ANALYSIS THE EFFECT OF LOAN LOSS PROVISION ON BANK PROFITABILITY

ANALISA DAMPAK CADANGAN KERUGIAN PENURUNAN NILAI TERHADAP PROFITABILITAS BANK

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Abstract: The credit risk is one of the biggest risks facing the banks, and arises from the possibility that loans or bonds held by banks will not be pay back either in part or in full. Therefore, bank should create loan loss provision. The purpose of this research is to examine the impact of loan loss provision on bank profitability. This research is using multiple regression analysis to analyze the effect of independent variables to dependent variable. This research provides the evidence that loan loss provision has not significant positive effect on bank profitability. It means the banking will get profits on loan loss provision but there is possibility to getting losses. The result of this research is also finding the effect of deposits and size of bank has not significant effect on bank profitability, while liabilities have a significant effect on bank profitability. The banking should pay attention to establishment the loan loss provision to anticipate the decline of profitability that will be obtained by the bank itself, or bank should pay attention to whose they have to give credit, so that the credit risk could be anticipated.

Keywords*: loan loss provision, bank profitability*

Abstrak: *Risiko kredit adalah salah satu risiko terbesar yang dihadapi Bank, dan timbul dari kemungkinan bahwa pinjaman atau obligasi yang diselenggarakan oleh bank tidak dapat dibayar kembali baik sebagian atau penuh. Oleh karena itu, bank harus membuat cadangan kerugian penurunan nilai (CKPN). Tujuan dari penelitian ini adalah untuk mengkaji dampak dari CKPN terhadap profitabilitas bank. Penelitian ini menggunakan analisis regresi untuk menganalisis efek variabel independen terhhadap variabel dependen. Penelitian ini memberikan bukti bahwa CKPN memiliki efek positif yang tidak signifikan terhadap profitabilitas bank. Itu berarti perbankan akan mendapatkan keuntungan dari CKPN tetapi ada kemungkinan untuk mendapatkan kerugian. Hasil penelitian ini juga menemukan efek deposito dan size bank memiliki efek tidak signifikan pada profitabilitas bank, sementara kewajiban memiliki efek signifikan pada profitabilitas bank. Perbankan sebaiknya memperhatikan pembentukan CKPN untuk mengantisipasi resiko kerugian yang akan diperoleh oleh bank itu sendiri, atau bank harus memperhatikan siapa yang akan mereka memberikan pinjaman, sehingga risiko kredit bisa diantisipasi.*

Kata kunci: *cadangan kerugian penurunan nilai, profitabilitas bank.*

INTRODUCTION

Research Background

Bank is one of the financial institutions used by society, which is to overcome the financial problems, such saving, credit, investment or other financial activities. The activities of the bank gave a big profit to the bank. Bank has two functions in general which is collecting funds from the public and distributing funds to the community. Bank collects funds from the public through savings, time deposits, demand deposits, or other forms of deposits. By raising funds, bank guarantees the security of the money by giving interest for the funds. After raising funds, the bank will distribute the funds to those who need it through a credit or loan system. Credit offered by the bank has charge interest to the borrower.

Credit is the largest source of income and profit for banks. In addition, credit is also a type of fund usage activity which is often become the main cause of banks facing the big problems. Therefore, Pratama (2013) said bank business stability was influence by success in managing their credit. Sitanggang and Marshall (2018) said throughout the year 2017, Bank Umum Kelompok Usaha (BUKU) IV success to accounted high growth. According to the calculations of the Otoritas Jasa Keuangan (OJK) in Statistik Perbankan Indonesia (SIP) last year, BUKU IV bank obtained net profit after tax reached RP. 86,85 trillion. The figure is up 25, 76 % compared to the year 2016, which is reached RP. 69,56 trillion. The most profitable source of bank income from banking operations is profit from interest and profit sharing. Interest and profit sharing are the income that the bank receives from the parties who borrow money to the bank. UU RI number 10, 1998 concerning banking, explain credit is the provision of money or bills that can be equalized, based on the agreement and borrowing agreements between banks and other parties that require the borrower to repay the debt after a certain period of time with interest, reward, or profit sharing (Booklet Bank Indonesia, 2012). The definition shows the credit will be helpful for anyone who needs financial assistance. In the other hand, the credit as one of the tools that shows the bank performance, because when the income of credit is rise, it will be positive impact to the bank performance. The bank's performance was quite positively in 2017, which was demonstrated by the growth of bank assets in which driven by credit and third party funds. Bank Indonesia (BI) added the statement of bank credit growth throughout 2017 was 8.1% (year on year). Credit growth increase compared with period 2016 in which is 7, 8% (Melani, 2018).

