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Effect of Loan Loss Provision, Number of Credits Given and Foreign Ownership on Corporate Financial Performance

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Abstract: The purpose of this study was to determine the effect of loan loss provision, the amount of credit given and foreign ownership to the profitability of the bank. Loan Loss Provisioning, Total Credits Given and return on equity are used to assess how the performance of National Commercial Banks in generating net assets that can support the achievement of net profit increase. The sample used in this research is Private Foreign Exchange Bank. method of data documentation through the official website of the Financial Services Authority. The results of the study inform that the loan loss provision, total credit given loans and foreign ownership significantly affect the profitability of banks.

Key Words: Loan loss provision, bank accounting, foreign ownership

I. INTRODUCTION

The existence of a bank has an important task in the economy of the country which is communicated thoroughly on the conditions of obtaining benefits from the provision of various types of financing and loans. Act No.10 of 1998 on banking states that banks are business entities that collect funds from the public in the form of savings and channelled to the community in the form of credit or other forms, which aims to improve the standard of living of the community. Indicators that can be used to measure bank performance can be known through the financial statements on the value of profitability. Financial statements can be analyzed using financial ratios. Financial ratio analysis is a commonly used analytical technique, because it is the fastest technique for knowing the financial performance of a bank (Chao, et al., 2017; Anand, et el. 2017). Loan loss provisioning, total credit given and return on equity are used to assess how the performance of National Commercial Banks in generating net assets that can support the achievement of net profit increase. In addition, this financial performance is very important because the management can evaluate the effectiveness and efficiency of bank management in managing all its net assets (Bushman et al 2016; Yong 2016; Padake & Soni 2015). Therefore, ROE can be used as an indicator of bank performance, because the increase in ROE is followed by an increase in other financial performance. The purpose of this study is to determine the effect of loan loss provission, the amount of credit given and foreign ownership to the profitability of banks.

The formulations of the problem in this research are:

1. Does the loan loss provision affect the profitability of the bank ?
2. Does the amount of credit given affect the profitability of the bank ?
3. Does foreign ownership affect the profitability of the bank ?

II. REVIEW OF LITERATURE

(a) Agency Theory

The agency theory explains a contractual relationship between two or more parties, in which one party is called the principal, the party giving the mandate to the other, while the agent is the party who performs all activities on behalf of the principals in their capacity as decision makers Jensen and Mackling, 1976). It can be concluded that there is a relationship between this research variables with the theory is that acting as principal and agent in banking company will be influenced by existence of regulator like the financial services authority or bank central. So from the contractual relationship, if the principal provides the service requirement and gives the responsibility in accordance with the agreed contract of work in accordance with the policy authorized by the regulator as a result can give confidence to the agent. This agency theory arises when there is a relationship of cooperation contract between manager and shareholder described as the relationship between principal and agent.

(b) Bank and Profitability

Bank is an institution or company whose activities collect funds in the form of demand deposits, deposits, savings, and other savings from the surplus spending unit and then put it back to people who deficit spending unit through the sale of financial services which further improve the economy and welfare of the people (Taswan, 2010). Profitability is the ability of the company to generate profits described by return on equity (ROE), according to Harahap (2015: 300) This ratio describes the level of efficiency of equity management companies to earn profits. This ratio also provides a measure of the effectiveness of ROE to demonstrate the company's success in generating past profits for future projection (Khurshid & Jenifer 2016; Nicolae & Bogdan 2015).

(c) Loan Loss Provisioning

Loan loss provision is a reserve that banks must establish when there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (adverse event), and the adverse event has an impact on the estimate future cash flows from a financial asset or group of financial assets that can be accurately specified. PSAK 55 (Revised 2015) as a local accounting standard in Indonesia.

(d) Amount of Credit Given

It is the provision of money or claims based on a loan agreement or agreement between the bank and another party requiring the borrower to repay the debt after a certain period of time with the giving of interest. The provision of credit in addition to providing benefits to the bank also contains various risks caused by the possibility of not repaid by the debtor at the end of the loan (maturity).

(e) Foreign Ownership

Ownership structure in company is a very important aspect in determining the performance of the company which will affect the profitability of the company. Foreign ownership is the percentage of share ownership by foreign investors. According to Law no. 25/2007 on Article 1 point 6 (local regulation issued by Central Bank of Indonesia) foreign ownership is an individual foreign citizen, foreign business entity, and foreign government who do investment in the territory of the Republic of Indonesia.

