CHAPTER II

THEORETICAL FRAMEWORK AND HYPOTHESIS DEVELOPMENT

2.1 Stakeholder Theory

Stakeholder theory argues that organizations or companies have an obligation to consider their activities' impact on stakeholders and are not only oriented toward increasing company profits (Rankin et al., 2018). According to Rankin et al. (2018), stakeholders involve groups or individuals who influence company goals, such as managers, shareholders, employees, consumers, government, and suppliers. Companies need to maintain good relationships with stakeholders who have resources and capabilities that can support the company's operational activities.

Therefore, the sustainability of the company depends on the support provided by stakeholders. Companies providing information related to their operational activities is one way for companies to meet stakeholder needs and expectations (Rankin et al., 2018). Providing information regarding company operations and performance is a way of corporate responsibility to stakeholders which is in the form of disclosure of annual reports and/or sustainability reports.

One way a company can fulfill the desires and expectations of stakeholders is if the company has efficient operations. Efficient company operations can reduce costs so that they can increase profits. Apart from that, the company can also meet stakeholder expectations if it has a high non-interest income. High non-interest income shows that the bank cannot only depend on

interest income alone. So, companies that are efficient and have good non-interest income can increase their competitive advantage to gain support from stakeholders.

2.2. Legitimacy Theory

Legitimacy theory discusses company actions and activities that are still based on society norms related to social and environmental issues. According to Rankin et al. (2018), legitimacy theory is based on a social contract between companies and society, operating companies are responsible for their operational activities by disclosing and informing about their activities in a transparent and accountable manner. Companies are required to consider the problems they face including the impact of their operational activities on social and environmental issues (Rankin et al., 2018).

In this case, the real form of legitimacy that can be carried out by banks is by disclosing green banking both in annual reports and/or sustainability reports. Disclosure of green banking is a form of real responsibility for the bank's concern for the social and environmental impacts arising from its operational activities. Disclosure of green banking is expected to increase the bank's reputation and trust in the community to gain support and legitimacy from the community.

2.3. Diversification Product Theory

Product diversification can be defined as an activity carried out by a company as a product development, while the old product can still be economically maintained (Assauri, 2017). In the context of banking, product development is carried out in the form of non-interest income. According to Markowitz (1952) do not put eggs in one basket, if it is related to this context that banks should not rely too much on interest income alone. Diversification of income can be a way for banks to get additional profits and at the same time reduce risk. In the context of banking, it can diversify income with non-interest income, so that by diversifying its income the company can increase its profits.

2.4. Capital Structure

The definition of capital structure according to Sulindawati et al. (2016) is the comparison between foreign capital and equity capital. The capital structure can consist of short-term funding, long-term funding, and equity. Short-term debt, long-term debt, and equity are usually obtained from parties outside the company. Management should manage its capital structure well. A good capital structure will attract the attention of investors because it shows the company's ability to manage company finances. Indeed, there is no definite measure that regulates the ideal composition of debt and equity in a capital structure, therefore banks must be careful in managing their capital structure to achieve their goals.

In this research, to calculate the capital structure, the research focuses more on the composition of the company's debt, by using the Debt-asset ratio, which compares total debt to the company's total assets. According to Kasmir (2010), the aim of using this ratio is to compare total debt to total assets owned by the company to see how many company assets are funded by debt. Although the use of known debt in the capital structure can provide benefits, it is necessary that debt holds its own risks that must be managed by company management, by having high debt the company must pay debt interest which can reduce its profitability.

2.5. Operational Efficiency

Operational efficiency can only be achieved if the company can manage all costs to generate maximum revenue. According to Gupta & Raman (2021) operational efficiency describes management's ability to manage expenses such as knowledgeable and skilled workers, capital utilization, and technology. Managing and improving company efficiency can provide great benefits, especially in the long run, such as competitive advantage by being able to offer lower prices or improve product or service quality, increase company satisfaction and reputation, support the continuity of business operations, etc.

