CHAPTER I

PRELIMINARY

1.1. Background

Banking sector is an industry and a part of the economy given to the holding of monetary resources for other assets and contributing those monetary resources as an utilized method to make more wealth. Banks are monetary establishments whose operational exercises rely upon reserves endowed by their administration users or clients (Irawati, 2019). Without an organization that can collect, manage and distribute assets from individuals, financial sectors won't develop. Accordingly, it is important if financial administration and working standards are all well created and developed. In order to carry out their mission to be successful, banks must be able to perform certain programs and be responsible for each task force. The importance of banking in the development of the national economy has been recognized (Romanova, 2017) , including in Indonesia.

The Banking sector has become one of the major sectors in Indonesia and plays an important role in the Indonesia economy operation. Banks in Indonesia are categorized into several categories based on their core activity and main capital or in other terms is called BUKU. BUKU (Bank Umum berdasarkan Kegiatan Usaha) is grouping terms created by Bank Indonesia

(BI) to increase the endurance and competition of national banks in Indonesia. According to Bank Indonesia, there are 4 categories in BUKU that are categorized based on their core capital. BUKU IV is the highest division with minimum main capital Rp. 30 trillion while BUKU III with range main capital Rp. 5 - 30 trillion, BUKU II with Rp. 1 - 5 trillion and BUKU I with less than Rp. 1 trillion. The list is renewed yearly by Bank Indonesia.

In Indonesia, Banks have important functions to sustain national economic development. Banks in Indonesia give extra effort to their performance. Obviously, it is not simply fundamentally significant banks that are keen for achieving high productivity – it is a point of every private bank and various stakeholders that have put resources into specific banks (or are wanting to). Lenders, depositors and bank account holders are additionally intrigued for their bank to be productive as it will in general think about emphatically the soundness and supportability of the bank (Bojare, 2019). There are some terms that can express a bank's performance like profitability, productivity and efficiency. Firms with better performance help to continue the stability of the financial system. (Athanasoglou, et al., 2008). Profitability is the primary measurement of the overall success of an enterprise. The analysis of profitability ratios is important for the sake of shareholders, creditors, investors, bankers, brokers and governments. Bank profitability is important for financial stability. Profits are the first line of defence against losses from credit impairment. Retained earnings are an important source of capital, enabling banks to build strong buffers to absorb additional losses. Banks with terrible structural profitability can face higher funding costs and may be forced to take on more risk. (Guinos, 2019). Low bank profitability can also matter for financial arrangement by impairing the accumulation of bank capital in the long run. Thinly capitalised banks reflects the ability of monetary policy to stimulate economic activity in downturns. Their capacity to lower the interest rates they charge toward their customers and increase the volume of lending to the real economy is obliged.

Profitability in economic aspects is a positive result for every business organization. (Romanova, 2017). The statement also applies to banks as their general presence has been acknowledged importantly for a nation's economic development. (Solovjova, 2019), stated that the importance of a bank is to connect one bank to another to achieve a higher prosperity level in economic development. There are other researchers (Hendricks et al., 2007) who portray banks' significance from the viewpoint of foundational hazard, introducing the end that banks give principal liquidity and development change that is important for improvement of nations economy, simultaneously affecting this volatility aspect (fundamental risk). Therefore, profitability of the banking sector is one of the most important sectors for Indonesia.

High profit in the banking sector always leads to a country's financial stability. (Kawswala, 2017). As academically acknowledged research uncovers there are various variables to consider when breaking down possible impacts on profitability (Romanova, 2017). Bank profitability is an important issue for a wide scope of stakeholders including bank executives and investors, monetary bosses and financial policy makers just as business analysts and journalists. Bank profitability can be measured using several profitability measurements. The most common measurements are ROA (Return on Asset) and ROE (Return on Equity). Those two are frequently used by researchers, hence ROA is the simplest one. ROA reflects the ability of a bank institution to generate profits from its asset management functions (Murcia & Contreras, 2018). Therefore it is frequently used as the key ratio for evaluation of bank profitability in the literature (e.g. Molyneux and Thornton (1992), Golin (2001), Claessens and Laeven (2004) and Mamatzakis and Bermpei (2016)).

