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The Affect of External and Internal Factors on Banking Profitability

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This study aims to determine whether there is a significant effect of CAR, BOPO, Inflation, and BI Rate on banking profitability, either partially or together. This study uses a descriptive and verification method; the population was taken from the Banking Sector registered in Kompas 100 for the period of 2012-2017. The sample was achieved by using purposive sampling in sampling. Data sources used secondary data, namely the eight financial statements of the Banking Sector firms registered in Kompas 100 for the period of 2012-2017. Data analysis used in this study is multiple linear analysis with a significance level of 5%. The program used in analyzing data uses E-Views 9. The results of the research partially show that CAR, Inflation, and the BI Rate do not significantly affect Return-On-Assets. BOPO has a partial effect on Return-On-Assets. Together, it shows that CAR, BOPO, Inflation, and BI Rate have a significant impact on Return-On-Asset of 37.5%.

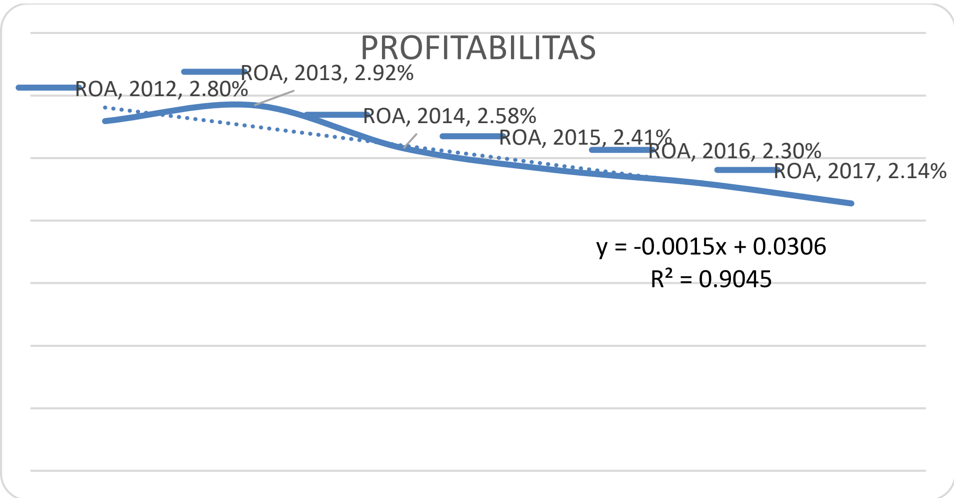
Key words: *Profitability, ROA, CAR, BOPO, Inflation, BI Rate.*

Introduction

The bank is an institution in the financial sector that plays an important role in helping the Indonesian economy. The bank has a function as an intermediary institution. The condition of global economic competition is increasingly high and increasing, banks must be able to fulfil an important role in improving the Indonesian economy. Sufian (in Prasanjaya and Ramantha, 2013) states that the world of piracy plays an important role in the economy of a country, because banking acts as a trading artery that aims to provide all kinds of financing and lending needs. As mentioned in Law No. 10 of 1998, banks are business entities that collect funds from the public in the form of deposits and distribute them to the public in the form of loans and / or other forms in order to improve the lives of many people. The bank is a supporter of the implementation of national development, in order to improve equity, economic growth and national stability; increasing the welfare of the people. Banks are very important and play a role in encouraging the growth of the economy of a nation because banks are fund collectors from communities who are over-funded and channel loans to people who are in need of funds, effective and productive savings places for the community; banks implement and facilitate payment traffic safely, practically, and economical.

Banks must be able to carry out their functions properly which is shown by good financial performance. Good financial performance can be reviewed through the bank's financial statements or those published by the Bank of Indonesia. Bank financial statements can be used by various parties that have interests, both external and internal. Profitability or profit is one indicator that is often seen by prospective investors to assess the financial performance of a bank. This is because the main purpose of the bank's operations is to acheive maximum profitability. According to Vernanda (2016), profitability is the ability of banks to generate or earn profits effectively and efficiently. According to Brigham and Houston (2010), to measure a bank's financial performance, the ratio used is the profitability ratio because this ratio includes debt ratios, activity ratios and liquidity ratios.