Based on Akhar (in Tahir and Ahmad, 2014) is opinion Credit operations are the main source of income for banks, and at the same time are the primary source of risk. Meanwhile Talbot and Jakeman (in Alhadab and Alsahawneh, 2016) are indicated the potential losses from which the bank will suffer, borrower failed to pay, or meet the interest payment on the loan obligations and repayment of the amount borrowed under the terms that have been agree between the bank and the borrower. The credit risk is one of the biggest risks facing the banks, and arises from the possibility that loans or bonds held by banks will not be pay back either in part or in full. In addition, to the credit risk which is often synonymous with the risk of default. To mitigate the risks, in principle, banks would set aside a specific amount as a cushion to absorb expected loan losses, many local and international organizations have taken many steps to minimize the negative effects of such risks, and the developed several procedures and policies that should be followed to avoid these risks. One of the most important steps was creating the Loan Loss Provision (LLP) or provisions for bad debts. In Indonesia, the establishment of provision of such funds is referred to as PPAP (Penyisihan Penghapusan Aktivia Produktif), and after the revision of PSAK 55 in 2006, the term of PPAP is replaced with CKPN (Cadangan Kerugian Penurunan Nilai) or Penyisihan Kerugian Kredit (Loan Loss Provision). Loan loss provision is provisioning for credit losses on the loan portfolio and its funding which occurred impairment in economic value (Budiarti, 2012). Provisioning for losses is important so that the bank financial statements representation actual situation. CKPN (Cadangan Kerugian Penurunan Nilai) or Loan Loss Provision is provision established by a bank if there is objective evidence of impairment of financial asset or group of financial assets as a cause of one or more events occure after the initial recognition of the asset and impacting the estimated future cash flow. Therefore, loan loss provision is an important tool that has employed to reduce the risk of customers' failure to pay their liabilities to the bank. Beatty and Lioa (in Alhadab and Alsahawneh, 2016), defined Loan Loss Provision as a policy that followed by commercial banks by putting some money aside (reserves) to face any potential loans default, which in turn would help to protect banks' positions in terms of profitability and capital.

Bank Performance could be evaluating by bank profitability. Sustainability banks depend on bank profitability and performance because banks must generate the income needed to cover their operating costs issued in banking activities. Assessment of financial performance of banking is one of the important factors for banks to see how the bank in performing, whether the performance already good or not. (Lipunga 2014),

defined Profitability could be calculated using Return on Assets (ROA). The level of profitability with the ROA aims to measure the ability of bank management to manage assets controlled to generate income. According to Tahir (2014), stated the independent variables to examine the impact of loan loss provision on bank profitability are Loan Loss Provision, Liabilities, Advances, deposits, and size of banks. This research will find out the independent variables such loan loss provision, liabilities, deposits, and size of banks. While dependent variable of this research are Return on Assets (ROA) as proxy of profitability.

Taking into description above, this research has interested to *Analyzing the effect of Loan Loss Provision on Bank Profitability.*

Research Objectives

The objective of this research is to analyze the effect of loan loss provision in bank profitability in Indonesia commercial banks those listed on the Bursa Efek Indonesia (BFI).

THEORETICAL FRAMEWORK

Financial Management

Financial management is an integral part of overall management. It is concerned with the duties of the financial managers in the business firm. Financial management is one of the important parts of overall management, which directly related with various functional departments like personnel, marketing and production. Financial management is focused on decision making with an eye toward creating wealth. It will deal with financial decisions such as when to introduce a new product, when to invest in a new asset, when to replace existing assets, when to borrow from banks, when to issue stock or bonds, when to extend credit to customer, and how much cash to maintain (Keown, 2002).

