

## FACTORS THAT INFLUENCE THE LEVEL OF BANKING PROFITABILITY IN INDONESIA



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### Abstract

This study aims to analyze the level of banking profitability in Indonesia using panel data analysis. Profitability is an important indicator reflecting a bank's financial health and is crucial in determining its sustainability and competitive advantage in the sector. This study examines the factors influencing the level of bank profitability in Indonesia. The sample used in this study was 40 conventional banks listed on the Indonesia Stock Exchange for five years (2019-2023). The sampling technique used was purposive sampling, and the analysis method used in this study was panel data regression. The independent variables in this study consisted of liquidity, capital adequacy, bank size, inflation, and bank income, while the dependent variable in this study was the return on assets. The results of the panel data regression in this study indicate that liquidity and bank size have a significant positive effect on the return on assets. Capital adequacy, inflation, and bank income do not affect the return on assets. The results of this study are expected to serve as a reference for conventional banks in increasing bank profitability by improving capital management efficiency, strengthening liquidity, and expanding the asset base. The results of this study are also expected to serve as a reference for investors in selecting banks with high liquidity and large size as indicators of better profit potential.

**Keywords:** Inflation, Capital Adequacy, Liquidity, Bank Income, Bank Size

## INTRODUCTION

Banks, as one of the most prominent financial intermediary organizational structures, essentially function as commercial enterprises (Sihotang et al, 2022). From this perspective, the primary goal of banks, like other commercial enterprises, is to maintain their existence by maximizing profits from transactions, both current and future. This profit is generally expressed by the term "profit." Conceptually, profit refers to the positive difference between an organization's revenues and expenses over a given period. Financially, profit is an important indicator and is also used as a guideline for investment and management decisions across various sectors, institutions, and organizations. In addition, profit levels also shape expectations regarding an organization's future performance and can influence the continuation or termination of its operations (Ferhat, Erarslan, Narman, and Sulukan 2024).

Profitability reflects a bank's financial performance, measuring the success and efficiency of operations and generating profits (Munawaroh et al, 2023). Achieving effective and efficient profitability requires risk management to mitigate potential uncertainty. Banking profitability is measured through liquidity, capital adequacy, bank size, inflation, and bank earnings. The negative impact of the COVID-19 pandemic on the global economy has led to a decline in company performance across various sectors, including banking. Banking plays a crucial role in economic growth as it is one of the financial institutions that significantly influences a country's economic development. As financial intermediaries, banks utilize available funding sources by collecting funds (funding) and redistributing them in the form of loans (lending) to the public.(Imahanani and Suwaidi 2022).

Liquidity indicates how much funds can be returned to fund holders due to withdrawals by the bank, using bank loans as a basis. The liquidity ratio reflects how much of a bank's assets have been converted into liquid assets. In other words, this ratio indicates how easily a bank's assets can be converted into cash to meet its liabilities. This ratio also indicates the extent to which a bank's current assets are sufficient to repay its debts.(Ferhat et al. 2024). Research conducted by El (2020) states that liquidity has a significant negative impact on bank profitability. Karakaş & Acar Boyacıoğlu (2022) state that there is a negative effect between liquidity and profitability. Although liquidity negatively impacts profitability because liquid assets do not earn interest or provide low returns, having sufficient liquid assets is crucial for banks to maintain their reputation in the market and with customers, especially during times of crisis. Liquidity management has been a focus of academic study. Empirical analysis with different variables across various markets is believed to contribute to the literature and the banking sector, by grouping banks by small, medium, and large size, or by public and private ownership, as well as banks with domestic and foreign capital (Ferhat et al. 2024).

Capital adequacy refers to a bank's ability to hold sufficient assets to cover financial obligations against potential risks. From this perspective, a bank's capital adequacy ratio at a certain level indicates that the bank has sufficient capital to face risks (Ferhat et al. 2024). Based on the research conducted Özer, Babuşçu, and Hazar (2021) Through panel data analysis using data from 2008 to 2018, a positive relationship was found between capital adequacy and return on assets (ROA). Capital adequacy has a significant positive impact on profitability, which can be explained by its ability to increase profitability by protecting against unexpected losses. This condition attracts the attention of investors, who view banks

as safe investments, thus driving up stock prices and facilitating access to the capital market.(Abdou and Alarabi 2024).