1.2. Problem Statement

According to Bank Sentral Indonesia, the number of total Private Commercial Banks in Indonesia are over one-third (34.22%) of total banks in Indonesia. Those private commercial banks are divided into two categories, National Private Foreign Exchange Banks and National Private non Foreign Exchange Banks. In 2018, 6 out of 10 biggest banks based on their assets were Private Commercial Banks. Based on the list released by BI (Bank Indonesia) in 2020, there are eight banks categorized in BUKU IV. BUKU is a classification created by Bank Indonesia based on each banks' main activity and core capital. The highest classification is BUKU IV, with conditions a bank must have over 30 trillion rupiah as their main capital. 62.5% or five from eight banks on BUKU IV are private commercial banks.

Based on several information on the previous paragraph above, it is hard to deny the presence and existence of Private Commercial Banks in Indonesia. Even though not owned and operated by the Indonesian government, private commercial banks manage to excel and perform well in the Indonesia banking industry. Nowadays, the competition among Private Commercial Banks is getting tougher, whether it is direct or indirect. Due to the fact that competition, banks are contesting to gain public interest to absorb more market share. Every bank will try to improve their performance in order to increase profitability and productivity of the bank.

There are several factors that can be used to measure the impacts to the profitability of a bank. The first factor that thought influences the profitability of a bank is Bank Deposit. Bank deposits can increase profitability in private bank institutions (Chapra and Habib, 2014). While on the other hand, according to Suyatno (2011), does not assure deposit can increase profitability of a bank.

In the banking market, profitability is the indicator of the bank's competitive position with the management quality. For banks, the difference between the interest paid and interest owed is their profitability. (Haddawee, 2020). Therefore, it is quite possible that the main factors that can increase or decrease the profitability of any bank is the volume and progression of the banks, as the benefit of the banks is likewise the foundation of their work. To create the most maximum return as high as possible and to provide an appropriate proportion of liquidity to money withdrawals, the divisions of these banks are needed to take care of their liquidity from the deposits in an ideal way.

The next factor that thought influences the profitability of a bank is leverage. Banking industry is all about leverage. To put it simply, banks are highly leveraged institutions that are in the business of facilitating leverage for other institutions. Businesses, be they financial or something else, invest a great deal of energy recognizing their ideal degree of leverage. Leverage ratios measure the degree to which a bank has financed its resources with equity. (Ingves, 2014).

It doesn't make any difference what those resources are, or what their risk characteristics are. Leverage ratios adequately place a cap on borrowings as a multiple of a bank's equity. Several researchers have different statements relating to leverage ratios' impact towards bank's profitability. Leverage ratios have a positive effect on the level of profitability (Muthmainnah, 2017). On the other hand, leverage has a significant negative effect on the company's financial performance (Mangondu and Yossi, 2016). While other researchers (Fachrudin, 2011), stated that leverage does not affect the company's performance.

The last factor that is thought to affect profitability is firm size. The size of a firm plays an important role in determining the kind of relationship the firm enjoys within and outside its operating environment (Bababola, 2013). The bigger a firm is, the more prominent the influence it has on its stakeholders. Companies with large total assets reflect the reliability of the company (Dogan, 2013). Just like leverage, the effect of firm size on profitability also has positive and negative impacts according to several researchers. Akbar (2013) stated that firm size has a positive impact on bank's profitability, while Dietrich and Wanzenried (2009) revealed that firm size has a negative effect on bank's profitability. Based on the explanation above, the purpose of this research is to examine the impact of leverage, firm size and bank deposit on profitability in private commercial banks in Indonesia from 2010 until 2020.

1.3. Objectives of the Study

The general objective of this study is to examine the relationship of several factors towards the profitability of Private Commercial Banks BUKU IV in Indonesia.

The specific objectives includes:

1.) To analyze the relationships between Leverage (Debt to Equity) ratio towards Profitability (Return to Asset) of Private Commercial Banks BUKU IV in Indonesia.

2.) To analyze the relationships between Total Asset (%age of Growth Total Asset) towards Profitability (ROA) of Private Commercial Banks BUKU IV in Indonesia.

3.) To analyze the relationships between Deposit (Deposit Ratio) towards Profitability (ROA) of Private Commercial Banks BUKU IV in Indonesia.