Loan Loss Provision

Loan Loss Provision has a key role to strengthen the financial position of the banks. loan loss provision is a reserve that established by the bank to deal with the risk of losses due to investment in productive assets. Loan loss provision as a policy that followed by commercial banks by putting some money aside (reserves) to face any potential loans default, which in turn would help to protect banks' positions in terms of profitability and capital Beatty and Lioa (Alhadab and Alsahawneh, 2016).

Bank Profitability

Profitability is the ability of a company to generate profits from its operating activities results from its business activities during a certain period. There are two types of profitability ratio. The ratios indicate the profitability of the sales and the profitability of investment (Van Horne, 2002). The group profitability ratio is to measure the firm's profit to sale figure, the level of particular asset or investment of the owner, (Gitman and Zutter, 2012). The ratio of the most widely used by investors is the ROA and ROE", (Rose and Hudgins, 2010).

Return on Assets

This ratio measured the effectiveness of management in generating profits compared with the availability of existing assets. The higher the value of this ratio indicates that the company is performing better, (Gitman and Zutter, 2012).

Liabilities

Liabilities are legally binding obligation that are payable to another person or entity. Settlement of a liability can be accomplishing through the transfer of money, goods, or services. Liabilities are either the deposits of customers or money that banks borrow from other sources to use to fund assets that earn revenue.

Deposits

Deposits are like debt in that money of the banks own to the customer but they differ from debt in that the addition or withdrawal of money is at the discretion of the depositor rather than dictated by contract. Bank Deposits consist of money placed into banking institutions for safekeeping. These deposits has made to deposit accounts such as saving account, checking account, and money market account.

Previous Research

Tahir (2014) is studying about the effect of loan loss provision on the stability and performance of banks working in Pakistan. The results in this study described the loan loss provision as an important factor in

affecting profitability of banks in ideal condition, a well establish bank is supposed to be having less loan loss provision and higher profitability moreover bank deposits and its advances also play a vital role in the stability and profitability of banks.

Alhadab and Alsahawneh (2016) are studying about loan loss provision and the profitability of commercial banks: evidence from Jordan. This study provides the first evidence that loan loss provision has a negative impact on the profitability of Jordanian commercial banks. This evidence suggests that Jordan banks adjust their loan loss provision due to several motives and, this in turn, leads to negative consequences for their profitability.

Mustafa (2012) are studying about does the loan loss provision affect the banking profitability of the banks operating in Pakistan. The results show that the loan loss provision of the banks is of paramount importance in affecting its profitability. In addition, banks advances and deposits which is represent the vital role for the determination of banking profitability.

Hypothesis

Consistent with these finding, the researcher have hypothesized the following:

H_1: There is significant effect of LLP on ROA

H_2: There is significant effect of liabilities on ROA

H_3: There is significant effect of deposits on ROA

H_4: There is significant effect of size on ROA

Conceptual Framework

In supporting this research, researchers use a conceptual framework to explain the research model that shows how the variables were used in this study.
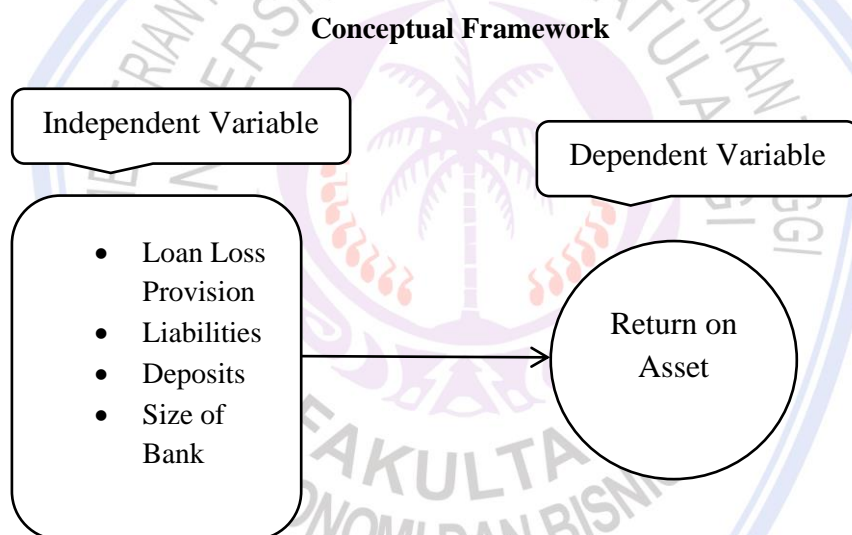
Conceptual Framework