(f) The Influence of Loan Loss provision to Bank Profitability

Loan loss provision is the amount that is derived from the carrying amount up to the amount recoverable from the asset. In this research loan loss provisioning is measured using loan loss provisioning ratio. With the calculation of loan disbursement or allowance based on the calculation of loan loss provisioning, the bank can reduce the occurrence of credit risk that will occur, which will improve the health of the banking system. Therefore, the greater the loan loss provision of a bank will cause the lower the profitability of the bank (Ma & Song 2016; Ahmed, *et al.* 2012; Das, *et al.* 2012; Vincent & Laetitia, 2012).

(g) The Influence of Total Credit Given to Bank Profitability

Credit is an asset that generates interest income, is the bank's main income. The greater of the amount of credit given, will cause the greater of the interest income to be obtained by the bank which will affect the acquisition of the amount of profit. Thus, it can be concluded that there is a positive relationship between the amount of credit given with profitability. If the number of credit given by the bank increases every year, then the profitability of the bank will also increase (Made & Fridayana, 2016; Ririh (2015); James, *et al.,* 2015).

(h) The Effect of Foreign Ownership on Bank Profitability

Foreign ownership is the ratio of the amount of capital held by foreign parties with their own capital derived from local investors to support the assets that generate risks, for example credit provided. The greater the foreign ownership, the demand for profits to be received by banks is also greater (Job & Alexander

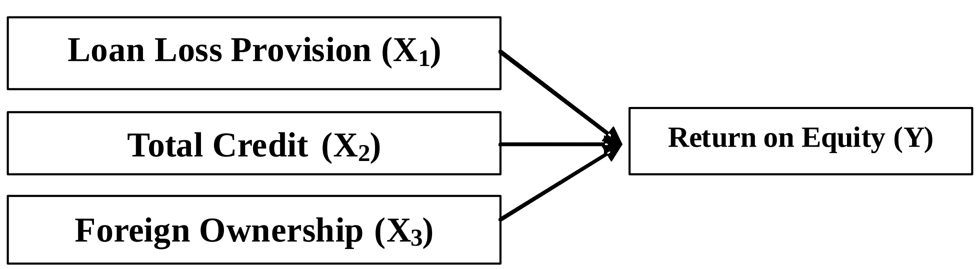

Figure 1: Research Framework

2015). It can be concluded that with a high level of foreign ownership, it will increase the cash reserves in expanding the bank's credit. Thus, high capital opens big opportunities for banks to increase their profitability (Yeterina & Yulius 2013; Tom & Joakim, 2010; Farooque *et al.,* 2007). The framework underlying this research can be described as follows:

III. RESEARCH METODOLOGI

The population used in this study is a banking company registered in the Financial Services Authority (OJK) in 2013 to 2016. The sample used in this study is the Private Foreign Exchange National Bank which are 148 banks. The sampling technique used in this research is purposive sampling technique based on consideration and using multiple regression analysis technique (Jogiyanto.2014). Data collection methods used in this study using the method of data documentation through the official website of the Financial Services Authority, namely www.ojk.go.id. Profitability as the dependent variable and loan loss provision , the amount of credit given and foreign ownership as independent variables.

Operational of variables definition as follows:

Profitability is the ability of a company to generate profits described by Harahap (2015: 300), Return on Equity describes the level of asset management efficiency or assets performed by the company concerned.

$$\text{ROE} = \frac{\text{Net Income}}{\text{Total Equity}} x100\ \%$$

Loan Loss Provision is a reserve that must be established by the bank if there is objective evidence of impairment of financial assets as one or more events that have occurred after the recognition of the asset and impacts the estimated future cash flows of PSAK No. 55 (Revised 2015).

$$\text{Loan Loss Provision} = \frac{\text{Loan Loss Provision}}{\text{Total Credit}} \text{ x } 100\%$$

Total Credit Given is the provision of money or claims based on a loan agreement between the bank and another party requiring the borrower to repay the debt after a certain period of time with the giving of interest.