According to Suteja & Ginting (2014), non-interest expense in banking can explain and show the management efficiency of a company. Non-interest expense can be measured by comparing non-interest expense to total assets (Suteja & Ginting, 2014). To see how efficient the company's operations are

compared to its assets. Good operational efficiency can reduce operating expenses to increase profits.

2.6. Non-Interest Income

Bank income can be classified into two types, namely interest income and non-interest income. Income obtained from interest can come from traditional bank activities, namely credit to parties outside the bank. Meanwhile, non-interest income, according to Koch and MacDonald (2015), is operational income other than interest income. Non-interest income can be in the form of fee-based income, trading income, and other non-interest income (Edirisuriya et al., 2015). Fee-based income in the form of fees or services provided in the form of fees and commissions, trading income including profits or losses on trading and derivatives, other securities, and assets at fair value through other profits or losses (Edirisuriya et al., 2015)

Since the 1998 economic crisis in Indonesia, there has been a shift in priority from non-interest income. This is due to avoiding bad credit and only relying on interest income. According to Suteja & Ginting (2014) in addition to functioning to increase income, non-interest income is also useful for reducing risk by diversifying income. Non-interest income can be measured by comparing non-interest income to total assets (Suteja & Ginting, 2014). To see how much income from non-interest income is compared to assets. Income diversification is an alternative for banks to seek other, more stable, apart from

that, diversification also provides benefits in reducing unwanted risks and increasing profits.

2.7. Green Banking

2.7.1. Green Banking Definition

The definition of green banking according to Al Ahbabi & Nobanee (2019) is a term used by banks to increase responsibility for the environment. Green banking practices are regulated in POJK regulation Number 51 / POJK.03 / 2017, green banking practices are expected to be clear evidence that banks are determined to preserve the environment and reduce or prevent environmental destruction practices that are very detrimental to humans and the nature in which we live. Green banking practices are not limited to investment activities but also to banking operations such as better waste management, reducing the use of paper, using renewable energy, etc.

2.7.2. Green Banking Disclosure

Disclosure of green banking is evidence that banks have carried out green banking practices in their operational and investment activities and are disclosed in the form of annual and/or sustainability reports. By disclosing green banking information, it is also expected to increase the trust and reputation of banks in the community that banks care about environmental sustainability, so that the community supports these banking operations.

2.8. Profitability

The definition of profitability according to Agus Sartono (2010) is the company's ability to earn profits relating to sales, total assets, and own capital. So, companies must be able to utilize their assets and capital optimally to obtain maximum profits. The sustainability of a company or in this case a bank is determined by measuring profitability. In this research, the calculation of banking profits uses the Return on Assets (ROA) ratio. According to Kasmir (2010), ROA is a profitability ratio that is useful for measuring a company's ability to generate profits from the assets it owns. The higher the ROA presentation shows the better the company's performance, this ratio is useful for measuring how effectively the company generates profits from the use of its assets.

2.9. Previous Research

Table 2.1.

Previous Research

NO	Researcher	Variable	Object	Research Result
1.	Azizah Basmar et al. (2023)	**Dependent Variable:** Profitability (ROA) **Independent Variable:** Capital Structure (DAR), Liquidity (Current Ratio)	Banks Listed on the Indonesian Stock Exchange in 2021-2022	H_1: Capital Structure (DAR) have a negative significant effect on profitability H_2: Liquidity (Current Ratio) have a positive significant effect on profitability