Figure 1. Conceptual Framework

Source: Theoretical Review (2018)

RESEARCH METHOD

Research Approach

This research is a quantitative research, and the design will use in this research is the hypothesis test, because this research wants to know the effect of loan loss provision on bank profitability which is measured by return on asset (ROA). Type of this research is causal type research where it will analyze the effect of loan loss provision. Causal study is a research study conducted to establish cause-and-effect relationship among variable (Sekaran and Bougie, 2010).

Population, Sample and Sampling Technique

Population is a generalization area, which is consists of object or subject that have certain quantities and characteristics set by the researcher to be study. Population refers to the entire group of people, events, of things of interest that the researcher wishes to investigate (Sekaran and Bougie, 2010). The population of this research is the banking company who listed in Bursa Efek Indonesia (BEI).

Sample is a part of the population number and characteristics possessed by the population or small part of the population taken, according to certain procedures. Sample is a subset of the population, (Sekaran and

Bougie, 2010). The sample will use in this research is the banking company who listed in Bursa Efek Indonesia (BEI) and who fulfilled the requirements used in this research. The technique used to determine the sample is purposive sampling. Purposive sampling is techniques to determine the sample of research with some specific considerations that aims to obtain data more representative (Sugiyono, 2013).

Data Collection Method
        This research is using the documentation method, which is the data gets from official website of Bursa Efek Indonesia (BFI) and assisted with the data of official website bank itself.
Operational Definition of Research Variables
        This research is multiple influenced between four independent variables to one dependent variable. Independent variables are Loan Loss Provision, Liabilities, Deposits, and Size of Bank. The dependent variables are Return on Assets.
Data Analysis Method
        The data analysis method in this research is using SPPS 20 software to interpret the data, while another analysis method is descriptive statistic and multiple regression analysis. The descriptive analysis used to provide an overview of the demographics of the respondents, and to describe the variable value of mean, minimum, maximum, and standard deviation, a guide in the process of analyzing data to find the final result of the research. Multiple regression analysis must meets with classical assumption. Therefore, before the data was used, the data must clear with classical assumption. The regression analysis is using to estimate the relationship between one dependent metric and one set of metric or independent variables. The regression analysis will produce an equation or regression model. Multiple regression analysis is used in a situation where more than one independent variable to explain variance in the dependent variable (Sekaran and Bougie, 2010).
Hypothesis Testing
        Hypothesis testing is the process about parameters by setting up null and alternative hypothesis, gathering sample data, computing statistic form the sample and using statistical techniques to reach conclusion about the hypothesis. This research use T_{test} to help the researcher to find out the relationship between dependent and independent variables.

RESULT AND DISCUSSION
Result
Descriptive Statistic Result
        This research is using descriptive statistic to describe and show the data summarized in terms of mean, standard deviation, the maximum and the minimum value for each variable used in this research.
Table 1. Descriptive Statistic

Descriptive Statistics				
	N	Minimum	Maximum	Mean	Std. Deviation
LLP	40	502	8900	3358.53	2160.488
LIAB	40	12681	95890	46011.35	26225.373
DEP	40	10464	86591	37370.80	25509.053
SIZE	40	79053	954898	447966.65	292053.998
ROA	40	-.0490	.0503	.026198	.0175868
Valid N (listwise)	40				

Source: Data processed, 2018
        The result of descriptive statistic above shows the value of the minimum, the maximum, mean, and standard deviation of each variable. The table shows number of observation is 40. The ROA ranges from -0.049

to 0.0503, the average value of ROA is -0.026, and the standard deviation of ROA is 0.017. The LLP ranges from 502 to 8900, while mean of this main variable is 3358.53, and the standard deviation of LLP is 2160.488. Liabilities range 2681 to 95890, and the average of liabilities is 46011.35, the standard deviation of liabilities is 26225.373. Deposit ranges 10464 to 86591, while the average is 37370.80, and the standard deviation is 25509.053. Size ranges 79053 to 954898. Mean of size is 447966.65, and standard deviation is 292053.998.

