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Assessing the Bank Profitability in Indonesia Based On RGEC Method

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ABSTRACT*: This study was conducted to analyze the effect of credit risk, liquidity risk, good corporate governance, earning, and capital on the profitability of conventional private banks. This study used purposive sampling and analyzed 25 banks with a five-year research period to obtain sample data of 125 data. Analyze tool used in this study is Eviews 10. This study uses the RGEC/Return, Good Corporate Governance, Earning and Capital Method to analyze the factors influencing bank profitability. Based on the analysis that has been made, the results are that credit risk has a significant negative effect on the profitability of banks. Liquidity risk has a significant positive effect on the profitability of banks. Good corporate governance has a significant negative effect on the profitability of banks. Earning and capital do not affect the profitability of banks.*

Keywords*: Credit Risk, Liquidity Risk, Good Corporate Governance, Earning, Capital, Profitability.*

Introduction

Banks are intermediary institutions as intermediaries for excess funds (financial surplus) with those who lack funds (financial deficits). Funding parties will be raised by banks through current accounts, deposits, savings, and other forms of deposits. The bank will channel the funds to those who experience a lack of funds through credit services. Banks carry out the collection and distribution of funds to improve the people's standard of living. Banks, as intermediary institutions, are expected to be institutions that can help improve people's lives.

The current national economy of Indonesia depends on the optimization of the financial services sector in Indonesia. The country's economy will stabilize when the financial services sector runs smoothly. When problems occur in the financial services sector, other business sectors can experience problems. The financial sector is one of the main sources of a country's economic sustainability, so the financial sector is the key to the success of Indonesia's national economic improvement.

Profitability is a parameter used to assess the ability of a business to generate profits. Banking today still plays an important role in the Indonesian economy. This profitability shows that banks, as financial institutions can maintain the country's economy. High profitability is, of course, supported by good performance in the company. Several factors in the bank's performance section influence banking profitability. Researchers are interested in analyzing the factors that affect the size of banks' profitability in Indonesia. From time to time, the method used to analyze profitability factors is growing.

The circular letter of Bank Indonesia no 13/1 / PBI / 2011 indicates that the factors used to analyze banking performance are changed to Risk profile, Good Corporate Governance, Earning, and Capital (RGEC). The risk profile is a risk that is always inherent in the banking sector, including credit risk, liquidity risk, legal risk, market risk, operational risk, strategic risk, compliance risk, and reputation risk. Good Corporate Governance (GCG) is an assessment of the quality of Bank management and the application of GCG principles. Earning is an evaluation of performance, source, sustainability and profitability management. Capital is an

evaluation of capital adequacy and management. The principles used in this method are more or less concerned with risk orientation, proportionality, materiality, and significance and are comprehensive and structured.

Several previous studies have been conducted. Yuniardi et al. (2014) research shows that credit risk significantly negatively affects profitability, while Dewi et al. (2016) has no effect. Lubis et al. (2017) research shows that liquidity risk significantly positively affects profitability, while Yanuardi et al. (2014) has no effect. Setiawan's research (2017) shows that GCG does not affect bank profitability, while the Nizamullah (2014) study shows a significant negative effect. Setiawan's research (2017) shows that earnings have a significant positive effect on profitability, while the Christaria and Kurnia (2016) studies have a significant negative effect. Research by Yanuardi et al (2014) shows that capital has a significant positive effect on profitability, while Nadi (2015) has no effect. The bank profitability impacted by comprehensive factors of macroeconomic, industry-specific and bank-specific determinants (Ben and Rachdi, 2014) . Fidanoski, Davidović, and Sergi (2018) proved the crucial positive impact of assets size (economies of scale), loan portfolio and GDP growth on the banks' profitability.

