CHAPTER I

INTRODUCTION

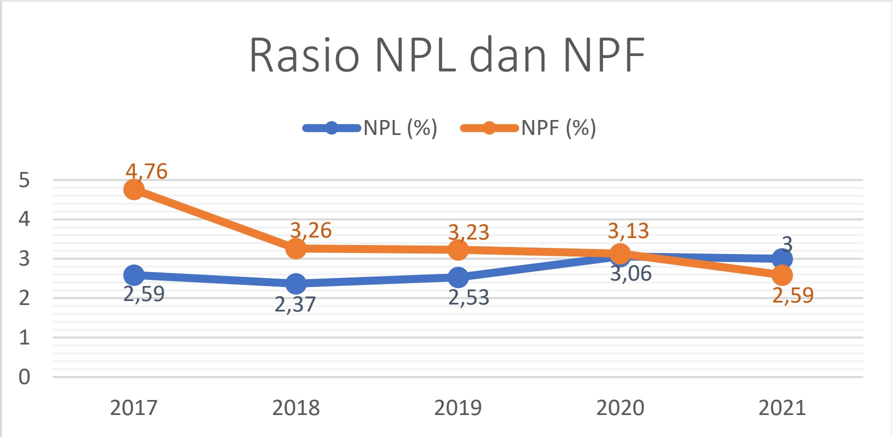
1.1 Background of the Research

Indonesia's economy is growing more rapidly, causing the needs and desires of the people related to funds to increase. The bank has a function as a financial intermediary between parties who have excess funds and those who have a shortage of funds. According to UU No. 10 Tahun 1998 defines that a bank is a business entity that collects funds in the form of savings and distributes these funds to the public in the form of credit or other forms in order to improve the standard of living of the community. Meanwhile, according to (Nasution et al., 2022) the function of a bank is to collect funds from the public through savings, time deposits, demand deposits, or other forms of savings. then distribute it in the form of credit or loans to those who need it and issue banknotes to improve the standard of living of the wider community. In its operational activities, banking is divided into two, namely conventional banks and Islamic banks, these two types of banks have the same function. The main difference between the two types of banks is based on the regulations and policies that apply.

Conventional bank regulations and policies are regulated in UU No. 10 Tahun 1998 and Islamic banks are regulated in UU No. 21 Tahun 2008. Conventional banks carry out their activities only for profit by using an interest system and for bank services applying various fees in a certain nominal or percentage. Meanwhile, Islamic banks carry out banking activities in accordance with Islamic provisions. Islamic banks do not recognize the interest system, because according to Islam interest is usury which is unlawful. So that profit only comes from profit sharing or revenue sharing between business actors and fund owners. One of the risks faced by banks, both conventional and Islamic banks, is Non-Performing Loan or non-performing financing. The cause of problematic financing is because the debtor fails to fulfill its obligations (Effendi et al., 2017). Credit risk in conventional banking is reflected in the Non-Performing Loan (NPL) ratio, while financing risk in Islamic banking is reflected in the Non-Performing Financing (NPF) ratio.

NPL or NPF can be used as an indicator in assessing the performance of bank functions and as a representation of the risk of disbursed financing and has a direct impact on banking profitability (Isnaini et al., 2019). NPL or NPF is one of the main causes of economic stagnation because it can affect company performance. NPL or NPF shows how much collectability the company has in recovering credit/financing that has been disbursed. The level of problem loans is reflected in the NPL or NPF credit ratio, which is used to measure a bank's ability to handle the risk of default by debtors. The lower the NPL ratio, the lower the level of Non-Performing Loan, which means the bank is in good condition. Based on the provisions of Bank Indonesia No.15/2/PBI/2013, the minimum value of the NPL or NPF ratio is said to be healthy if it is not more than 5%. In the Kompas Daily release in October 2020 it was said that the Non-Performing Financing (NPF) ratio of Islamic banks is better than conventional banks. This can be proven from the graph of NPL and NPF levels at Conventional banks and Islamic banks in 2017-2021.