Classical Assumption Result
The multiple regression analysis needs to meet basic assumption as shown below
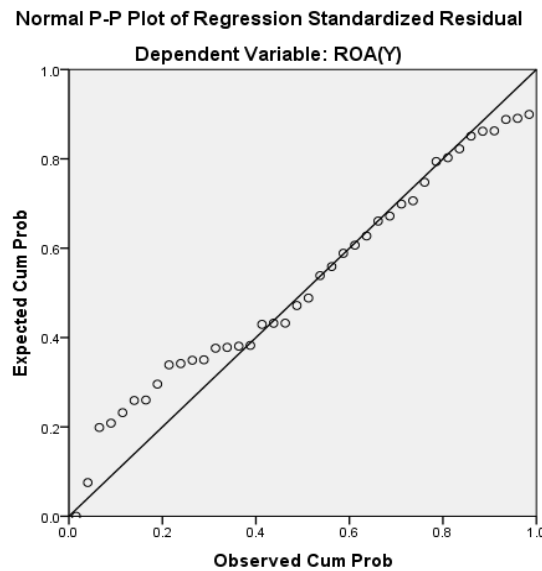

Figure 2. Normality Test Output
Source: Data processed, 2018

Figure 2. shows the data is presenting by the dots are spreading almost near with the diagonal line but not follow the direction of diagonal line. This proves the model is normal.

Table 2. Multicollinearity Test Output

Model		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	LLP	.942	1.062
	Liabilities	.227	4.402
	Deposits	.273	3.663
	Size	.648	1.542

Source: Data processed, 2018

The tolerance value of LLP is 0.942, tolerance value of liabilities is 0.227, tolerance value of deposits is 0.273, and tolerance value of size is 0.648. That means the tolerance values of those variables are more than 0.1. While the VIF value of LLP is 1.062, the VIF value of liabilities is 4.402, the VIF value of deposits is 3.663, and the VIF of size is 1.542. That means the VIF values of the variables are less than 10. It has shown the variables are free of multicollinearity.
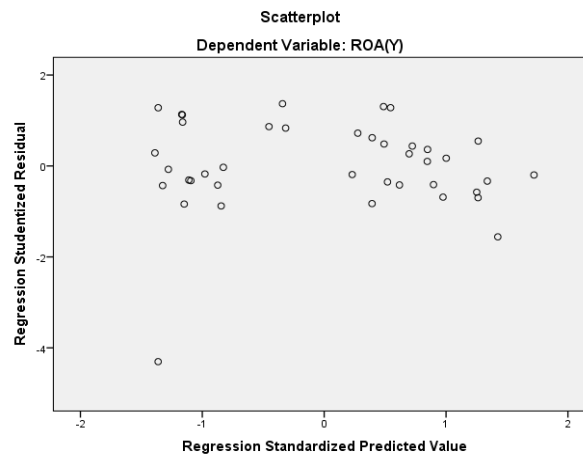
Figure 3. Heteroscedasticity Test Output

Source: Data processed, 2018

Based on the output, Scatterplot shows the dots is spreading without particular pattern and the dots are below and above zero on the Y's axis. It proves the data is free of heteroscedasticity.

Multiple Regression Analysis Result

The result of multiple regression analysis will show at table 4.5 below with coefficients. This test is using 1-tailed to determine the significant value, where the formula is (Sig : 2) < 0.05.