Previous studies have shown differences determinant of bank profitability. This study analyzes the factors that influence bank profitability using the bank performance appraisal component: RGEC method (Return, Good Corporate Governance, Earning and Capital) method, in accordance with Indonesian government regulations contained in Bank Indonesia Regulation no 13/1/PBI/2011, and adds third party funds to the value of securities issued by banks in the calculation of bank liquidity, based in Bank Indonesia regulation 17/11/PBI/2015. This research will use bank overhead expenses in the valuation of earnings. The research will use panel data of conventional private banks that go public in the Indonesian Capital Market.

Theoretical Review

Profitability.

Simorangkir (2004) states that profitability is the company's operational goal because increasing reserves increases public trust, profit is an assessment of leadership, and profits will attract investors to invest. Dendawijaya (2009) states that profitability is the ability of the company to manage assets for operational activities to gain profits. Bank Indonesia Regulation number 13/1 / PBI / 2011, evaluating bank performance using the RGEC method.

Credit Risk

A risk Profile is a series of procedures and methodologies used to identify, measure, monitor, and control risks arising from bank business activities. This risk profile consists of credit risk (failure of the debtor to pay its obligations), liquidity risk (the ability of the bank to pay off its short-term obligations so that it can become an intermediary), legal risk (juridical weaknesses), market risk (risk on exchange rates and interest rates), operational risk (internal problems in company operations), strategy risk (error in taking strategy), compliance risk (violation of juridical aspects), reputation risk (decreased trust of stakeholders). Credit risk is the failure of the debtor to pay their obligations to the bank. The higher the problem loans faced by the bank, the greater the losses suffered by the bank. Banks with a high level of loss will reduce the company's profitability.
H1: Credit risk has a significant negative effect on the profitability of conventional private banks

Liquidity Risk

Liquidity risk indicates the bank's ability to pay off its short-term obligations. Banks are intermediary institutions that mainly collect funds from the community and channeling back to the community in the form of credit. A liquid bank will be trusted by the financial surplus community so that they invest their funds in the bank. Liquid banks will be able to raise large third-party funds. The availability of third-party funds will increase the credit channeled to the community, thereby increasing credit interest income. Increased bank income will increase the bank's profitability.
H2: Liquidity risk has a significant positive effect on the profitability of conventional private banks

Good Corporate Governance

Corporate governance, as indicated by the weight of composite values, shows that the bigger the number, the better corporate governance is. Banks that have a high composite value indicate bad bank governance. Banks with better governance will lead to unfavorable organizational culture and environment. Management, staff, and employees who work in a culture and environment that are not good will reduce the performance and operations of the company, so that income will decline. Declining income will reduce profitability.

Based in Regulation No. 9/12 / DPNP / 2007 Good Corporate Governance is based on openness, accountability, accountability, independence, and fairness. Assessment is based on an assessment of 11 factors for implementing GCG which are weighted. Banking includes several important aspects, namely related to the evaluation of profitability performance, sources in obtaining profitability, and stability of profitability. One source that supports profitability is overhead expenses, which are all operating expenses except interest expenses.
H3: Good Corporate Governance has a significant negative effect on the profitability of conventional private banks