2.	Husin & Purnamasari (2021)	**Dependent Variable:** ROA **Independent Variable:** LDR, SIZE, DAR	Banking companies listed on the Indonesia stock exchange 2015-2019	H_1: LDR has a negative significant effect on ROA H_2: Size has a positive significant effect on ROA H_3: DAR has a negative significant effect on ROA
3.	Suteja & Ginting, (2014)	**Dependent Variable:** ROA **Independent Variable:** Non-Interest Income, Non-Interest Expense, Loan Loss Provision, Equity (ETA), Total Asset, GDP, Market Capitalization	Banks listed on the Indonesian Stock Exchange during the research period 2003–2011	H_1: NII has no significant effect on profitability H_2: NIE has a significant negative effect on profitability H_3: LLP has a significant negative effect on profitability H_4: Equity has a significant positive influence on profitability H_5: Total Assets has a significant positive effect on profitability H_6: GDP has no effect on profitability H_7: MCAP has a significant negative effect on profitability
4.	Saaba & Yunita (2022)	**Dependent Variable:** ROA **Independent Variable:** LAR, DAR, NIETA, GDPERC, Inflation, SMCGDP	Banking sub-sectors listed on the IDX in 2016-2020	H_1: LAR has no effect on ROA H_2: DAR has no effect on ROA H_3: NIETA has a negative effect on ROA H_4: GDPERC has no effect on ROA H_5: INF has no effect on ROA

				H_6: SMCGDP has no effect on ROA
5.	Abu Khalaf et al. (2024)	**Dependent Variable:** Bank Profitability (ROA) **Independent Variable:** Non-Interest Income **Control Variable:** SIZE, CAR, Loan Loss Provision, Overhead	40 banks (5 banks from each country) operating in Bahrain, Egypt, Jordan, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates between 2010 and 2022	H_1: Non-interest income has a significant positive effect on ROA H_2: Size has a significant positive effect on ROA H_3: LLP has a significant negative effect on ROA H_4: CAR has no effect on ROA H_5: Overhead has a significant negative influence on ROA
6.	Mehzabin et al. (2023)	**Dependent Variable:** Bank Profitability (ROA, ROE) **Independent Variable:** Capital Structure (Leverage/DAR, LDTA), Non-Interest Income, Operating Efficiency (NIE), **Control Variable:** SIZE, CAP (TETA), Credit Risk (NLTA)	492 banks from 28 countries of Asia for the time span of 15 years from 2004 to 2018.	H_{1a}: Leverage has a significant positive effect on ROA H_{1b}: leverage in Middle East has a negative but Non-Middle East has positive influence on ROE H_{2a}: LDTA has no effect on ROA H_{2b}: LDTA in Middle East and Non-Middle East has a significant positive influence on ROE H_{3a}: Operational Efficiency Has a positive significant influence on ROA H_{3b}: Operational Efficiency in Middle East and Non-Middle East has a significant

				positive influence on ROE H_{4a}: NII has a significant positive influence on ROA H_{4b}: NII in Middle East and Non-Middle East has a significant positive influence on ROE H_{5a}: SIZE has no effect on ROA H_{5b}: SIZE in Middle East and Non-Middle East has a significant positive influence on ROE H_{6a}: CAP has a significant positive influence on ROA H_{6b}: CAP in Middle East has a positive but in Non-Middle East has a negative significant influence on ROE H_{7a}: Credit Risk has no effect on ROA H_{7b}: Credit Rish in Middle East and Non-Middle East has no effect on ROE
7.	Karadayi (2023)	**Dependent Variable:** Profitability (ROA) **Independent Variable:** LDR, NPL, NII, OOE	31 banks operating in Turkiye from 2002-2022	H_1: LDR has a significant positive effect on ROA H_2: NII has a significant positive effect on ROA H_3: NPL has no effect on ROA H_4: OOE has no effect on ROA

8.	Asfahaliza & Anggraeni (2022)	**Dependent Variable:** Profitability (ROA) **Independent Variable:** Green Banking	Commercial banks listed on the Indonesia Stock Exchange for the period 2016-2021	H_1: Green banking has a positive and significant effect on bank profitability in Indonesia.
9.	Rachmawati & Jayanti (2023)	**Dependent Variable:** Profitability (ROA) **Independent Variable:** Human Capital, Green Banking Disclosure, Liquidity	Banking sub-sector companies listed on IDX 2016-2020 period	H_1: Human capital has a significant positive effect on profitability. H_2: Green banking disclosure has no effect on profitability. H_3: Liquidity has no effect on profitability.