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.004	.006		.711	.482
LLP	6.182E-007	.000	.076	.546	.588
LIAB	3.229E-007	.000	.481	1.701	.098
DEP	-5.512E-008	.000	-.080	-.310	.759
SIZE	1.530E-008	.000	.254	1.516	.139

Source: Data processed, 2018

The multiple regression analysis is using to determine the influence of four independent variables on one dependent variable and the calculation process of correlating analysis. The computed result of the variables has done by SPSS 20 software. The computerized calculation ensures the accuracy of the analysis. The model of regression defined as:

$$\text{ROA}_{it} = \alpha_{it} + \beta 1\ X1_{it} + \beta 2\ X2_{it} + \beta 3\ X3_{it} + \beta 4\ X4_{it} + e$$

$$\text{ROA}_{it} = 0.004_{it} + (6.182)\text{LLP}_{it} + (3.229)\text{LIAB}_{it} - (5.512)\text{DEP}_{it} + (1.530)$$

$$\text{SIZE}_{it} + e.$$

1.   Constant = 0.004

Constant positive value indicated if the independent variable is positive, then the influence to dependent variable is positive. It means if the independent variable is zero and the variable dependent will be 0.004. If the independent variables rise, then the ROA will be rises.

2.   LLP = 6.182

It shows the value of LLP to ROA. It means if LLP rise up one rupiah, then ROA will be rises 6.182. The coefficient value is positively, it means there is influence between LLP and ROA. The significant value is (0.588 : = 0.294 > 0.05.

2.   LIAB = 3.229

It shows the value of LIAB to ROA. It means if LIAB rise up one rupiah, then ROA will be rises 3.229. The coefficient value is positively, it means there is influence between LIAB and ROA. The significant value is (0.098 : 2) = 0.049 < 0.05.

3.   DEP = -5.512

It shows the value of DEP to ROA is negative. It means if DEP rise down one rupiah, then ROA will be down -5.512. The coefficient value is negatively, it means there is no influence between LIAB and ROA. The significant value is (0.759 : 2) = 0.379 > 0.05.

5.   SIZE = 1.530

It shows the value of SIZE to ROA. It means if LIAB rise up one rupiah, then ROA will be rises 1.530. The coefficient value is positively, it means there is influence between SIZE and ROA. The significant value is (0.139 : 2) = 0.069 > 0.05

Based on the result of multiple regression analysis, the loan loss provision has influence on return on asset as a proxy of bank profitability. It means, if loan loss provision in the bank increases, then bank profitability will increase too. Since providing loan loss provision to overcome bank losses is the main solution of bank, therefore the bank is trying to increase the establishment of provision or allowance to overcome losses. This passion of bank creates difficulties for the bank itself. Why is difficult? Because, when the bank must establish the loan loss provision, the asset of bank will decrease, and it will be make the bank did not show the actual assets to the public. The output of the multiple regression analysis is also shows the control variables of this research such liabilities, deposits, and size of bank. The liabilities and size of bank are influence on return on asset. It means if the liabilities and size of bank are increases, then return on asset will increase too. This thing happened because the liabilities and size of bank are two accounts whose help the bank's capital, and if the capital of the bank is high, the bank will run their business bigger and certainly the bank will get more return. Different with other, the deposits is negatively influence on return on asset. It happened because deposits made from savings from customer and other banks. The bank is only a tool customers used to run their business by means if the business is gaining profit, the profit will share-out.

Hypothesis Testing Result

The T_{test} is using to determine the effect of each independent variable to dependent variable, considering the other variables remain constant. T_{test} value will obtain by comparing T_{count} with T_{table}. If T_{count} is more than T_{table}, then H_o is rejected and H_1 is accepted. If T_{count} is less than T_{table}, then H_o is accepted and H_1 is rejected.

Table 4. T_{test} Output

Model	Unstandardized Coefficients		Standardized Coefficient		
	B	Std. Error	Beta	t	Sig.
1 (Constant)	.004	.006		.711	482
LLP	6.182E-007	.000	.076	.546	.588
LIAB	3.229E-007	.000	.481	1.701	.098
DEP	-5.512E-008	.000	-.080	-.310	.759
SIZE	1.530E-008	.000	.254	1.516	.139

Source: Data processed, 2018

The partial influence variables will explain as follows:

1)   LLP(X1) to ROA(Y)

Rejected H_0 If $T_{count} > T_{table}$, or accepted H_0 If $T_{count} < T_{table}$.

