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The Effect of Lending, Third-party Funds, and Company Size on Profitability of Banking Companies Listed on IDX

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ABSTRACT: Banking performance is an important part of the infrastructure for formulating strong macroeconomic and monetary policies at the national level in terms of the level of profitability that can be generated. This study aims to analyze the effect of lending, third-party funds, and company size simultaneously and partially on profitability. Profitability can be measured by calculating the bank's financial performance ratio from the financial statements published every year. The data analysis technique used in this study is multiple linear regression analysis using SPSS on 38 companies selected through the purposive sampling method. The results of this study indicate that lending, third-party funds, and company size have a positive effect on the profitability of banking sector companies for the 2016-2020 period listed on the Indonesia Stock Exchange (IDX). The theoretical implication of this research is to provide empirical evidence that this research is following agency theory which explains the relationship between agent and principal in the form of the nexus of contract cooperation. Meanwhile, the practical implications of this research are a consideration for investors and other related parties in making decisions based on profitability.

KEYWORDS: *Lending, Third-party Funds, Company Size, Profitability*

I. INTRODUCTION

The banking industry is an important part of the monetary sector to support the government's strategy in the regional economy (Supartoyo et al., 2018). A bank is always required to have financial performance that can inspire customer trust so that they are confident and feel safe in transacting with a bank so the profitability ratio becomes a reference in assessing this (Sondakh et al., 2021).

Bank profitability can be seen by calculating the bank's financial performance ratio from the financial statements published every year. The financial report in the form of a balance sheet will provide information to parties outside the bank, such as the Central Bank, the public, and investors to assess the financial position of a bank (Sari & Septiano, 2020). 3 ratios are generally used in calculating the profitability of banks by the Circular Letter of the Financial Services Authority Number 9/SEOJK.03/2020 concerning Transparency and Publication of Conventional Commercial Bank Reports, namely Return on Assets (ROA), Return on Equity (ROE), and Net Interest Margin (NIM).

One of the main activities of banks to increase profitability is the provision of credit. Credit distribution has an important role for banks to earn interest, the more loans disbursed, the interest income that will be received by the bank will increase along with the increase in profitability. One indicator to see the level of bank lending is the Loan to Deposit Ratio (LDR). LDR is an assessment of a bank's ability to carry out its operational activities by comparing total deposits in the form of Third-party Funds collected by banks to total loans (Asri & Suarjaya, 2018). The total credit referred to is the provision of loan funds to third parties (not including credit to other banks). Meanwhile, DPK (Third-party Funds) in question are funds obtained by banks originating from savings, current accounts, and deposits by third parties to channel credit and investment. LDR can show the level of credit expansion carried out by banks, so this ratio can be a benchmark for measuring whether the bank's intermediation function is running (Utami and Putra, 2016).

The management needs to pay attention to the percentage of the LDR ratio that remains within the safe limit determined by Bank Indonesia. Research related to the influence of the level of lending proxied by LDR on profitability as proxied by profitability has been widely carried out, including research conducted by (Octaviani & Andriyani, 2018), and (Peling & Sedana, 2018) giving the result that LDR has a positive effect on profitability. Meanwhile, the results of the research conducted by Sukma & Yadnyana (2019) showed that LDR had a negative effect on profitability. In addition, the research conducted (Praja, 2018) gives the results of LDR does not have a significant effect on profitability.

The source of funds is the most important thing for banks to increase the amount of credit that will be distributed to the public. In providing credit, the banking sector needs the availability of funds. The more bank funds, the greater the opportunity for the bank to carry out its functions. Third-party funds (TPF) are funds sourced from the wider community which are an important source for bank operational activities and are a measure of the success of a bank if the bank can bear its operating costs from this source of funds (Kasmir, 2018).

