CHAPTER 1

INTRODUCTION

1.1. Background

All activities in daily life involve economic activities, buying and selling goods, then lending money and borrowing money, etc. To become run smoothly, bank is one of the entities that can maintain it. The existence of banks allows people can do many transactions, like take loans out, save their money, and most importantly, can conduct long distance and remotely transactions easily. Therefore, people will still choose a bank that has a better performance for them to conduct buying and selling transactions and also borrow money. So that, the condition of bank stability must be carefully maintained by each of the internal parties of the bank

Banks are one of the entities that play a big role in managing and can run the smooth circulation of economic movements in a country. Therefore, if there are many banks with bad conditions, people may not be able to trade. Not only that, but additional new funds from the state will also be made available to the community through credit loans from banks. If people trust a bank, they will conduct credit loans or borrow money from bank and use that money to create new businesses that can increase the circulation of economic movement in a country. If the financial condition of many banks deteriorates, people will hesitate to lend to banks, and if people remain silent, the economy will not improve then become an economic turnover. When the economic turnover and become an economic recession worsens

and spirals out of control. In that case, the company's inflation in a country will increase significantly in the sense that demand will increase but the existing supply will not be able to meet the demand at that time. Therefore, the sales value of many goods is high, and people stop spending money on consumption and spending transactions, the economic cycle begins to worsen. This could cause the GDP (Gross Domestic Product) to fall and the country's currency to move in the same direction as GDP. A decline in GDP will lead to an economic crisis and further increase poverty within the country.

According to Bank Indonesia law, Indonesian banking institutions are typically classified into commercial and rural banks. Commercial banks differ from rural banks in the sense that the latter do not involve directly in payment system and have restricted operational area. In term of operational definition, bank in Indonesia is classified into Non-Sharia and Sharia-based commercial banks. Based on the definition from Financial Services Authority of Indonesia or usually called by *Otoritas Jasa Keuangan,* commercial bank is a bank that performs business activities conventionally and/or based on Sharia principles, with activities that provide services in payment transferring. Commercial banks usually give an credit, gather funds from society in the forms of demand deposit, time deposit, deposit certificate, savings and/or other forms of fund equivalent to those. This type of bank is very commonly found in Indonesia, for instance Bank Central Asia (BCA), Bank Mandiri, Bank Negara Indonesia (BNI), etc.

The condition of a good or bad for a bank can be determined by looking at the value of the bank, but this can be influenced both by external and internal parties of the bank. For determining the bank value can be reflected by market value and intrinsic/book value of the bank. The bank's market price can be easily increased or decreased in the same period, because this value is determined by the supply and demand from society to the shares. Investors will be interested to by the bank's shares if the bank has a good financial performance and low risk at a favorable price (Meliza, 2021). Other than that, intrinsic/book value is the actual value of bank, this value is determined by the internal parties using total amount of assets minus the total amount of liabilities. Accordingly, market and book values differ, and the former cannot adequately reflect the enterprise's internal value. The difference between market value and book value is an indication of the expected rewards for investing in a security (Abuzayed et al., 2009). If the stock fails to rise to a value commensurate with stockholders' expectations, current investors may seek to unload their shares and the bank will have difficulty in raising new capital to support its future growth.

Bank value if using market value there will fluctuate, because this value can be affected by external and internal from the bank. These external factors may include inflation and Gross Domestic Product. If there is an increase in inflation bank debt will be also increasing, and this will make the bank value become bad. This effect will apply the same as other external factors, namely GDP. If GDP is higher, the quality of a bank will worsen. Apart from that, performance, risk, or efficiency are some internal factors that can influence the condition of the bank's

market value. However, what really influences a bank's market value is performance and risk, because using performance can find out how the bank is able to create capital and increase profits, assets and future performance. While risk can measure the risk of loss resulting from credit failure, causing more bad credit and bank circulation becoming less smooth.

There are so many ratios or measurements for calculating the performance of bank, for instance, Return on Asset or ROA, Return on Equity or ROE, etc. If use the Return on Asset ratio, it can show the ability of bank management to generate income from managing the assets owned. While the Return on Equity ratio can show the bank management's ability to manage available capital to obtain net income (Purwoko & Sudiyatno, 2013). The higher the return ratio, the better the condition of the bank, because the dividends distributed or reinvested as retained earnings will also be greater. Both measurements have advantages and disadvantages, but from the perspective of investors who invest their shares in banks, it is better if investors use ROA as a measurement to see the condition of a bank, because it can determine the ability of bank management to manage assets to generate profits.

The other internal part that can affect bank value is risk. Risk is a deviation of actual results from expected results, or risk is the possibility of a result being different from what was expected (Purwoko & Sudiyatno, 2013). Risk can be categorized into 4, namely market risk, credit risk, operational risk and reputation risk. However, the most important thing for banks is credit risk. Credit risk is the

risk of loss due to failure or inability of the debtor to fulfill its obligations according to the agreement which cannot be predicted in advance. In other words, it is the risk faced by the bank regarding the amount of credit distributed to customers. The greater the amount of credit distributed, the greater the credit risk. This credit risk can be measured by Non-Performing Loans or NPL. Non-performing loans are amounts of credit that are not paid or cannot be collected, in other words bad credit or problematic credit. The higher the NPL ratio, the worse the credit quality, causing the bank's value to become worse.

Due to the several factors that have been mentioned, the condition of banks, especially commercial banks in Indonesia, has become relatively unstable. There are several banks that have very high profits, but there are some banks that have experienced very large declines. Under these circumstances, the banking sector is experiencing some difficulties or still struggling to regain its turnaround, but then in the end of the period can perform a good condition. Like in 2017, banks have a better condition compared to the last period. In this year commercial bank recorded a slight increase in asset. From 6.729,79 trillion rupiah in 2016 become 7.387,14 trillion rupiah in 2017, this recorded an increase of 9,76% from the asset (Rossiana G. , 2018). While, the bank share price is also increasing, like PT Bank Central Asia Tbk. (BBCA) in 2016 the share price is about Rp2,000, then in 2017 the share price is increasing become about Rp4,000 per share. It could be considered that the condition of the bank is doing well.