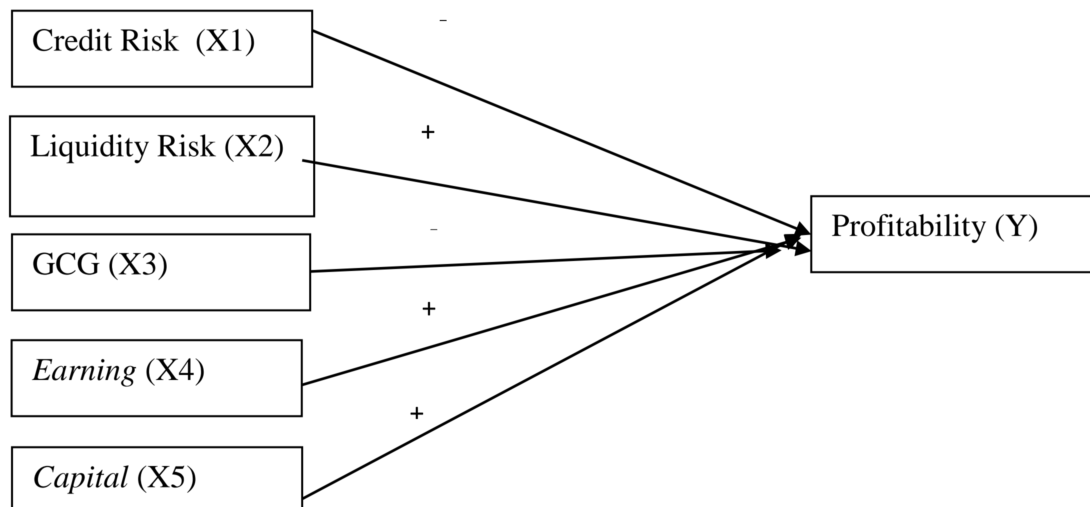
Earning

Overhead expenses represent total operating expenses except for interest expense. This burden is intended by companies to improve service to customers so that it becomes a source of support for profitability. Improved service to customers is expected to increase the public's use of banking services. The higher the use of banking services by the community, the higher the income received. Banks that have more income will increase profitability.
H4: Earning has a significant positive effect on the profitability of a conventional private bank

Capital

Capital valuation related to capital includes the evaluation of bank capital adequacy and adequacy of capital management. Capital adequacy is the availability of company funds to serve requests for public funds and the availability of capital to guarantee the possibility of possible risks. The higher the bank's risk, the bank must provide capital to the company.
The availability of capital to serve requests for public funds and bear the existing risks will increasingly support banks to expand in credit. Banks will be able to spend more credit because they have risk reserves. The availability of capital will increase banks' ability to issue loans to increase bank income. This income will increase profitability.
H5: Capital has a significant positive effect on the profitability of conventional private banks

Research Model:



Methodology

Population and Samples

The object of this study was conventional private banks listed on the Indonesia Stock Exchange (IDX) for 2013 - 2017. Samples were selected using a purposive sampling technique based on criteria:

conventional private banks listed on the IDX during successive research periods and private banks who assess and publish the results of GCG implementation self-assessment in a row.

Operational Definition and Variable Measurement

1. Profitability

Profitability in this study is measured by Return on Assets (ROA). ROA is a ratio that shows the company's ability to manage assets to gain profits. Based on Attachment I of SEOJK number 14 / SEOJK.03 / 2017, ROA is formulated as follows:

$$ROA = \frac{profit\ befor\ tax}{Total\ Assets}$$

2. Credit Risk

Credit risk is the failure of the debtor to pay their obligations. This study measures credit risk with Non Performing Loans (NPL). NPL is a ratio that compares the number of non-performing loans with total loans. Based on attachment I of SEOJK number 14 / SEOJK.03 / 2017, the NPL is formulated as follows:

$$NPL = \frac{Total\ problrm\ loans}{Total\ loans}$$

3. Liquidity Risk

Liquidity risk is the company's ability to pay off its short-term obligations. These short-term obligations include the withdrawal of customer funds. Funds collected from the public are the bank's principal capital in issuing credit, so the bank will get high funds when the bank is liquid. This study measures liquidity risk with the Loan Funding Ratio (LFR). LFR is a ratio that shows the management of multiple funding into a credit product. Based on PBI number 17/11 / PBI / 2015, the LFR is formulated as follows:

$$LFR = \frac{Total\ loans}{DPK + securities\ issued}$$

4. Good Corporate Governance

Based on Regulation No. 9/12 / DPNP / 2007 Corporate governance based on the principles of openness, accountability, accountability, independence, and fairness is assessed based on 11 factors of GCG implementation. The assessment is weighted with the following values:

