article 21 Paragraph (1) above, foreign nationals and/or foreign legal entities cannot establish their own Commercial Banks but must form partnerships with individual Indonesian citizens and/or Indonesian legal entities, including state-owned enterprises, regionally-owned enterprises, cooperatives, and/or privately-owned enterprises as partner options. Previously, Foreign Parties were required to fulfill the requirements as mentioned in the explanation of Article 22 Paragraph (1) letter c, i.e.:

“Foreign legal entities establishing a Commercial Bank must first obtain a recommendation from the monetary authority of the country of origin. The recommendation shall at least contain a statement that the foreign legal entity concerned has a good reputation and has never committed a disgraceful act in the banking sector.”²³

Thus, the establishment of commercial banks involving foreign shareholding can only be done under certain conditions, including in this case there must still be shareholding by Indonesian citizens and/or Indonesia's legal entity.

However, the definition of “partnership” itself is not further elaborated in the explanation. As a result, the form of partnership as regulated is still unclear and its limits are unknown. Therefore, the author suggests that the form of partnership in share ownership should be understood as all actions that constitute cooperation as well as space for Foreign Parties to enter the national banking industry by owning shares in Commercial Banks.²⁴

The author's opinion is also based on the consideration that ‘partnership’ is included in the purchase of commercial bank shares as stipulated in Article 26 Paragraph (2) of Law Number 10 of 1998 which states that Indonesian citizens, foreign citizens, Indonesian legal entities, and or foreign legal entities may purchase shares of Commercial Banks either directly and or through the stock exchange. However, Law Number 10 of 1998 does not determine the maximum limit for the purchase of Commercial Bank shares by Foreign Parties, but its implementing regulation, namely Government Regulation Number 29 of 1999 (“PP 29/1999”), Article 3 which states:

“The maximum amount of Bank shares owned by Foreign Nationals and/or Foreign

21 Law on Banking Number 10 of 1998, LN. 1998/ No. 182, TLN NO. 3790, as amended by the Job Creation Law, Explanation of Article 22 paragraph (1).

22 Pande Putu Indahyani Lestari and I Gede Agus Kurniawan, “Perluasan Pengaturan Pengurusan Perseroan Terbatas Dalam Pembaharuan Hukum Perseroan Terbatas,” *Kertha Semaya: Jurnal Ilmu Hukum* 8, no. 10 (2020).

23 Law on Banking Number 10 of 1998, LN. 1998/No. 182, TLN NO. 3790, as amended by the Job Creation Law, Explanation of Article 22 paragraph (1).

24 I Gede Agus Kurniawan, “The Reconstruction of Subjectum Litis in Term of Reflections on Constitutional Dissolution of Political Parties,” *Akta* 9, no. 1 (2022): 104–19.

Legal Entities obtained through direct purchase or through the Stock Exchange is 99 % (ninety-nine percent) of the total shares in question.”²⁵

Based on the wording of the article, it can be clearly drawn that the purpose or core of the principle of “partnership” which has been regulated in Article 22 Paragraph (1) of Law Number 10 of 1998 is to partner in the establishment of a Commercial Bank in the form of a limited liability company whose capital consists of shares so that the maximum share ownership by foreign parties in a Commercial Bank can reach 99 % while 1 % of the bank’s share ownership remains owned by Indonesian citizens and or Indonesia’s legal entities. Furthermore, restrictions on the purchase of bank shares by foreign parties are contained in Article 4 of PP 29/1999 which reads:

“(1) The purchase of shares by foreign nationals and/or foreign legal entities through the Stock Exchange may reach 100 % (one hundred per hundred) of the total shares of the bank listed on the Stock Exchange. (2) A bank may only list its shares on the Stock Exchange at a maximum of 99 % (ninety-nine percent) of the total shares of the bank concerned. (3) At least 1 % (one per hundred) of the Bank’s shares as referred to in paragraph (2) that are not listed on the Stock Exchange must still be owned by Indonesian Citizens and or Indonesian Legal Entities.”²⁶

This provision indicates that the form of partnership in share ownership by foreign parties can reach 99 % of the total shares. The partnership is a way for foreigners and/or BHA to hold shares and establish commercial banks in Indonesia.