Many studies related to the influence of third-party funds on profitability have been carried out, but the results obtained vary widely. Previous research has found that third-party funds have a positive effect. This can be seen from the more TPF, the LPD manages these funds by redistributing it in the form of credit, with distribution, of course, it will get income in the form of interest, the increase in interest income means the LPD gets a profit contribution so that profitability increases (Putri et al., 2020). On the other hand, research conducted on rural credit banks shows that TPF does not affect profitability. TPF does not affect profitability due to an imbalance between the number of incoming funds and the amount of credit extended to the public. The higher the third-party funds collected in the bank but not matched by lending, the possibility of the bank experiencing a loss or decreasing profitability because the interest income from lending to debtors is not sufficient to cover interest costs that must be paid to depositors.

Company size is also an important element that affects banking performance. Company size is a scale to assess the size of an entity, whether a company is a small, medium, or large company. Utari (2019) states that the size of the company can be measured from the total assets in an entity or company so the greater the total assets owned, the greater the size of the entity. Company size can be calculated using the total assets of the company at the end of the period. The following study measures the size of a company using total assets because total assets are representative and stable compared to sales which can be influenced by supply and demand (Agustini & Sulindawati, 2020).

II. CONCEPTUAL MODEL AND HYPOTHESIS

The bank's main source of income is loan interest obtained from lending. Therefore, the level of lending by the bank will greatly determine the amount of income earned by the bank. In agency theory, when the agency problem can be suppressed, this indicates that the conflict of interest between the principal, agent, and depositor has been minimized. This shows that the manager has made the right decision in determining the level of lending using optimal third-party funds with minimized risks to bring in higher profits. If it is associated with the abstinence theory, every loan disbursement made to the debtor should receive a reward in the form of interest. The greater the credit distributed, the greater the rewards obtained so that the profits obtained by the company will increase. The level of lending disbursed to the public or customers can be seen from the LDR ratio. LDR is the ratio between total credit and total funds raised, the greater the LDR ratio indicates that the volume of lending to the bank is increasing. Research conducted by Romli & Alie (2017), Fahmi et al. (2018), Putri et al. (2020), Astutiningsih & Baskara (2018), and (Saleh & Winarso, 2021) give the results that LDR has a positive effect on profitability as proxied by NIM.

H_1: Lending has a positive effect on profitability

The source of funds is the most important thing for banks to increase the amount of credit that will be distributed to the public. In providing credit, the banking sector needs the availability of funds. The more bank funds, the greater the opportunity for the bank to carry out its functions. Third-party funds (TPF) are funds sourced from the wider community which are an important source for bank operational activities and are a measure of the success of a bank if the bank can bear its operating costs from this source of funds (Devi, 2022). Banks are expected to always be in the community so that the flow of money from people who have excess funds can be accommodated and then channeled back to the community. The bank's main advantage comes from sources of funds with interest to be received from certain allocations. DPK increases, and the bank has the opportunity and the opportunity to have high profitability. Research conducted by Asri and Suarjaya in 2018 shows that third-party funds have a positive effect on profitability. Parenrengi and Hendratni's 2018 research also found that third-party funds can affect profitability. The study entitled “Analysis of the effect of third-party funds, capital adequacy ratio, and loan to deposit ratio on bank's profitability after the application of IFRS” shows that third-party funds can affect profitability (Sari & May 2017). If the third-party increases, the profitability will increase with the assumption that bank lending is smooth.

H_2: The level of lending has a positive effect on profitability

Company size reflects the size of the company which can be seen in the total value of the company's assets such as the number of branch offices. The larger the size of the company, the more the company has the resources and assets to make a profit. This is because large companies tend to have more stable conditions. Research conducted by Unal et al. (2017) on the manufacturing industry in Turkey showed positive results on

profitability as assessed using Return on Assets (ROA). In addition, other previous studies also mention that company size has a significant positive effect on the profitability of commercial banks listed on the Indonesia Stock Exchange. The size of the banking company in this study reflects the size of the banking company which can be seen in the total value of the company's assets such as the number of branch offices. With the larger the size of the bank, the company will have more resources and assets in the form of branch offices and human resources to make a profit. This is because large companies tend to have more stable conditions. This stability will make large companies tend to be able to generate greater profits than smaller companies (Adawiyah & Suprihhadi, 2017).