Bank size impacts a company's profitability, as larger banks tend to have easier access to funding sources. It's important for banks to optimize their operations to achieve maximum profitability.(Rini Syahril Fauziah and Fadhilah 2022). Research conducted by Al-Homaidi, Al-Matari, Anagreh, Tabash, and Mareai Senan (2021) And Isayas (2022) states that bank size has a significant positive effect on profitability. Research conducted by Abdou & Alarabi (2024) states that there is a positive influence of bank size on profitability.

Relatively high inflation is considered a negative signal for investors. For consumers, high inflation reduces their purchasing power. When raw material and labor prices rise during inflationary periods, producers tend to hesitate to raise their product prices, ultimately leading to lower corporate profits.(Dwijayanti 2021). Research conducted by Davis, Karim, and Noel (2022) Research has shown that inflation has a positive impact on bank profitability, as measured by ROA and ROE, in developed countries. Conversely, a negative impact is found in developing and emerging countries. Inflation has a negative impact because it can reduce people's purchasing power, increase economic uncertainty, and potentially hinder growth.

Bank earnings can achieve high profits by optimizing financing, as this can contribute to profitability through profit sharing.(Nurhamidah and Diana 2021) Banks must be extremely careful and selective when disbursing funds or providing financing to potential customers. Before disbursing financing, banks must assess potential customers applying for financing. This step aims to prevent potential losses, such as the customer's inability to meet payment obligations.(Fauziyah, Dwiarta, Afkar, and Sukandani 2022). Research conducted by Puspita & Mustanda (2019) states that bank earnings have a significant negative effect on profitability. High revenues from banking activities may be accompanied by significant increases in operating expenses or credit risk, which can erode net income. Furthermore, if a bank focuses on an aggressive expansion strategy without considering asset quality or risk management, this can increase the cost of providing for credit losses, thereby reducing the ratio of net income to total assets. Therefore, high bank earnings do not necessarily reflect healthy efficiency or profitability if they are not supported by sound cost and risk management.(Ferhat et al. 2024).

Based on the main article used with the title "Analysis of Profitability Levels of Deposit Banks in Turkey" written by (Ferhat et al. 2024) by using the measurement of return on assets as the dependent variable and using liquidity, capital adequacy, and bank earnings as independent variables in this study. The supporting article used to add variables in this study is entitled "The Dynamics Behind Private Banking Growth in Egypt," written by Abdou & Alarabi (2024).

## REVIEW OF LITERATURE

### Bank

Banks are financial institutions that aim to maximize profits by investing funds collected from depositors in productive sectors of the economy, and play a vital role in the economic system. Their primary tasks include accepting deposits, providing credit and payment services, and ensuring financial security. Their continued operations depend on a high level of customer trust and their funding capabilities.(Ferhat et al., 2024).

### **Profitability**

Bank profitability is defined as the ratio of profit after tax to total assets, which is the bank's ability to generate profit from its operations and shows how much profit the bank earns relative to its assets or shareholders' equity (Khalaf, Awad, and Ellis, 2024). According to Ferhat et al., (2024) The return on assets (ROA) variable is used as an indicator to show how much profit a bank can achieve relative to its assets. This indicator can be calculated by dividing the bank's net profit for a given period by its total assets.

### **Liquidity**

Based on Bank Indonesia Regulation (PBI) No. 11/25/2009, liquidity risk refers to the risk faced by banks due to the bank's inability to meet maturing financial obligations from cash flow funding sources or liquid assets without disrupting the bank's daily operations. Therefore, banks are required to have reserve funds that can be used in situations where there is a sudden withdrawal of funds by customers, as well as having investments in assets that are sufficiently liquid so that they can be quickly disbursed to meet funding needs and obligations.