2.2. An Introduction to the Parent-Subsidiary Bank Concept

In the context of bank ownership, *parent bank*²⁷ refers to a financial institution that has a controlling stake in one or more subsidiary banks.²⁸ This controlling ownership can be achieved through direct ownership of the majority of the subsidiary’s shares or through indirect ownership through the holding company structure.²⁹

Parent banks typically have significant influence over subsidiaries, including in terms of strategic direction, risk management, and operational policies. The parent bank may provide financial support, technological expertise, and brand recognition to the subsidiary, enabling the subsidiary to expand its reach, enhance its product offerings, and improve its competitiveness.³⁰

The “parent-subsubsidiary bank” structure in banking is often used for various strategic reasons. This structure allows banks to diversify their operations across different geographies, business lines, and customer segments, thereby reducing risk and expanding their revenue streams.³¹ In addition, this structure can facilitate the efficient allocation

²⁵ Government Regulation on the Purchase of Shares of Commercial Banks, Government Regulation No. 29 of 1999, LN. 1999 No. 62, TLN No. 3841, Article 3.

²⁶ Government Regulation on the Purchase of Shares of Commercial Banks, Government Regulation No. 29 of 1999, LN. 1999 No. 62, TLN No. 3841, Article 4.

²⁷ Can mean the same as the term commonly known as ‘head office’.

²⁸ Małgorzata Iwanicz-Drozdowska, “Subsidiary banks in emerging markets: how strong is the coordination on a group-wide basis?” *International Journal of Emerging Markets* 18 (2023): 86-101.

²⁹ Małgorzata Iwanicz-Drozdowska.

³⁰ I Gede Agus Kurniawan, “Valuasi Merek Sebagai Jaminan Kredit Perbankan: Relevansi Dalam Pembentukan Lembaga Penilai Kekayaan Intelektual,” *Jurnal Magister Hukum Udayana* 9, no. 4 (2020).

³¹ Adam B. Ashcraft, “Are Bank Holding Companies a Source of Strength to Their Banking Subsidiaries?” *Journal of Money, Credit and Banking* 40 (2008): 273-294.

of capital and resources within the banking group, allowing subsidiaries to benefit from the expertise and economies of scale of the parent bank.

The existence of parent-subsidiary banks has the potential to improve operational efficiency and risk management.³² Through consolidating resources, expertise and technology under a centralized parent bank, subsidiaries can benefit from economies of scale and shared infrastructure. This can result in reduced costs, better product offerings and enhanced customer service. In addition, diversification of business lines and geographical presence through subsidiaries can mitigate risks associated with specific markets or sectors, thereby enhancing the stability of the banking group as a whole.

In addition, parent-subsidiary banks can facilitate access to capital and funding for subsidiaries, especially in emerging markets where local banks are limited in the capital they have to run banks—a reason that makes local banks vulnerable to insolvency.³³ Parent banks can provide financial support and act as guarantors to subsidiary banks, thereby improving their credit-worthiness and allowing them to access funding on more favorable terms.³⁴ This can be crucial for the growth and development of the banking sector in developing countries.

However, the parent-subsidiary bank structure raises concerns over potential conflicts of interest. The parent bank may prioritize its own interests over those of the subsidiary, potentially leading to suboptimal decision-making for the subsidiary and endangering its financial health.³⁵ In addition, the complex ownership structure can pose challenges for transparency and accountability, making it difficult for regulators and investors to assess the risk profile of the banking group as a whole.

In addition, the parent-subsidiary bank structure may exacerbate the “too-big-to-fail” problem, meaning that the failure of a large, interconnected banking group may have systemic consequences for the entire financial system.³⁶ The failure affected the entire financial system in that the amount of money managed by the bank was owned by many customers with significant amounts that when accumulated amounted to a very large amount.

However, this situation raises concerns of moral hazard in the parent-subsidiary bank relationships. Under these conditions, parent banks may take excessive risks in order to maintain the existence of the subsidiary bank. Such actions are taken by the parent bank due to the realization that it will be bailed out by the government if it fails.