Table 1. GCG Assessment

Composite Rating	Rating
Composite Value <1.5	Very Good
1.5 composite value <2.5	Good
2.5 composite values <3.5	Good Enough
3.5 composite values <4.5	Not Good
4.5 composite values <5	Bad

Based on attachment I of SE OJK number 14 / SEOJK.03 / 2017, GCG is formulated as follows:

Good Corporate Governance = Self Assessment value of 11 implementation factors

5. Earning

Earning measured by Overhead expenses represent the overall operating expenses except interest expenses used by the company to finance the company's operations to improve services to customers to increase the company's revenue. This study measures earnings from the source side that supports profitability, namely overhead expenses, which compares total overhead costs with total assets held. Based on Attachment I of SEOJK number 14 / SEOJK.03 / 2017, overhead expenses are formulated as follows:

$$Overhead\ load = \frac{Overhead\ load}{Total\ Assets}$$

6. *Capital*

Capital is the adequacy of the company's capital to serve the demand for public funds and overcome existing risks. This study measures capital with Capital Adequacy Ratio (CAR). CAR is a ratio that compares capital

to risk-weighted assets. Based on Annex I of SEOJK number 14/SEOJK.03/2017, overhead expenses are formulated as follows:

$$CAR = \frac{capital}{ATMR}$$

Results And Discussion

The Result

Descriptive statistics

Table 2. Descriptive statistics

	ROA	NPL	LFR	GCG	BOV	CAR
Mean	1.197899	2.603981	81.99001	1.992000	3.676369	20.21570
Median	1.372510	2.178270	84.37354	2.000000	3.199870	18.37944
Maximum	5.189360	15.82105	111.0840	3.000000	10.14107	87.48742
Minimum	-13.35426	0.000000	45.49909	1.000000	0.251970	10.43612
Std. Dev.	2.032259	2.124192	12.61913	0.430603	1.810860	8.405235
Observations	125	125	125	125	125	125

Based on the results of descriptive analysis, table 3 shows the variable profitability (ROA) has an average value of 1.197899. Credit risk (NPL) has an average value of 2.603981. Liquidity risk (LFR) has an average value of 81.99001. Good Corporate Governance (GCG) has an average value of 1.992. Earning (BOV) has an average value of 3.676369. Capital (CAR) has an average value of 20.2157.

Model Selection

Table 3. Selection of the Regression Model

Testing	*Effect Test*	Probability	Information
Uji *Chow*	*Cross Section F*	0.0001 < 0,05	*Fixed Effect*
Uji *Hausman*	*Cross Section random*	0.4773 > 0,05	*Random Effect*
Uji *Lagrange Multiplier*	*Breusch Pagan*	0.0000 < 0,05	*Random Effect*

Based on table 4 above shows that the suitable model used in this study is a random effect model. The Chow test shows a probability smaller than 0.05, so the fixed effect model is the most appropriate. The Hausman test probability shows greater than 0.05, so the most appropriate random effect model is used. The last test, namely the Lagrange multiplier test, shows that the probability is smaller than 0.05, so the random effect model is the most appropriate to be used in this study.

Classic assumption test Based on the results of the model selection, this study uses a random effect model. Research with random effects means that the method used is the Generalized Least Square (GLS) method. Gujarati (2015, 395 - 396) states that Classic assumption test Based on the results of the model selection, this study uses a random effect model. Research with random effects means that the method used is the Generalized Least Square (GLS) method. Gujarati (2015, 395 - 396) states that: The estimation method known as generalized least square (GLS) calculates information explicitly and produces a BLUE estimator. This procedure changes the original variable to satisfy the classical assumption model. It assigns the OLS model to the GLS model. In short, this GLS method has produced BLUE.

1. Coefficient of Determination

Table 4. Coefficient of Determination

R-squared	0.612052

The research R-squared value of 0.612052 shows that the independent variables (credit risk, liquidity risk, GCG, earnings, capital) contribute 61.20% to the dependent variable profitability. Other variables outside the variables in this study explain the remaining 38.80% of influence.