### **Capital Adequacy**

Capital adequacy is defined as the bank's ability to maintain sufficient equity capital in anticipation of losses that may arise due to various risks faced. (Ferhat et al. 2024) The capital adequacy ratio (CAR) measures regulatory capital against risk-weighted assets. Banks with more capital are assumed to bear lower risks. This ratio is a proxy for assessing the effectiveness of macroprudential policies on financial stability by reducing the likelihood and severity of financial crises. (Jalloh 2024).

### **Bank Size**

Bank size is measured using the logarithm of total assets, providing insight into how banks can improve efficiency and profitability by reducing unit costs, while strengthening operational efficiency, core capital, and market share. (Ebimobowei and Felix 2021) Bank size affects a company's profitability because larger banks have easier access to funding sources.

### **Inflation**

Inflation is generally calculated through the consumer price index (CPI), which measures changes in prices paid for goods and services. (Radovanov, Milenković, Kalaš, and Horvat, 2023) Inflation is a sustained tendency for prices to rise, which can also be interpreted as a decrease in the overall value of the money supply. Basic economic concepts state that inflation depends on the amount of excess money circulating in an economy (Esumamba, Danaa, & Konadu, 2019).

### **Bank Earnings**

Bank earnings show the proportion of a bank's total revenue to its total expenses during the operating period. This indicator is calculated as the ratio of total revenue divided by total expenses. (Ferhat et al. 2024) Positive accounting theory explains that managers use their understanding of accounting methods and policies to influence reported earnings. The goal is to increase their chances of obtaining contractual benefits that depend on the value of reported earnings. (Ozili 2023).

## RESEARCH METHOD

### Research Design

The research design used in this study is hypothesis testing, which aims to examine the influence of independent variables, such as liquidity, capital adequacy, bank size, inflation, and bank earnings, on the dependent variable, namely return on assets. The data for this study are conventional banks operating in Indonesia and listed on the Indonesia Stock Exchange (IDX) for five years (2019-2023). The analytical method used in this study is panel data regression with Eviews 9.0 software.

### Method of Collecting Data

In this study, the data used is secondary data, that is, data obtained indirectly through published sources. This data was obtained from conventional banking financial and annual reports on the Indonesia Stock Exchange website ([www.idx.co.id](http://www.idx.co.id)), OJK website ([www.ojk.go.id](http://www.ojk.go.id)), the World Bank website ([data.worldbank.org](http://data.worldbank.org)) for five years (period 2019-2023).

### Sampling Method

This study applies the purposive sampling method in sampling, which means that the banks selected as samples must meet a number of specific criteria, including:

1. Conventional banking listed on the Indonesia Stock Exchange (IDX) for five years (2019-2023 period).
2. The sample used in this study is conventional banking so it does not use Islamic banks and regional banks.

## RESULTS AND DISCUSSION

### Descriptive Statistical Analysis

Descriptive statistical analysis describes a summary of research data, including the minimum, maximum, average (mean), and standard deviation values for each studied variable. The minimum value indicates the lowest number for each variable, while the maximum value represents the highest number. The mean value indicates the average of each research variable, and the standard deviation presents the distribution of the data, indicating the level of homogeneity or heterogeneity of the fluctuating data. The results of the descriptive statistical analysis are explained as follows:

Table 1.

Descriptive Statistical Analysis Results

Variables	Observation	Minimum	Maximum	Mean	Std. Dev
Return on Assets	200	-0.180600	0.041400	0.004062	0.024236
Liquidity	200	0.123200	5.632800	1.020637	0.643565
Capital Adequacy	200	0.055300	0.925100	0.218659	0.148582
Bank Size	200	12.12090	16.43750	14.18709	1.045269
Inflation	200	0.016800	0.055100	0.028780	0.013801
Bank Earnings	200	-6.821900	4.244000	-2.083244	1.993511

Source: Eviews 9.0 Regression Data Panel Output

Based on the descriptive statistical analysis in table 1, the interpretation results can be described as follows.