The regulatory framework governing parent-subsidiary bank relationships is vital in mitigating these risks. Regulators need to ensure that parent banks have sufficient capital and liquidity buffers to support subsidiaries, monitor intra-group transactions to prevent risk transmission, and implement strict corporate governance standards to prevent conflicts of interest and protect

32 Allen N. Berger dan Robert Deyoung, “The Effects of Geographic Expansion on Bank Efficiency,” *Journal of Financial Services Research* 19 (2001): 163-184.

33 William Senyu Wang, “Does subsidiary bank failure affect parents’ capital decisions? Evidence from US bank holding companies,” *Journal of Empirical Finance* 69 (2022): 208-223.

34 William Senyu Wang.

35 Rainer Frey dan Cornelia Kerl, “Multinational banks in the crisis: Foreign affiliate lending as a mirror of funding pressure and competition on the internal capital market,” *Journal of Banking & Finance* 50 (2015): 52-68.

36 George G Kaufman, “Too big to fail in banking: What remains?” *The Quarterly Review of Economics and Finance* 42 (2002): 423-436.

the interests of all stakeholders.³⁷

Parent-subsidary bank relationships are subject to regulatory oversight to ensure the stability and integrity of the financial system. Regulators typically require parent banks to maintain adequate capital and liquidity buffers to support subsidiaries, monitor intra-group transactions to prevent risk transmission, and ensure that subsidiaries operate in accordance with applicable laws and regulations.³⁸

A bank's parent-subsidary structure can pose challenges to corporate governance, particularly in relation to conflicts of interest and agency issues.³⁹ Parent banks may prioritize their own interests over those of subsidiary banks, potentially leading to non-optimal decision-making for subsidiaries. In addition, complex ownership structures can pose challenges for transparency and accountability, making it difficult for regulators and investors to assess the risk profile of the banking group as the whole.

The concept of parent-subsidary banks is relevant in both global and national contexts. Globally, multinational banking groups often operate through a network of subsidiaries in different countries that are subject to regulations applicable in the country with the branch office of the international bank. Similar to the reason why the parent-subsidary bank concept is relevant in the national banking industry, the parent bank can be the controlling shareholder of the local bank.

This illustrates that parent banks play an important role in the bank ownership landscape, shaping the structure, operations and risk profile of the banking group in strengthening local banks. Understanding the dynamics of parent-subsidary relationships is critical for regulators, investors, and policymakers to ensure the stability, efficiency, and fairness of the banking system.

2.3. An Introduction to the Parent-Subsidiary Bank Concept

Small-scale enterprises in developing countries are almost a major economic activity in terms of the number of businesses and their ability to absorb labour. Although in terms of contribution to the gross national income of each country it is not quite as high as medium and large enterprises, this sector remains a cornerstone for national economic stability. The small business sector is a sector that is able to function as a damper and containment of the explosion that could potentially occur with rising unemployment from time to time.

Despite efforts to develop it, the reality is that small businesses have not been completely free from the problems or constraints faced, especially the problem of limited capital, both working capital and investment for business development remains an obstacle. The main problem in the capital aspect is the mobilization of start-up capital and access to working capital, as well as long-term finance for investments that are necessary for long-term product growth.⁴⁰

37 Rainer Frey dan Cornelia Kerl, "Multinational banks in the crisis: Foreign affiliate lending as a mirror of funding pressure and competition on the internal capital market."

38 Judit Temesvary dan Adam Banai, "The drivers of foreign bank lending in Central and Eastern Europe: The roles of parent, subsidiary and host market traits," *Journal of International Money and Finance* 79 (2017): 157-173.

39 Rainer Frey dan Cornelia Kerl, "Multinational banks in the crisis: Foreign affiliate lending as a mirror of funding pressure and competition on the internal capital market."

40 Indria Widyastuti, "Analysis of the role of rural banks (BPR) in improving the performance of micro and small enterprises (MSEs)." *Cakrawala-Journal of Humanities* 16 (2016): 1-16.