The health of Indonesian banks in 2018 is better compared to 2017. Seen from the growth of banking credit in 2018 reaching 12.88%, it consists of domestic bank credit grew by 11.73% and credit from overseas banks grew by 35.3%. This growth can be said to have increased significantly compared to 2017. Apart from that, credit risk conditions were also maintained, using the banking gross non-performing loan (NPL) ratio which fell to the level of 2.73% (Ananta, 2019). In the following year, commercial banks faced the problem of slowing performance (Gunawan, 2019). It can be seen that net interest income only grew 3.17%, whereas in the same period last year net interest income grew 5.12%. This year there was growth, but this growth did not cause any significant changes.

Bank conditions during this period were still very volatile. some are positive, some are still decreasing (Sutianto, 2021). The banking data in the positive trend is total assets and third-party funds. These two things are still growing positively, total banking assets recorded an increase of 7.1%. However, banking credit growth decreased by 2.41%. This also happened at the end of the month in 2020, there was a decrease of 1.59% in banking ROA. This decline was caused by the previous pandemic period. In the following year there was a flow that was still the same as the previous year, namely that banking remained maintained until the end of 2021, accompanied by the accumulation of funds in the capital market which continued to improve, driven by the control of the Covid-19 pandemic (Wareza, 2021). In this way, the CAR increased to 25.62%. This happens with the recovery of mobility so that economic activity is also increasing.

Bank conditions in 2022 are considered to have started to improve, seen from banking credit growing by 11.6% with banking risk indicators still maintained (Alamsyah, 2023). This recorded growth rate has exceeded pre-COVID-19 pandemic levels. Apart from that, credit risk tends to decrease, with non-performing loan gross at 2.65%. This is due to the improvement in credit quality which was restructured due to the impact of Covid-19. As of October 2023, the risk of non-performing loans using the gross NPL ratio has decreased to 2.42%, which means that more loans are not experiencing problems (Rachman, 2023). Apart from that, in November 2023, the recorded growth in credit disbursed by banks was 9.74% on an annual basis, this figure was higher compared to the previous month, namely 8.99%. Increasingly better conditions will begin to appear at the end of 2023.

These phenomena can cause any aspect of this country. This is due to the fact that banking companies are one of the backbones of the economy and provide several intermediary services between investors and various industries of the country. A bank company is also an entity that collects funds from the public in the form of savings, distributes it to the community in the form of loans and credits to individuals and businesses, and provides other financial services to people at different levels. The primary goal of the bank is to maximize profit. Profitability means making a profit or to earn and gain profits. This analysis is used to analyze how a bank can successfully and efficiently generate profits. If the bank has difficulty increasing their profits, the bank will minimize lending, which may affect the circulation of public money.

From an investor's perspective, profitability growth is an indicator of a company's future prospects. When profits are high, the company is more likely to grow in the future because the profits generated can be reinvested into the company's operations. Conversely, if a company is less profitable, its grow opportunities are lower than if it is highly profitable. Since bank stability is important in all aspects, researchers wanted to identify the factors that influence bank stability. Empirical studies support the use of the better idea of bank profitability in enhancing the banking industry's profit margin (Mehzabin et al., 2022). Furthermore, one of the main concerns regarding financial management is indeed the capital structure, i.e. the combination of debt and equity ratios and its potential impact on a company's performance.

Additionally, bank credit risk is considered an important factor that affects bank stability. Therefore, the objective of this study is to determine the extent to which return on asset, credit risk using non-performing loan as the calculation and bank size influence the value of the Indonesian banking sector. The amount of assets is an essential part for knowing the bank value, because the higher asset is better the bank is. Other than that, credit risk also plays a significant role in determining the bank value, if the credit risk is high, so there are many customers who cannot pay the credit, and this could make the bank circulation stop. Therefore, bank has a good value, if the bank has a much asset, and the credit risk is low.

Although there are many researchers studying this topic in a wide range of fields, there are not as many in Indonesia itself as in international and other fields.

Therefore, this study aims to focus on the bank value, which is the benchmark for people to invest their assets in financial institutions, especially those included in commercial banks and learns more about the stability situation of banks. Other than that, want to provide with a new information about banks performance and risk situation on commercial banks in Indonesia from 2017 until 2023.

1.2. Research Questions

The health of the banking sector has struggled to recover after plummeting in 2019 during the initial COVID-19 pandemic. So far, bank value is not well developed. This condition can also cause trouble in society. There are many aspects that can affect a bank's value, such as return on assets, non-performing loan, and also bank size. Therefore, the research question of this study is whether bank performance has a positive impact on bank value and whether risk has a positive impact on bank value.

1.3. Research Objectives

Information about the value of banks is important information for society, including investors, creditors, and even those who want to invest their funds. Therefore, this study aims to provide empirical evidence on the impact of bank performance on bank value and the impact of risk on bank value, especially in Indonesia.

1.4. Research Contributions

Research is generally conducted in the hope of increasing knowledge and benefiting the public and professionals who need it. The following are some advantages that this research should bring about:

1.4.1. Theoretical Contributions

The results of this study are intended to be used as further references, sources and knowledge for readers regarding analysis of the impact of bank performance and risk on bank value.

1.4.2. Practical Contributions

This study is expected to promote profitability improvement of Indonesian banks. Furthermore, the result is expected to provide additional information to enable investors to consider bank value when making investment decisions.