1. **Return on Assets** has an average value (mean) of 0.004062 and a standard deviation of 0.024236. The minimum return on assets value is -0.180600 owned by PT Bank Rakyat Indonesia Agroniaga Tbk in 2021, while the maximum value is 0.041400 owned by PT Allo Bank Indonesia Tbk in 2021.
2. **Liquidity** has an average value (mean) of 1.020637 and a standard deviation of 0.643565. The minimum liquidity value is 0.123200 owned by PT Bank Capital Indonesia Tbk in 2021, while the maximum value is 5.632800 owned by PT Krom Bank Indonesia Tbk in 2023.
3. **Capital Adequacy** has an average value (mean) of 0.218659 and a standard deviation of 0.148582. The minimum capital adequacy value is 0.055300 owned by PT Bank Tabungan Negara (Persero) Tbk in 2020, while the maximum value is 0.925100 owned by PT Krom Bank Indonesia Tbk in 2022.
4. **Bank Size** has an average value (mean) of 14.18709 and a standard deviation of 1.045269. The minimum bank size value is 12.12090 owned by PT Bank Jago Tbk in 2019, while the maximum value is 16.43750 owned by PT Bank Multiarta Sentosa Tbk in 2023.
5. **Inflation** has an average value (mean) of 0.028780 and a standard deviation of 0.013801. The minimum inflation value is 0.016800 for each bank in 2020, while the maximum value is 0.055100 for each bank in 2022.
6. **Bank Earnings** has an average value (mean) of -2.083244 and a standard deviation of 1.993511. The minimum value of bank earnings is -6.821900 owned by PT Bank Raya Indonesia Tbk in 2019, while the maximum value is 4.244000 owned by PT Bank Capital Indonesia Tbk in 2021.

**Panel Data Regression Analysis Results**

This study uses panel data regression analysis to test the influence of independent variables such as liquidity, capital adequacy, bank size, inflation, and bank earnings on the dependent variable, namely return on assets. The results of the regression equation in this study can be described as follows.

$$ROA = -0.382358 + 0.009487LIQit - 0.009725CAPit + 0.026456SIZEit + 0.091255INFit - 0.000433ADDit$$

**T-Test Results**

The T-test (Individual Test) aims to test whether there is an influence of independent variables, such as liquidity, capital adequacy, bank size, inflation, and bank earnings individually, in influencing the dependent variable, namely return on assets.

**Table 2.**

**T-Test Results**

Independent Variables	Dependent Variable		
	Return on Assets		
	Coefficient	Prob	Conclusion
Constant	-0.382358	-	-
Liquidity	0.009487	0.0165	Significant Positive
Capital Adequacy	-0.009725	0.6573	No effect
Bank Size	0.026456	0.0000	Significant Positive
Inflation	0.091255	0.3277	No effect

Bank Earnings	-0.000433	0.6441	No effect
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Source: Eviews 9.0 Regression Data Panel Output

Based on the T-test in Table 2, the results that can be described in this study are as follows:

1. **Liquidity** has a coefficient value of 0.009487 with a profitability value of  $0.0165 \leq 0.05$ , indicating that H0 is rejected, so that liquidity has a positive and significant effect on profitability.
2. **Capital adequacy** has a coefficient value of -0.009725 with a profitability value of  $0.6573 \geq 0.05$ , indicating that H0 is accepted, so that capital adequacy does not affect profitability.
3. **Bank size** has a coefficient value of 0.026456 with a profitability value of  $0.0000 \leq 0.05$ , indicating that H0 is rejected, so that bank size has a significant positive influence on profitability.
4. **Inflation** has a coefficient value of 0.091255 with a profitability value of  $0.3277 \geq 0.05$ , indicating that H0 is accepted, so that inflation does not affect profitability.
5. **Bank earnings** have a coefficient value of -0.000433 with a profitability value of  $0.6441 \geq 0.05$ , indicating that H0 is accepted, so that bank earnings do not affect profitability.