Capital limitations are mainly due to their lack of direct access to financial services and facilities provided by formal financial institutions (banks) or non-bank financial institutions. This means that most or all of the funds required for investment (business expansion or increased production volume) and working capital come from informal sources. These sources of financing vary widely, from personal savings (owner/entrepreneur), loans or financial assistance from family or acquaintances, loans from raw material suppliers in the form of later payments, money in the form of upfront payments (partial or full) from buyers, to a share of profits invested.

To overcome the problems faced by small businesses above, the role and existence of People's Economic Banks (BPR in Indonesia), which are part of Microfinance Institutions (MFIs), is one solution. Referring to the P2SK Law, BPR changed its name from Bank Pengkreditan Rakyat to Bank Perekonomian Rakyat, which is defined as a bank that conducts business activities conventionally or based on Sharia Principles, which in its activities does not provide services in chiral traffic directly.

This definition is slightly different from the previous definition, which was a financial institution specifically established to provide business development and community empowerment services, either through loans or financing in micro-scale businesses to community members, deposit management, business strengthening, partnerships, or providing consulting services for business development that is not solely for profit. The definition implies that BPR as one of the MFIs is a profit motive institution that is also social motive, whose activities are more community development in nature without overriding its role as a financial intermediary institution.⁴¹

BPRs carry out financial sector activities in the form of raising funds and providing loans or financing on a micro scale with a simple procedure to the poor and or low income. BPRs provide financial services to customers who have a medium to low business scale and tend to have never been in contact with the banking world. BPR is also a forum for empowering the potential of the people based on the ability of the people with a togetherness approach as an integral part in strengthening the national economy.

BPR as part of microfinance institutions, in practice, is more appealing to small businesses because it is more flexible. For example, in terms of requirements and loan amounts that are not as strict as banking requirements and flexibility in credit disbursement. This is one indicator that the existence of BPRs is in line with the needs of small businesses, which generally require financing according to the scale and nature of small businesses.⁴²

The importance of BPR as one of the banking industry sectors that is in great demand by small communities is indicated by the number of BPR / BPRS which is the largest financial institution in Indonesia with the number of BPR and BPRS as of February 2024 recorded as many as 1,567 banks spread throughout Indonesia.⁴³ With this number, unfortunately BPR and BPRS contribute relatively low and tend to stagnate

41 Tedi Rustendi, "The Effect of Capital Adequacy on the Financial Stability of Rural Banks," *Journal of Accounting and Finance Research* 7 (2019): 531-544.

42 Lusy and Maria Widyastuti, "Performance of Rural Banks (BPR) in Strengthening MSMEs," *Journal of Accounting and Tax*, Vol. 23, No. 2 (2023): 1-8.

43 Financial Services Authority, *Roadmap for the Development and Strengthening of the BPR and BPRS Industry*, (Jakarta: Financial Services Authority, 2021), p. 38.

in the banking sector. In 2023, the BPR and Syariah BPR industry contributed 1.8 % to total national banking assets, 2.1 % to national banking lending or financing, and 1.8 % to national banking third party funds.⁴⁴ In this regard, BPR faces several obstacles in the development of its banking sector, including the high cost of funds, weak human resources, limited capital, technology and communication systems that are relatively less sophisticated than commercial banks, limited products and transaction schemes and financing.

The problems faced by BPRs in their competition with commercial banks are mainly limited capital. In terms of capital, the BPR and BPRS industry has relatively low capital. Based on core capital, most of the BPR industry is concentrated at a low capital level, which is below Rp15 billion, and there are 24.1 % of BPRs that have not met the minimum core capital requirement of Rp6 billion.⁴⁵

In this case, BPRs with lower capitalisation tend to have several problems, such as a higher incidence of fraud and revocation of business licenses, poor financial performance, especially in terms of profitability and efficiency, and have a lower contribution compared to medium and large-scale BPRs. Considering the weaknesses and challenges faced by BPRs in general, it is not easy for BPRs to win the competition in the national banking industry.