2. F test

Table 5. F Test

F-statistic	37,54844
Prob(F-statistic)	0.000000

Table 5 shows the Prob F-statistic value showing 0.000000 <α = 0.05, indicating that the variable credit risk (NPL), liquidity risk (LFR), GCG earnings (BOV), and capital (CAR) together have a significant effect on the dependent variable is profitability (ROA).

3. Test the Hypothesis

Table 6. t Test

Variable	Coefficient	Std.Error	t-Statistic	Prob
C	2.342325	1.389288	1.685990	0.0944
NPL	-0.683012	0.060177	-11.35009	0.0000
LFR	0.024835	0.012818	1.937500	0.0551
GCG	-0.746454	0.310103	-2.407115	0.0176
BOV	0.100894	0.082460	1.223552	0.2235
CAR	-0.014153	0.015162	-0.933482	0.3525

Based on the t-test above, the regression equations obtained are as follows: ROA = 2.342325 - 0.683012 NPL + 0.024835 LFR - 0.746454 GCG + 0.100894 BOV - 0.014153 CAR + e

Discussion

The results of testing the first hypothesis indicate that credit risk significantly negatively affects profitability. The higher the credit risk value indicates, the higher the number of problem loans the company faces. Banks that face many loan problems mean the bank is in a dangerous condition. Banks that have many problem loans will suffer huge losses. Losses experienced by the company will reduce the profitability of the bank. The bank's maximum NPL limit is 5%; the data show that above 5%, the bank is in a dangerous condition. This research is in line with the research of Christaria and Kurnia (2016), Putrianingsih and Yulianto (2016), and Lubis et al (2017). The results of previous studies state that non-performing loans will reduce company profits and cause losses.

The results of testing the second hypothesis indicate that liquidity risk significantly affects bank profitability. Liquid banks attract customers to put their funds in the bank. Banks that have the availability of third-party funds can then issue more credit. Increasing credit will increase credit interest income and will increase bank profitability. Banks that have a LFR value of 78% - 94%, the bank is liquid and able to manage third-party funds into credit products. The results of this study are consistent with the research of Yusriani (2018) and Agustiningrum (2012). The study states that the higher the credit, the more banks get more income and can maintain liquidity.

The results of testing the third hypothesis indicate that GCG significantly negatively affects bank profitability. Banks that have GCG values increasingly show that corporate governance is getting worse. Banks whose management is not good, the organization's culture and environment are also not good. Management, staff, and employees who work in a culture and environment are not good, so the performance is not good either. Banks with poor performance will undoubtedly decrease their income, so profitability will decrease. This research is in accordance with the research of Nizamullah (2014).

The results of testing the fourth hypothesis indicate that earnings do not affect profitability. Earning, as measured by overhead costs is intended to be able to increase revenue by increasing services, but this increase in expenses will increase credit interest. Thus the debtor is not interested in high credit interest. The income received by the bank is only enough to cover the increase in expenses so that it does not affect profitability.

The results of testing the fifth hypothesis indicate that capital does not affect the bank's profitability. Banks with many capital reserves are indicated not using all their capital for credit. Capital that is not used for credit will not bring bank income. Thus capital does not affect the bank's profitability.

Conclusions And Recommendation

The results of the analysis that have been done show the conclusion that credit risk has a significant negative effect on bank profitability; liquidity risk has a significant positive effect on bank profitability; GCG has a significant negative effect on bank profitability; earnings and capital do not affect the profitability of the bank

Recommendation. Based on the result, banks must be able to manage credit professionally. The bank must also maintain bank liquidity and implement corporate governance in accordance with applicable regulations. Banks must pay attention to the use of capital expenses and management so that they can be optimized to support increased income. For the next researcher, it is expected to take into account other risks of the risk profile component

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