Figure 1. Banking Profitability



Based on the graph above, it can be seen that profitability of the banks listed on compass 100 has decreased. Banking profitability is influenced by various factors, both external and internal factors. Internal factors are variables that have a direct relationship with bank management. These internal factors are bank specific factors in determining profitability. While external factors are variables that do not have a direct relationship with bank management, but these factors indirectly have an effect on the economy and the law which will have an impact on the performance of banking financial institutions.

CAR is a banking performance ratio that functions to measure the capital adequacy owned by banks to support assets that are potentially exposed to risks such as the amount of credit channelled by banks (Sudarmawanti and Pramono, 2017). In a simpler explanation, CAR can be interpreted as a ratio of capital that must be owned by banks to loans channelled by banks. CAR is one of the variables used in measuring the level of banking health. If the value of CAR owned by a bank is high, then the bank is in good condition, and vice versa. The high number of CARs in a bank also indicates a greater bank profit while at the same time showing that the banking system is in good health.

In measuring operational efficiency, the BOPO ratio is a ratio which affects ROA. According to Aprilia (2018), Operational Costs per Operational Income (BOPO) is a ratio that shows how efficient the bank is in carrying out its operations which can be seen from the bank's operational costs to the operating income of the bank. Operational efficiency is carried out by the bank in order to analyse the bank's operations related to the bank's main business, as well as to show whether the bank has used all its production factors on target and is able to achieve the desired targets. If the BOPO ratio is higher, it shows that management performance is less efficient in using the resources that are owned which results in a decrease in pre-tax profit which will affect the decreasing ROA ratio in the bank (Vernanda, 2016). The more efficient bank operations are, the better the profits obtained by the bank.

Inflation is a condition where the price of an item experiences an increase, in a certain period of time, in an area of the economy (Sumarlin, 2016). The price increase associated with inflation occurs from the current period to the next period and the rate of increase differs between regions. The impact of inflation is not only on goods, but also on the financial sector (Ali, Mamoor, Yaacob, Gill: 2018). One macroeconomic variable that also affects the ROA of Islamic banks is the BI rate. The increase in the BI rate will be followed by an increase in the savings rates, so that it will result in customers transferring funds to conventional banks to obtain higher returns.

Based on the background above, the researcher is interested in conducting research with the intent of determining the affect of external and internal factors on banking profitability (Study on banks registered in Kompas 100).

Literature

According to Article 1 paragraph 2 of Law No. 10 of 1998, concerning banking:
"Banks are business entities that collect funds from the public in the form of deposits and redistribute them to the community in the form of loans and / or other forms in order to improve the lives of many people."

According to Kasmir (2014; 3): "Banks can be interpreted as financial institutions whose business activities are to raise funds from the public and redistribute the funds to the public and provide other banking services." From the definition of the bank, it is concluded that banks are financial institutions that have a function as intermediaries in the circulation of money with their activities as public funds collectors and distributors; channelling funds back to the community and providing other banking services.

CAR is a ratio based on the aspects of capital owned by banks. Bank capital is the amount of funds invested for the establishment of a bank. Capital is important for banks in developing services provided by banks to the public and for accommodating risks. Banking for International Settlements (BIS) has determined that a healthy bank capital is 8%. CAR calculates how much, all banking assets held, contain credit risk. CAR is a bank's performance ratio to measure the capital adequacy of a bank to support assets that contain or produce risks, for example loans given (Diva, 2013). According to Kasmir (2014: 48) “CAR is a comparison of the ratio between bank capital to risk-weighted assets and according to government regulations. The amount of CAR that must be achieved by a bank is at least 8%.”

CAR shows the extent to which the decrease in assets can be covered by available banking capital; the higher the CAR, the better the condition of the bank. The greater the CAR, the greater the profitability of the bank. This means that the smaller the risk of a bank, the larger the increase in the bank’s profitability. The same thing was stated by Rufaidah (2018) stating that the relationship between CAR and ROA is positive, where if the CAR of a bank increases, ROA also increases.