Financial issues and bank stability are always of concern to all central banks since they have direct implications for the sustainability of the banking industry. Capital, human resources, governance, third-party funding, non-performing loans, and fraud are factors that are still serious issues to be addressed by most BPRs in order to compete with commercial banks and other financial services institutions. If issues related to these factors are not addressed, there is the potential for BPRs to experience financial difficulties that could lead to business failure.

In addition, the main consumers of BPR businesses are the middle and small communities so if their consumers experience business failure, then most likely, BPRs will be affected because small BPR capital tends to be sensitive to the occurrence of non-performing loans. Therefore, BPRs set higher interest rates for both deposits and loans. This has implications for the costs that people have to bear when requesting loans, making it burdensome for them.

Therefore, BPRs must have the ability in the long term to anticipate the risk of non-performing loans. One of them is through the provision of sufficient core capital (equity capital) as a capital buffer as well as to maintain bank solvency. Capital adequacy has a positive and significant effect on the financial stability of banks. If BPR has good capital adequacy, it will tend to have good bank financial stability, and vice versa, if BPR has insufficient capital adequacy, it will tend to have unstable financial aspects. In this case, BPRs that have good financial stability tend to have relatively high capital buffers, and relatively low leverage. Conversely, BPRs that have unstable financial aspects tend to have low or even negative capital buffers.⁴⁶

⁴⁴ Financial Services Authority., page, 39.

⁴⁵ Irawati, "Bps OJK: There are Still 5 Percent of BPRs that Have Not Met Tier 1 Capital," available at <https://infobanknews.com/bos-ojk-masih-ada-5-persen-bpr-yang-belum-penuhi-modal-inti/>, accessed on June 28, 2024.

⁴⁶ N. A. Fauzia, "Analysis of Factors Affecting Capital Buffer," *Diponegoro Journal of Management* 5 (2016): 1-12.

In this regard, it is important for BPR management to have a comprehensive management plan to evaluate profitability performance and develop rentability projections in order to respond to business risks including credit risks that may disrupt the financial stability of the bank. BPRs must comply with minimum capital adequacy limits, strive for a safe capital buffer in order to reduce the risk of business losses especially from non-performing loans that can negatively correct the bank's net equity which can lead to bank insolvency. BPRs that are undercapitalised or even negatively capitalised are expected to devise strategies that are most beneficial from a long-term perspective.

The increasing concentration of the banking industry in Indonesia is considered as a form of efficiency by banks in improving their performance, but competition in improving efficiency has actually disrupted bank stability. In this case, bank efficiency is more influenced by the high cost of funds, where banks with small core capital such as BPRs rely heavily on third party funds. It is this aspect of capital that OJK is targeting in an effort to strengthen the finances of banks including BPRs.

In response to this, in 2021, OJK has issued the BPR and BPRS Industry Development Roadmap 2021-2025 which contains the policy direction for the development of BPR and Sharia BPR as an effort to develop this industry towards a better direction and be able to face future challenges. However, there are changes in the regulations governing BPR and Sharia BPR in line with the enactment of the P2SK Law, thus requiring adjustments to the BPR and Sharia BPR Roadmap 2021-2025 to become the BPR and Sharia BPR Roadmap 2024-2027.

Through the P2SK Law, BPR and Sharia BPR have gained wider space to develop through institutional strengthening, as well as expansion of business activities and activities of BPR and Sharia BPR. The expansion of business activities and activities of BPR and Sharia BPR is certainly not free from various accompanying risks. For this reason, BPR and Sharia BPR are expected to have a stronger structure to be able to absorb these potential risks so that they can take advantage of the opportunities from the P2SK Law to grow.

Furthermore, through the P2SK Law, the Government seeks to respond to conditions and challenges in order to realize a deep, innovative, efficient, inclusive and trustworthy, as well as strong and stable financial sector, including strengthening BPR and Sharia BPR. Noting that in the previous regulation there were many restrictions related to access to capital and business activities for BPR and BPRS, in the P2SK Law, BPR and BPRS are given wider opportunities from the aspects of capital, product and service development, and expansion of activities that can be carried out by BPR and Sharia BPR. This is an effort to strengthen BPR and Sharia BPR so that they can grow and develop both in terms of performance and contribution to the economy in their region.