H_3: Company size has a positive effect on profitability

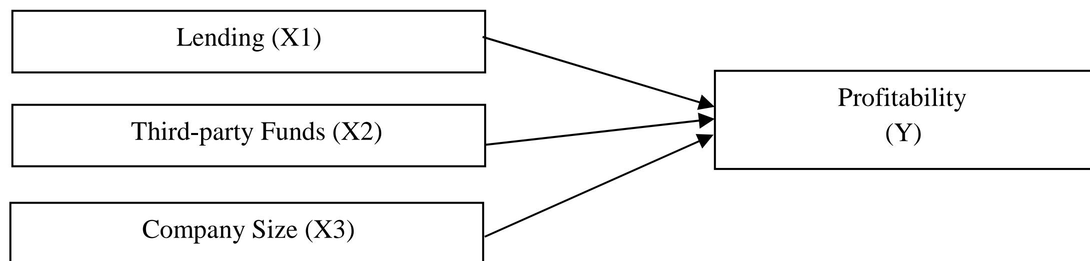

Figure 1. Conceptual Framework

III. RESEARCH METHODS

This study uses a quantitative approach in the form of an associative. This research was conducted on banking sub-sector companies listed on the Indonesia Stock Exchange (IDX) for the 2016-2020 period. Where the scope of the research chosen in this study is all types of banking listed on the Indonesia Stock Exchange. The population used in this study are all banking sub-sector companies listed on the Indonesia Stock Exchange from 2016-2020. The sample selection of this study was based on a non-probability approach using the purposive sampling method. The data analysis technique used in this research is a multiple linear regression test with the help of the SPSS program. However, before that, descriptive analysis and classical assumption test will be carried out which include a normality test, multicollinearity test, heteroscedasticity test, and autocorrelation test.

The operational definitions of variables in this study are as follows:

1) Lending
   The level of lending is measured by the Loan to Deposit Ratio or LDR ratio. The greater the LDR ratio indicates that the volume of lending at the bank is increasing. The formula used in calculating the LDR ratio as stated in Pujiati et al (2020) is as follows:
   LDR = Total Third-party Credit/Total Third-party Funds x 100
2) Third-party Funds
   Third-party funds (savings) are funds entrusted by the public to banks based on agreements for depositing funds in the form of demand deposits, time deposits, certificates of deposit, savings, and other forms. The formula used to calculate third-party funds as stated in (Riadi, 2018) includes three main components:
   Third-party Funds = Current Account + Savings + Time Deposit
3) Company Size
   The size of the company in this study is expressed by total assets, the greater the total assets of the company, the greater the size of the company. The larger the assets, the more capital is invested. Company size can be seen from the total assets owned by the company.

IV. RESULTS AND DISCUSSION

The sample of this research was taken by the purposive sampling method. The purposive sampling method is sampling based on the consideration of the research subject. The sample is selected based on the suitability of the characteristics with the specified sample criteria to obtain a representative sample. The sample selection criteria are presented in Table 1 below.

Table 1. Process and results of sample selection based on criteria

No	Information	Total
1	Companies that are included in the banking sub-sector are listed on the Indonesia Stock Exchange from 2016 to 2020.	45
2	Conventional commercial banking presents complete Financial Statement data regarding the variables that will be used in this study.	7
	Number of samples	38

Source: *Secondary data processed, 2021*

Table 2. Multiple Linear Regression Analysis Results

Coefficients[a]

	Unstandardized Coefficients		***Standardized Coefficient***		
Model	**B**	***Std. Error***	**Beta**	**t**	**Sig.**
1 (*Constant*)	-,002	,009		-,259	,796
LDR	,010	,010	,077	1,054	,043
DPK	,018	,026	,176	2,184	,030
SIZE	,003	,002	,135	1,670	,470

Source: *Secondary data processed, 2021*

Multiple linear regression equations can be formulated as follows:
Y = -0,002+0,010X1 +0,018X2 +0,003X3

Information:

Y = Profitability
X_1 = Lending
X_2 = Third-party Funds
X_3 = Company Size

The Effect of the Level of Lending on Profitability

The first hypothesis (H1) states that the level of lending has a positive effect on profitability. Testing using multiple linear regression shows that the level of credit distribution has a positive coefficient value of 0.010 with a significance level of 0.043 which is smaller than alpha (0.05). The test results state that the level of lending affects profitability, so it can be concluded that H1 is accepted.