2.10. Hypothesis Development

2.10.1. The Influence of Capital Structure on Bank Profitability

The company's capital structure is divided into two types, namely debt and equity. To fund its operational activities, companies can choose to use debt and equity. Using debt to fund a company's capital can be an alternative for funding its activities, but it needs to be understood that using debt can be detrimental to the company. Where the company must bear the interest burden paid by the company and this can reduce the company's profits. Therefore, the high use of debt requires more careful management from company management to meet stakeholder expectations and needs.

Because in the end the company has an obligation to pay off its debts if it is unable to face the risk of bankruptcy. Based on research by Azizah Basmar

et al. (2023) shows that Capital Structure (DAR) has a significant negative effect on profitability and Husin & Purnamasari (2021) show that DAR has a significant negative effect on profitability so that the use of debt in the capital structure reduces profits. Based on the description above, the hypothesis of this research is:

H_1: Capital Structure Has a Negative Influence on Bank Profitability

2.10.2. The Influence of Operational Efficiency on Bank Profitability

Operational efficiency is the company's ability to manage expenses to increase profits. In addition, good operational efficiency shows stakeholders that the company can respond to pressure from stakeholders who want the company to streamline its operations. This is in accordance with stakeholder theory where companies consider stakeholders in their operations. Good operational efficiency can save resources efficiently, such as saving resources, using mobile banking, saving transportation costs, etc.

With good operational efficiency, banks can allocate their resources for product development and innovation so that they can continue to grow and enable banks to meet expectations and gain stakeholder support. Based on research by Mehzabin et al. (2023) shows that operating efficiency (NIE) has a positive influence on profitability so, the more efficiently the company operates, the more profits it can increase. Based on the description above, the hypothesis of this study is:

H_2: Operational Efficiency Has a Positive Influence on Bank Profitability

2.10.3. The Influence of Non-Interest Income on Bank Profitability

Non-interest income is income generated by banks other than interest. There is a demand from stakeholders for banks to diversify their income so as not to depend on risky interest income to continue operating, so non-interest income is an option for banks to seek profits without relying solely on conventional methods. Banking companies earn non-interest income by earning fee-based income in the form of fees or services provided in the form of fees and commissions, trading income including gains or losses on trading and derivatives, other securities, and assets measured at fair value through other gains or losses.

Non-interest income can increase company income so that it can enable banks to meet needs, expectations and at the same time get stakeholder support. This is in line with stakeholder theory which considers stakeholders in its operational activities. By diversifying bank income can reduce risk and increase stability to increase profits. Based on research by Abu Khalaf et al. (2024), Karadayi (2023), and Mehzabin et al. (2023) shows that non-interest income has a positive influence on profitability. So, by increasing non-interest income, the company's profits can be increased. Based on the description above, the hypothesis of this research is:

H_3: Non-Interest Income Has a Positive Influence on Bank Profitability

2.10.4. The Influence of Green Banking on Bank Profitability

Green banking is basically a bank's concern for the environment, in practice green banking is implemented through bank operational activities which can be in the form of saving paper, using renewable energy, using mobile banking technology, etc., funding activities by financing sustainable or environmentally friendly projects, can also be in the form of appeals, company regulations, etc. Banks disclose green banking information in the form of responsibility for their operations in accordance with the values and norms of society. This is in line with legitimacy theory where companies and society are bound by a social contract and must be responsible for the impact of their operational activities on the environment by disclosing information in the form of green banking disclosures.

By disclosing green banking, banks can show their commitment to social and environmental matters so that they can increase their reputation and support society to continue operating. This support can be through investment support, partnerships, or increasing customer loyalty, etc. So good disclosure of green banking can increase support and reputation so that it can increase profitability. Research by Asfahaliza & Anggraeni (2022) shows that green banking has a positive and significant effect on bank profitability in Indonesia. So, the higher the disclosure of green banking, the higher the profits obtained. Based on the description above, the hypothesis of this research is:

H_4: Green Banking Has a Positive Influence on Bank Profitability