Since the enactment of the P2SK Law, access to capital for BPR and Sharia BPR has been expanded to the capital market. In other words, BPR and Sharia BPR can conduct an initial public offering (IPO) on the stock exchange as long as they fulfill the requirements in the applicable OJK regulations. In addition, BPR and Sharia BPR can also innovate products and services related to the Payment System, including

fund transfers. Furthermore, there are also several expansions of BPR and Sharia BPR activities, such as alternative placement of funds through the purchase of securities issued by Bank Indonesia, Government, and/or Local Government, equity participation in BPR and Sharia BPR supporting institutions, and transfer of receivables.

Strengthening capital is one of the fundamental things that needs to be done in an effort to structure the BPR and BPRS industry. In this case, OJK will focus on the fulfillment of Minimum Core Capital (MIM) of BPR and Sharia BPR as regulated in POJK Number 5/POJK.03/2015 concerning Obligations for Minimum Capital Provision and Fulfillment of Minimum Core Capital of Rural Banks (POJK KPMM BPR) and POJK Number 66/POJK.03/2016 concerning Obligations for Minimum Capital Provision and Fulfillment of Minimum Core Capital of Rural Banks. /2016 Regarding the Obligation to Provide Minimum Capital and Fulfillment of Minimum Core Capital of Sharia People's Financing Banks (POJK KPMM Sharia BPR), along with follow-up for BPR and Sharia BPR that cannot fulfill the obligation to fulfill MIM of Rp6 billion in 2024 for BPR and in 2025 for Sharia BPR.⁴⁷

In line with strengthening capital, OJK also encourages the structuring of BPR and BPRS through accelerated consolidation, especially for BPR and Sharia BPR under the same ownership or control (BPR and Sharia BPR Group) through the SPP policy. With the SPP policy, it is expected to achieve an increase in business scale and efficiency in BPR and Sharia BPR Groups, so as to increase the competitiveness of BPR and Sharia BPR in the future. These two policies are expected to be fundamental improvements in the structuring of BPR and Sharia BPR, so that in the future it will be easier to implement other initiatives and action plans in the RP2B optimally.⁴⁸

In addition, these two policies also indicate that in the BPR banking sector it is possible to use a partnership scheme in its shareholding. In this case, given the absence of restrictions on consolidation of BPRs, it is possible for companies incorporated in Indonesia to own BPR shares. The BHI company can be a company with foreign share ownership. Thus, the strengthening of the BPR sector does not rule out the possibility of foreign share ownership in an effort to strengthen its capital structure.

Furthermore, through a partnership scheme, foreign ownership in conventional commercial banks in the form of BHI can enter and own shares in BPRs. This is a good opportunity for BPRs to strengthen their capital. Through strong capital, its existence can also be sustained. It is hoped that this scheme can further strengthen the national banking sector, especially BPRs that require large capital injections in developing their banking service products.

2.4. The implementation of the Bank's Parent-Subsidiary Policy through Shareholding

The Financial Services Authority (OJK) stated that People's Economic Banks (BPRs) and Sharia BPRs can conduct initial public offerings (IPOs), as one of the steps to increase capital. The regulation is contained in POJK Number 7 of 2024 concerning BPR and BPRS (POJK 7/2024) to strengthen the institutional aspects of people's economic banks

⁴⁷ Financial Services Authority, Roadmap for the Development and Strengthening of the BPR and BPRS Industry, (Jakarta: Financial Services Authority, 2021), p. 60.

⁴⁸ Financial Services Authority.

in accordance with the mandate of Law Number 4 of 2023 concerning Development and Strengthening of the Financial Sector (P2SK Law).

In response, OJK's Director of Valuation, I Gede Nyoman Yetna, said that BPR and BPRS can participate in listing on the Indonesia Stock Exchange ('IDX'), with the condition that they must have a minimum core capital of Rp80 billion and a governance assessment with a predicate of at least rank two. Risk profile assessment of at least rank two and health level of at least PK-2, all assessed in the last two periods.⁴⁹

The opening of opportunities for BPRs to conduct IPOs is an entry point for the implementation of the parent bank policy in BPR share ownership. This is because the IPO mechanism allows BPR shares to be offered to the public for the first time. That way, interested companies or conventional commercial banks can buy the shares.