BOPO is ratio which is often called the efficiency ratio, and is used to measure the ability of bank management in controlling operational costs against operating income. The BOPO ratio is a ratio that is considered to affect the profitability of banks. This ratio is the aspect of profitability of a bank that compares between Operating Costs and Operating Income. Operational costs are calculated based on the sum of total costs and other operating expenses. And operating income is the sum of total interest income and operating income (Dinulhaq, 2017).

A high BOPO ratio value indicates that the bank does not operate efficiently because the high value of this ratio shows the large amount of operational costs that must be spent by the bank to obtain operating income. And a large amount of operating costs will reduce the amount of profit that will be obtained because costs or operating expenses act as a deduction factor in the income statement (Rembawati, 2014).

Inflation is an event that shows an increase in the price level in general and persists continuously (Murni, 2013). Inflation is a condition in which the general prices of goods and services tend to rise in price over time. According to Wibowo (2012: 19) "Inflation is a process of increasing prices in general and continuously related to the market mechanism which can be caused by various factors, including, increased public consumption, excess liquidity in the market which triggers consumption or even speculation, to include due to the inability of distribution of goods."It can be concluded that inflation is the process of a condition of prices experiencing an upward trend continuously and affecting each other. The term inflation is also used to mean an increase in the money supply which is sometimes seen as the cause of rising prices.

Sunariyah (2006) cited in Ramdani (2014) argues that "Interest is the price of a loan expressed as a percentage of principal per unit of time". Tandelilin (2001) cited in Esa (2017) argues that "Interest rates that are too high will affect the present value of the company's cash flow so that existing investment opportunities will no longer be attractive. High interest rates will also increase the cost of capital to be borne by the company. Besides that, high interest rates will cause the return required by investors in an investment to increase ". So, based on the above, it can be concluded that interest rates are the price of a loan which will affect the value of the company's cash flow; therefore the Bank of Indonesia applies a policy to regulate interest rates in Indonesia, which is called the BI Rate.

According to (Munawir 2010: 33) in Dinulhaq (2017), "Profitability is the ability to generate profits during a certain period with total assets or capital owned. Profitability Ratio is a ratio used to measure the effectiveness of company management as a whole seen from the amount of profits obtained by the company." Meanwhile according to Hasibuan (2016), "Profitability is the ability of banks to generate profits." Based on the opinions of experts, it can be concluded that profitability is the company's ability to generate profits for a certain period. There are many ways to measure the level of profitability by calculating the Return-On-Asset (ROA) ratio. ROA is a ratio that measures a company's ability to generate profits based on the total assets owned by the company.

According to Frianto (2012; 71) the level of profitability with the ROA approach aims to show the level of efficiency of asset management carried out by the bank concerned. ROA is the ratio between pre-tax profits to total assets. The Bank of Indonesia as the monetary authority sets a ROA of 1.5%; a bank that achieves this ROA can be said to be in a healthy condition.

Research Methods

This research is intended to test the truth of the hypothesis implemented through data collection using statistical calculations. This study uses multiple linear regression statistical analysis to see if the variables (CAR, BOPO, Inflation and Bi Rate) simultaneously and partially have a significant effect on Return-On-Assets. The research methodology used in this research is descriptive and verification research methods. This study uses a unit of analysis of companies or organizations, namely banks registered in Kompas 100 for the period of 2012-2017.

The population in this study are banks registered in Kompas 100 for the period of 2012-2017. The population in this study was 9 banks. From the existing population the sample is taken using non-probability sampling technique with a purposive sampling method. Sugiyono (2017: 124) states that purposive sampling is a sampling technique with certain considerations. The selection of samples by purposive sampling was carried out in order to obtain a representative sample based on the specified criteria. Based on the sampling criteria, the number of companies sampled in this study was 8 banks registered in Kompas 100 for the period of 2012-2017.

Data Analysis Method

The method of data analysis in this study is panel data regression analysis. Panel data is a combination of cross section data and time series, which are a number of observation variables on a number of categories and are collected in a certain period of time. This panel data regression test is used to determine the relationship between independent variables and the dependent variable. Testing will be carried out through the following stages: testing classical assumptions, multiple linear regression analysis, coefficient of determination, simultaneous and partial hypothesis testing. The testing was carried out with the help of Eviews 9 software.