#### **The Effect of Liquidity on Bank Profitability**

The regression test in this study shows that liquidity has a significant positive effect on return on assets. This finding is in line with research by Fidanoski, Choudhry, Davidović, and Sergi (2018) and Paul, Bhowmik, and Famanna (2021), which proves that there is a positive and significant influence between liquidity and return on assets. Haryati, Roswinna, and Anggraeni (2024) also support the significant positive effect of liquidity on return on assets, due to the relationship between a company's ability to meet its short-term obligations and its efficiency in generating profits from its assets. This suggests that relatively high levels of liquidity can benefit companies by increasing profitability. In other words, the higher the level of liquidity, the more positive the impact on profitability, particularly in the banking sector (Setianingrum, Wibowo, and Utami 2018). However, the results of this study contradict research by Mercan, Botsvadze, Dzagania, Khoshtaria, and Rachvelishvili (2023), which states that liquidity has a significant negative effect on return on assets.

#### **The Influence of Capital Adequacy on Bank Profitability**

The regression test in this study shows that capital adequacy has no effect on return on assets. This finding is in line with research by Ariyanti & Saryadi (2018), which states that capital adequacy has no effect on return on assets. This occurs because bank financial report data shows that capital adequacy has increased, but return on assets has decreased. The results of this study contradict the theory that states that the lower a bank's risk, the greater its potential profits. This is due to the high CAR, which needs to be considered in the context of bank management. An excessively high CAR ratio indicates that equity capital is not being utilized optimally, thus increasing the bank's burden due to high funding costs (Ariyanti and Saryadi 2018). However, the results of this study contradict the research conducted by Nguyen (2020) states that bank capital adequacy has a significant positive influence on bank profitability.

#### **The Influence of Bank Size on Bank Profitability**

The regression test in this study shows that bank size has a significant positive effect on return on assets. This research result is in line with Alex & Ngaba (2018). Using panel data from 2012 to 2016, bank size positively impacts return on assets. Bank profitability is

influenced by bank size due to the benefits of economies of scale. Larger banks can allocate fixed costs more efficiently, resulting in lower average costs per unit of output. This efficiency contributes to increased profitability (Abdou and Alarabi 2024). However, the results of this study contradict research by Mir & Shah (2022), which states that bank size has a significant negative effect on return on assets.

#### **The Effect of Inflation on Bank Profitability**

The regression test in this study shows that inflation has no effect on return on assets. This finding is in line with research by Shah (2018), which states that inflation has no significant effect on return on assets. This occurs because rising interest rates make people less interested in applying for loans from banks. However, the results of this study contradict research conducted by Saif-Alyousfi, (2022), which states that inflation has a significant positive effect on profitability.

#### **The Influence of Bank Earnings on Bank Profitability**

The regression test in this study shows that bank earnings have no effect on return on assets. This research aligns with research conducted by Mulyani & Agustinus (2023) which states that bank earnings do not affect profitability, because if the income is derived from unsustainable or high-risk activities, the impact on long-term profitability will be minimal. Therefore, bank earnings are not always a direct indicator of increased ROA without proper efficiency and risk management. However, this study disagrees with research conducted by Ozili & Outa (2019) states that bank earnings negatively impact profitability, because earnings generated from non-sustainable or non-operational sources, such as one-off gains from asset sales or non-interest income, may not reflect the bank's ability to generate long-term profits. This can reduce profitability if core earnings are inadequate. Another study conducted by Ferhat et al. (2024) states that there is a reciprocal causal relationship between profit and the average rate of return on assets in deposit banks.

### **CONCLUSION**

This study aims to determine and test whether independent variables such as liquidity, capital adequacy, bank size, inflation, and bank earnings influence the dependent variable, namely return on assets, at 40 conventional banks listed on the Indonesia Stock Exchange over five years (2019-2023). Based on the analysis and discussion, the following conclusions emerge:

1. Liquidity has a positive and significant effect on return on assets.
2. Capital adequacy does not affect return on assets.
3. Bank size has a positive and significant effect on return on assets.
4. Inflation does not affect return on assets.
5. Bank earnings do not affect return on assets.

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