1.4. Previous Research Study List:

This research is based on several previous studies that are related to this subject. The researcher has read and understood carefully the previous studies and applied the available theory/information to this current research. Those research are :

1.) According to Harisa and Adam (2019), there are many variables that can determine the effect of Bank's profitability. In their research, they choose three independent variables consisting of Good Corporate Governance Disclosure, Leverage and Firm Size. Based on their research, Quality of GCG Disclosure and Leverage did not affect the bank's profitability, while the firm size variable affected the bank's profitability. This journal chosen by the researcher to be the main journal, as the researcher use two out of three independent variables (Leverage and Firm Size) to be used in the research.

1.5. Significance of The Study

Although there have been various studies on Banks' profitability in several developed and developing countries, it is uncommon to find such studies about the impacts of Banks' profitability towards Private Commercial Banks. The common studies that the researcher managed to found mainly are the impacts of Banks' profitability towards Syariah Banks (*Islamic Banks).* This study is an attempt to assess the factors of profitability of Private Commercial Banks BUKU IV in Indonesia. This study provides evidence on the impacts of Leverage, Firm Size and Bank Deposit towards Private Commercial Banks BUKU IV in Indonesia. The result of this analysis can show whether the factors of Banks profitability gives impacts towards Private Commercial Banks BUKU IV in Indonesia or not.

The findings on this study is expected to give benefits to bankers, economists, and others who are interested in the impacts of Profitability Factors towards Banks' profitability in Private Commercial Banks BUKU IV Indonesia. This study also expected to give insight for customers that might be helpful before finally deciding to choose their bank preferences. It is also hoped that the outcome of this study will also provide information or literature of the Bank's

Profitability to other researchers. At last, this study also expected to give information to academic people, whether lecturers or students, relating to the bank's profitability.

1.6 Scope and Limitations of the Study

This study was limited only to acknowledge the impacts of profitability factors towards banks' profitability of Private Commercial Banks BUKU IV in Indonesia starting from 2010 to 2019 fiscal year. Since the 2021th data that is published either by IDX (Indonesia Stock Exchange) or each bank are not yet released, then this paper is limited to analyze the data from 2010 until 2019. Most of the previous study mostly analyze three profitability factors, hence in this study the researcher will also use three factors to analyze the impacts of Profitability factors of Private Commercial Banks BUKU IV in Indonesia. Those three factors are Leverage (Debt to Equity Ratio), Firm Size (%age Growth of Total Asset) and Bank Deposit (Deposit Ratio).

This study also limits to use five out of eight banks categorized in the BUKU IV. Those five Banks are selected because those banks are not owned by the Republic Nation of Indonesia. The list of those banks are :

Table 1.1. List of Private Commercial Banks BUKU IV in Indonesia

No	Bank Name
1	Bank Central Asia, Tbk (BCA)
2	Bank CIMB Niaga, Tbk (CIMB NIAGA)

3	Bank PAN Indonesia, Tbk (PANIN)
4	Bank Danamon Indonesia, Tbk (DANAMON)
5	Bank Permata, Tbk (PERMATA)

Source : IDX.com

1.7 Organization of the Paper

The following information shows how this research is organized:

1.7.1 CHAPTER I: PRELIMINARY

This chapter consists of the Introduction of the research, which includes the background of the research, the problem statement, research questions and objectives, scope of the research, the benefits of the research, the techniques of data collection, and last is the organization of the paper.

1.7.2 CHAPTER II : LITERATURE REVIEW

In this chapter, the researcher provides information and knowledge that is related to the study of this research. The researcher also provides several existing theories according to several authors that are related to this study. The main purpose of this literature review is to support the reliability of the researcher.

1.7.3 CHAPTER III : RESEARCH METHODOLOGY

In this chapter, the data of the study will be explained deeply. This chapter includes the type of the research, data collection method and the analysis of the data. Every data that needed and collected to support this study will be stated and explained in this chapter.

1.8.4 CHAPTER IV : DATA ANALYSIS

In this chapter, the data that has been collected by the researcher are being distributed using software. All the data is being processed using SPSS software. The data are processed using simple regression analysis to identify the relationship between the dependent and independent variables.

1.8.5 CHAPTER V : CONCLUSION

In this chapter, all the theories, data, information, analysis and results are being concluded. This chapter will also include critics, suggestions and recommendations related to the topic. Chapter V : CONCLUSION is the last chapter in this thesis.