T_{count} of LLP is 0.546. The value on T_{table} used to comparison the finding at the level of significant is 0.05, which is the confidence level is 95%. The outcome of T_{table} is 1.305. Comparing T_{count} with T_{table} : 0.546 < 1.305. The T_{count} is less than T_{table}, then H_0 has accepted and H_1 has rejected. Thus, LLP has not significant effect on ROA.

2)   LIAB(X2) to ROA(Y)

Rejected H_0 If $T_{count} > T_{table}$, or accepted H_0 If $T_{count} < T_{table}$.

T_{count} of LIAB is 1.701. The value on T_{table} used to comparison the finding at the level of significant is 0.05, which is the confidence level is 95%. The outcome of T_{table} is 1.305. Comparing T_{count} with T_{table} : 1.701 > 1.305. Since the T_{count} is more than T_{table}, then H_0 has rejected and H_1 has accepted. Thus, liabilities have a significant effect on ROA.

3)   DEP(X3) to ROA(Y)

Rejected H_0 If $T_{count} > T_{table}$, or accepted H_0 If $T_{count} < T_{table}$.

T_{count} of DEP is -0.310. The value on T_{table} used to comparison the finding at the level of significant is 0.05, which is the confidence level is 95%. The outcome of T_{table} is 1.305. Comparing T_{count} with T_{table} : -0.310 < 1.305. Since the T_{count} is less than T_{table}, then H_0 has accepted and H_1 has rejected. Thus, deposit has not significant effect on ROA.

4)   SIZE(X4) to ROA(Y)

Rejected H_0 If $T_{count} > T_{table}$, or accepted H_0 If $T_{count} < T_{table}$.

T_{count} of LLP is 0.546. The value on T_{table} used to comparison the finding at the level of significant is 0.05, which is the confidence level is 95%. The outcome of T_{table} is 1.305. Comparing T_{count} with T_{table} : 1.530 > 1.305. Since the T_{count} is less than T_{table}, then H_0 has accepted and H_1 has rejected. Thus, size of bank has not significant effect on ROA.

The result of T_{test} shows the hypothesis of loan loss provision, and size of bank rejected, because the T_{count} of the variables are less than T_{table}. Therefore, the loan loss provision has not significant effect on bank profitability, as well as size of bank. The hypothesis of deposits rejected because the T_{count} of the deposits are less than T_{table}. Therefore, deposit has not significant effect on bank profitability. Liabilities are different with other variable, because liabilities have a significant positive effect on bank profitability. It proved by result of T_{test} has shown the T_{count} value of liabilities is less than T_{table}. Therefore, the hypothesis of liabilities accepted. Finally, T_{test} answer the effect of loan loss provision and other variable on bank profitability.

CONCLUSION AND RECOMMENDATION

Conclusion

This research is using multiple regression analysis to test the hypothesis where this research has examined the effect of loan loss provision on bank profitability. The result of this research shows the loan loss provision has no significant effect on bank profitability. The loan loss provision has influence but has not significant effects on bank profitability. The result of output of multiple regression shows the influence of loan loss provision is positive. Therefore, if the loan loss provision increases, then the return on asset will increase. Based on the finding, the main variable in this research has a positive effect to profitability but not significant. It means the banking will be get profits on loan loss provision but there is possibility to getting losses.

The result of this research is also finding the effect of variables control used in this research. Deposits and size of bank have not significant effect on bank profitability, where the deposits has a negative influence but has not significant, while the size of bank has a positive influence but has not significant too. Liabilities have a significant effect on bank profitability. The result of this research stated only liabilities has a significant positive effect on bank profitability.

Recommendation

Based on the conclusion above, there is a recommendation of this research, as follow:

1)   As for the banking company, since found the loan loss provision has influence on bank profitability as a positive but not significant, means the banking company can get profit and losses as the same time. Therefore, the banking should pay attention to establishment the loan loss provision to anticipate the decline of profitability that will be obtained by the bank itself, or bank should pay attention to whose they have to give credit, so that the credit risk could be anticipated.

2)   As for the future researcher, since this research is only to prove the hypothesis, then it is good to pay attention with the sample was used of the object who wants to researched.

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