As for foreign parties, they can contribute in the event that the conventional commercial bank or legal entity's share composition consists of foreign share ownership. That way, foreign banks or legal entities can indirectly become parent banks of BPRs.

IPO allows BPRs to raise equity capital from public investors. The capital raised can be used to increase working capital in order to finance the company's growth, to repay debt, to make investments, or to make acquisitions. After becoming a public company, BPRs can utilize the capital market to obtain further funding, among others through limited public offerings whose offerings are limited to investors who already own the company's shares, or through secondary offerings, and private placements. The company will also find it easier to attract strategic investors to invest in the company's shares.

In this case, with the opening of the IPO opportunity, the legal form of BPR also changes to a limited liability company or cooperative as stipulated in the P2SK Law and POJK Number 7 of 2024 concerning BPR and Sharia BPR. Thus, the shareholding of BPRs will no longer stand at 100 % and will have to share votes in the general meeting of shareholders. However, founding shareholders need not worry about losing control of the company. Founding shareholders can still maintain their status as controlling shareholders, as long as their shareholding is more than 50 % of all fully paid shares, or has the ability to determine the management or policy of the listed company.

Thus, the parent bank policy mechanism can be done with the IPO opportunity for BPR. In this case, conventional commercial banks or other legal entities can purchase BPR shares. This causes other shareholders who exceed the majority to become the parent bank of the BPR.

2.5. Impact of Parent-Subsidiary Bank Policy on Local Bank Capacity Building

The presence of the P2SK Act not only opens the door for innovation in BPR product design but also boosts BPR's business capacity. This is characterised by the expansion of BPR financial intermediation services, such as allowing BPRs to conduct foreign exchange activities and transfer funds for both their own and their customers' interests. In addition, BPRs can now transfer receivables and are allowed to conduct public offerings on the stock exchange or so-called Initial Public Offering (IPO). Through this,

49 Khoirifa Argisa Putri, "OJK Restui BPR and BPRS IPO Here's the IDX Response," <https://infobank-news.com/ojk-restui-bpr-dan-bprs-ipo-begini-respons-bei/>, accessed on June 26, 2024.

it can encourage increased capital, profitability, efficiency, income, and improvement of good corporate governance (GCG).

Furthermore, the IPO actually opens up opportunities for foreign ownership in BPRs. In line with the OJK's objectives, it states that BPR and BPR Syariah can conduct an initial public offering of IPO shares, as one of the steps to increase capital. In terms of regulation, this is stated in POJK Number 7 of 2024 concerning BPR and Sharia BPR to strengthen the institutional aspects of people's economy banks in accordance with the mandate of Law Number 4 of 2023 concerning Development and Strengthening of the Financial Sector (P2SK).

In this case, the opening of opportunities for BPRs to conduct IPOs is actually a door to the entry of foreign ownership in BPRs. This is not done directly but through the purchase of shares on the stock exchange by conventional commercial banks incorporated in Indonesia whose shares are affiliated with foreign ownership. This is the pathway for foreign entry into BPRs. Thus, the IPO can indirectly strengthen the capital of BPRs because it opens up opportunities for legal entities with high capital to contribute to the provision of BPR capital.

Strengthening capital is an important aspect in BPRs because BPRs with higher capital will be able to anticipate any negative shocks and have a smaller chance of bankruptcy risk, which in turn can increase their profitability.⁵⁰ There are several strategies that BPRs can adopt to increase their capital, such as seeking new investors or the existing owners adding capital injections, or merging with other BPRs. Another way is of course that the BPR must operate efficiently, i.e. increase revenue while reducing costs so as to generate profits (profitability). This means that BPRs must pay attention to their financial performance, which includes the quality of management (efficiency), capital, liquidity, and credit expansion. However, BPRs must still pay attention to risk aspects, especially credit risk and liquidity risk. Thus, there is a mutually determining relationship between efforts to fulfill capital adequacy and aspects of efficiency and credit risk in the BPR business.