$$\text{Credit} = \frac{\text{Total of Credit}}{\text{Total Aset}} x100\%$$

Foreign Ownership, is a very important aspect in determining the performance of the company which will affect the profitability of the company. Foreign ownership is the percentage of share ownership by foreign investors. According to local regulation No. 25/2007on Article 1 point 6 foreign ownership is an individual foreign citizen, foreign business entity, and foreign government who do investment in the territory of the Republic of Indonesia. Foreign ownership in this study is measured using the percentage of foreign share ownership. Companies with foreign ownership of > 5% will be included in the sample (Yeterina & Yulius 2013; Tom & Joakim, 2010; Farooque *et al.,* 2007). The structure of foreign ownership can be measured in accordance with the proportion of ordinary shares held by foreigners, it can be formulated:

$$\text{Foreign Ownership} = \frac{\text{Sum of Foreign ownership stocks}}{\text{Total Stock}} x100\%$$

IV. DISCUSSION

Table 1
t- Test

Model	*B*	*Std Error*	*t*	*Sig*
(Constant)	.659	.556	1.185	.238
Loan loss provision	-.021	.070	-.296	.024
Total credit given	.035	009	3.714	.000
Foreign investor	.003	007	2.631	.042

1. Effect of Loan Loss Provision on Bank Profitability

   Loan Loss Provision (LLP) is the amount derived from the carrying amount up to the amount recoverable from the asset. The banks established a special reserve fund to tackle the uncollectible credit risk through loan loss provision. The t test results inform that the variable reserve loss impairment effect on the profitability of banks with a significance of 0.024 <0.05. The results of this study support Ma & Song research (2016); Ahmed, et al. (2012) which informs that loan loss provision has an effect on ROE. These results prove the bank will establish loan loss provision when the estimated occurrence of high possibility of default of credit disbursed, the greater reserves formed potentially become a default so that the burden due to uncollectible credit will also be great. Unsecured credit further affects the amount of profit earned by the bank. The establishment of a loan loss provision shall be made by the bank as a consequence of the application of IFRS to PSAK 50 and 55 (local accounting standard) in Indonesia. Loan loss provision was established by the bank with the aim of enhancing the bank's efforts to treat impairment accounting caused by nonperforming loans. Loan loss provision will provide an opportunity for banks to first assess individual or collective credit declines. If the bank can properly manage loan loss provision, then the potential for credit default through optimum billing will have an impact on increasing bank profitability.

2. Influence of Total Credit Given to Bank Profitability.

   Credit is the provision of money or invoices under a loan agreement or agreement between the bank and another party requiring the borrower to repay the debt after a certain period of time with the grant of interest. Provision of credit can provide benefits for the bank also contains many risks caused by the possibility of not paid off by the debtor at maturity credit. Based on the results if statistics on t test can be seen that the variable amount of credit given with a significance value of 0.000 <0.05, then the value indicates that the variable total of credit given significantly affects the profitability of banks. The results of this study are consistent with the results of research conducted by Ririh (2015); James, et al. (2015) stating that the total of credit given significantly affects bank profitability. These results indicate that during this bank will run its core business as an agent of lending that will get a large spread of income through lending. The increase in income generated from the spread of income will lead to increased bank profits.

3. The Influence of Foreign Ownership on Bank Profitability
Foreign ownership in the company can increase the capital of the company, besides the presence of foreign investors tend to bring changes to the company's operational climate with the application of information systems technology as has been applied in the country of origin. Support capital and development of information technology is the reality improve the operational efficiency of the company so it will affect the increase in corporate profits. T test results can be seen that the foreign ownership variable has a significance value of 0.042 <0.05, then the value indicates that the variable of foreign ownership affect the profitability of the bank. The results of this study are consistent with research conducted by Job & Alexander 2015, which shows ownership by foreign investors affecting profitability. Foreign ownership has an impact on increasing the source of capital from outside parties that can be utilized for the company's operations. The increase in capital will increase the bank's ability to expand its business and profit. Foreign ownership is also a catalyst for banks to implement good corporate governance with reference to international standards. The impact is that the company is able to increase the firm's value which in turn can increase the profit earned (Job & Alexander 2015; Yeterina & Yulius 2013; Tom & Joakim, 2010).

V. CONCLUSION

This study aims to determine the effect of loan loss provision, the amount of credit given and foreign ownership of bank profitability. The sample used in this research is at private foreign exchange. The results of the study inform that the loan loss provision, total credit given and foreign ownership significantly affect the profitability of banks. Suggestions in subsequent studies are expected to use variations of independent variables that may affect profitability such as the use of capital adequacy ratio, and loan to deposit ratios. The use of data across all groups and types of banks is also likely to provide more comprehensive results.

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