The bank's main source of income is loan interest obtained from lending. Therefore, the level of lending by the bank will greatly determine the amount of income earned by the bank. In agency theory, when the agency problem can be suppressed, this indicates that the conflict of interest between the principal, agent, and depositor has been minimized. This shows that the manager has made the right decision in determining the level of lending using optimal third-party funds with minimized risks to bring in higher profits. If it is associated with the abstinence theory, every loan disbursement made to the debtor should receive a reward in the form of interest. The greater the credit distributed, the greater the rewards obtained so that the profits obtained by the company will increase. The level of lending disbursed to the public or customers can be seen from the LDR ratio. LDR is the ratio between total credit and total funds raised, the greater the LDR ratio indicates that the volume of lending to the bank is increasing. In a study conducted by Romli & Alie (2017), Fahmi et al. (2018), Putri et al. (2020), Astutiningsih & Baskara (2018), and Pincur (2018) gives the results that LDR has a positive effect on profitability.

The Effect of Third-party Funds on Profitability

The second hypothesis (H2) states that third-party funds affect profitability. Testing using multiple linear regression shows the results that third-party funds have a positive coefficient value of 0.018 with a significance level of 0.030 which is smaller than alpha (0.05). The test results state that third-party funds affect profitability, so it can be concluded that H2 is accepted.

The source of funds is the most important thing for banks to increase the amount of credit that will be distributed to the public. In providing credit, the banking sector needs the availability of funds. The more bank funds, the greater the opportunity for the bank to carry out its functions. Third-party funds (TPF) are funds sourced from the wider community which are an important source for bank operational activities and are a measure of the success of a bank if the bank can bear its operating costs from this source of funds (Devi, 2022). Banks are expected to always be in the community so that the flow of money from people who have excess funds can be accommodated and then channeled back to the community. The bank's main advantage comes from sources of funds with interest to be received from certain allocations. DPK increases, and the bank has the opportunity and the opportunity to have high profitability. Research conducted by Asri and Suarjaya in 2018 shows that third-party funds have a positive effect on profitability. Parenrengi and Hendratni's 2018 research also found that third-party funds can affect profitability.

The Effect of Company Size on Profitability

The third hypothesis (H3) states that firm size affects profitability. Testing using multiple linear regression shows that the firm size has a positive coefficient value of 0.003 with a significance level of 0.047 which is smaller than alpha (0.05). The test results state that firm size affects profitability, so it can be concluded that H3 is accepted.

Company size reflects the size of the company which can be seen in the total value of the company's assets such as the number of branch offices. The larger the size of the company, the more the company has the resources and assets to make a profit. This is because large companies tend to have more stable conditions. Previous research stated that company size has a significant positive effect on the profitability of commercial banks listed on the Indonesia Stock Exchange. The size of the banking company in this study reflects the size of the banking company which can be seen in the total value of the company's assets such as the number of branch offices. The larger the size of the bank, the more the company has the resources and assets in the form of branch offices and human resources to make a profit. This is because large companies tend to have more stable conditions. This stability will make large companies tend to be able to generate greater profits than smaller companies (Adawiyah & Suprihhadi, 2017).

V. CONCLUSION

The results of this study provide empirical evidence regarding lending, third-party funds, and company size affecting profitability. The results of this study can contribute to the development of agency theory. This theory explains the relationship between the agent (business manager) and the principal (business owner) in the form of a nexus of contract cooperation, where the principal as the authority authorizes other parties to carry out the authority (agent) to carry out the company's activities. The results of this study can be used as consideration for investors and related parties who will make decisions based on profitability.

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