Results and Discussion

Random Effect model is an approach offered to overcome the shortcomings and problems in the Fixed Effect model related to the degree of freedom if it has many cross-sectional units (Ghozali and Ratmono, 2013: 285). This model estimates panel data whose residual variables are thought to have a relationship between time and between subjects. The method used to estimate this approach is the Generalized Least Square (GLS) method. The random effect model used as panel data estimation results in the conclusion that the independent variables, namely CAR, BOPO, Inflation and the BI Rate, together have an effect on bank profitability (Taib, Ashraf & Razimi, 2018).

Based on the regression output, empirical estimates are obtained as follows:

$$Y = 0{,}037838 - 0{,}001481\ X_1 - 0{,}041453\ X_2 + 0{,}048079\ X_3 + 0{,}0121027\ X_4$$

Based on the regression results, we obtained an R2 value of 0.375818 which means that the dependent variable (Return On Asset) can be explained by 37.5% of the independent variables used in this study, while the remaining 63.5% can be influenced by other variables. The probability of F count shows a significant result. These results are in accordance with the initial hypothesis that was found in this study.

The effects of CAR on ROA

Based on the estimation of the effect of the CAR variable on ROA the value of t count is -0.030195 with a probability of 0.976. A significance value of t greater than 0.05, indicates that the CAR variable does not have a significant effect on ROA. This research is supported by research conducted by Warsa and Mustanda (2016) which states that CAR does not have a significant effect on bank profitability. This is because prospective investors choose banks that will be made an investment place by looking at the capital aspects owned by banks so that the CAR continues to increase (Kamarudin et al., 2019).

The effects of BOPO on ROA

Based on the estimation of the effect of the BOPO variable on ROA the value of t count is -4.001306 with a probability of 0.0003. A significance value t smaller than 0.05, indicates that the BOPO variable has a significant effect on ROA. With a negative coefficient direction, this means that any decrease in BOPO will increase bank ROA. The lower the BOPO level, the higher the value the company gets for ROA. The company is able to manage operational costs as low as possible to get the maximum operating income that will increase bank profitability.

The effects of Inflation on ROA

Based on the estimation of the effect of the variable inflation on ROA the value of t count is 1.001622 with a probability of 0.3234. A significance value t greater than 0.05, indicates that the Inflation variable has no effect on the level of profitability of Kompas 100 banking in Indonesia during the study period. This shows that although inflation has increased, it does not reduce the level of profitability of banking. Likewise, where inflation has decreased it does not cause the increase in the level of profitability of banks in Indonesia during the study period. This finding supports the results of research conducted by Welta and Lemiyana (2017) and Sumarlin (2016).

The effects of BI Rate on ROA

Based on the estimation of the influence of the BI Rate variable on ROA the value of t count is 1.589268 with a probability of 0.1230. A significance value of t greater than 0.05 indicates that the BI Rate variable does not affect the level of profitability of the Kompas 100 banks. The benchmark interest rate or the so-called BI rate indicates no significant effect on profitability. The results of this study are supported by previous research conducted by Wibowo and Syaichu (2013) which showed that interest rates did not have a significant effect because even though the interest rates of commercial banks increased, the bank's profitability did not experience a significant decline. However, this study contradicts the research conducted by Swandayani and Kusumaningtias (2012) which states that interest rates affect the level of bank profitability.

Conclusions

Based on the results of the study it was found that CAR, Inflation and BI Rate did not partially affect the ROA of banks in Kompas 100. BOPO had a partial effect on bank ROA in Kompas 100. Simultaneously CAR, BOPO, Inflation and BI Rate had an effect of 37.5 % and the remaining 62.5% are influenced by other factors. This study shows that ROA can highlight the good financial performance of a bank, which can change the interest of investors; changing how investors invest capital which will increase stock prices as well as the value of the company.

Suggestions

This study still contains several limitations and is expected to be refined in subsequent studies, such as expanding the location of research and extending the research period so that the results obtained will be more comprehensive.

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