Furthermore, the entry of foreign ownership in the national banking sector can also provide benefits in technology transfer that enhances the country's technological development. Foreign companies contributing to national banking through the Parent Bank policy not only bring in large capital to strengthen the economy, but also contribute to the technology transfer process. In this case, foreign capital also helps in industrialisation and creating wider employment opportunities. Foreign capital brings not only money and machinery but also technical skills that provide efficiency and advancement in the service process.

This is one of the strategic impacts that can strengthen the national banking sector because it brings alternative uses of technology that can facilitate access to services. With easy access to services, it can expand and improve the performance of the banking sector itself. The existence of a technology gap between Indonesia and developed countries with capital owners as parent banks is a potential to be able to learn and adopt

50 Farah Latifah Nurfauziah, "Capital, Efficiency, Credit Risk, and Liquidity of Rural Banks in West Java," *Journal of Accounting*, Vol. 14, No. 2 (2020), p. 104.

the technological developments of these countries. That way, the ideals of strengthening the national banking sector can be realized.

Moreover, in the banking sector, OJK has developed instruments aimed specifically at realizing technology transfer, namely through Financial Services Authority Regulation Number 37/POJK.03/2017, dated 12 July 2017, concerning Utilisation of Foreign Workers and Knowledge Transfer Programs in the Banking Sector, State Gazette of the Republic of Indonesia Year 2017 Number 143 (POJK 37/2017). Based on Article 17 Paragraph (1) of POJK 37/2017, Banks are required to ensure knowledge transfer in the utilization of foreign workers. That way, foreign ownership can support banking in Indonesia, such as from technology applications.

However, this obligation is not without loopholes. Supervision of the knowledge transfer obligation in the utilization of foreign workers is very weak. This is because it is only based on reports from foreign companies.⁵¹ In line with Tjuk Kuswartojo's opinion that the transfer of technology in total or the entire system is not an easy thing that requires special tactics.

So far, what should be transferred from developed to developing countries and what should be developed in and by developing countries themselves have not found any international and multilateral programmes that can serve as a reference.⁵² Therefore, developing countries must devise their own tactics. One of the tactics that can be chosen is through legal instruments.

3. CONCLUSION

The partnership policy has been recognized since the presence of the 1998 Banking Law which was then maintained and even strengthened through the P2SK Law. However, the partnership only regulates the provisions on cooperation between banks with foreign elements including commercial banks with foreign ownership with local Indonesian banking institutions such as BPR and BPD. This opens up room for interpretation regarding the implementation of this partnership concept, one of which is through the parent-subsidiary bank mechanism between commercial banks with foreign ownership and local Indonesian banks.

Commercial banks with foreign ownership has strong financial resources and the availability of other non-financial resources such as aspects of financial technology, human resources and networks, opening up opportunities to own shares and become shareholders in BPD and BPR. Thus BPD and BPR will become stronger and can develop business activities faster and better. BPD and BPR are able to increase financial inclusion and become intermediaries so as to provide financial products and services that are appropriate and in accordance with the needs of the community, including micro, small and medium enterprises (MSMEs), If this is done, then undoubtedly economic growth and development will increase and the banking industry will be strong. Of course, clear limits and rules are still needed regarding the entry of commercial banks with foreign

51 Reinardus Budi Prasetyo, "The Development of Legal Aspects of Technology Transfer in Indonesia," *Progressive: A Journal of Law* Vol. 15, No. 2 (2020), pp. 109.

52 Fitriani Jamaluddin, "Foreign Investment and Technology Transfer," *Al-Amwal: Journal of Islamic Economic Law*, Vol. 4, No. 1 (2019), pp. 89.

ownership into BPD and BPR. These clear and implementable and enforceable limits or rules are still needed for the creation of healthy business competition among banking and financial industry players. The recommendation from this research is that technical regulations are needed that regulate legal partnerships in the banking world, which consist of partnership procedures in the banking world.

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