Figure 1.1 Non-Performing Loan Ratio and Non-Performing Financing



Source: Statistik Perbankan Indonesia, OJK 2022 (processed)

Seen from Figure 1.1, the level of NPL at conventional banks from 2017 to 2019 tends to be stable, but in 2020 NPL has increased from the previous 2.53% to 3.06%, this increase is still below the ratio limit set by Bank Indonesia, which is < 5%. Whereas the highest NPF achieved by Islamic banks was 4.76% which occurred in 2017, but from 2018 to 2021 the NPF value has decreased every year. The picture above proves that the NPF ratio in Islamic banks is better than conventional banks because the lower the NPL/NPF ratio, the lower the level of Non-Performing Loan / Non-Performing financing that occurs, which means that the bank's condition will be better. Providing credit/financing is the most important bank activity to generate profits. Bank activities are related to and influence the development of external and internal banking environmental factors. External factors are macro variables from outside banking activities that are formed from monetary and fiscal policies, while internal factors are bank specific factors that come from banking operational activities listed in financial ratios.

To see bank health indicators and analytical tools to predict the profit that will be generated, you can pay attention to the bank's financial performance, such as the Loan to Deposit Ratio (LDR) or Financing to Deposit Ratio (FDR), Capital Adequacy Ratio (CAR), and External factors are macro variables from outside banking activities that are formed from monetary and fiscal policies, while internal factors are bank specific factors that come from banking operational activities listed in financial ratios. To see bank health indicators and analytical tools to predict the profit that will be generated, you can pay attention to the bank's financial performance, such as the Loan to Deposit Ratio (LDR) or Financing to Deposit Ratio (FDR), Capital Adequacy Ratio (CAR), and Operational efficiency ratio (BOPO) and External factors are macro variables from outside banking activities that are formed from monetary and fiscal policies, while internal factors are bank specific factors that come from banking operational activities listed in financial ratios.

Table 1.1 Operational efficiency ratio, CAR, LDR

Conventional Commercial Banks (%)

Year	BOPO	CAR	LDR
2017	78.64	23.18	90.04
2018	77.86	22.97	94.78
2019	79.39	23.40	94.43
2020	86.58	23.89	82.54
2021	83.55	25.66	77.49

Source: Statistik Perbankan Indonesia, OJK 2022 (processed)

Based on table 1.1 above, it can be seen the inconsistency of the BOPO, CAR, LDR ratio data. In the 2018 period the BOPO ratio decreased from 78.64% to 77.86%, then experienced an increase from 2019 and 2020, and again decreased in 2021. In addition, the CAR ratio decreased from 23.18% to 22.97, but in 2019 to 2021 CAR has increased. The LDR ratio has increased in 2018 from 90.04% to 94.78%, but in 2020 the LDR ratio has decreased quite significantly compared to the previous year, which was 94.43% to 82.54%.

Table 1.2 Operational efficiency ratio, CAR, FDR

Islamic Banking (%)

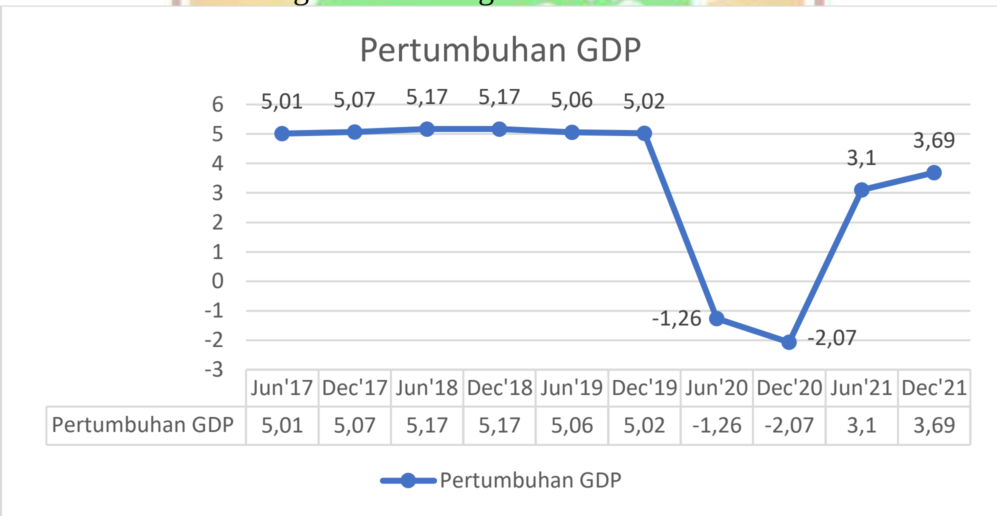
Year	BOPO	CAR	FDR
2017	94.91	17.91	79.61
2018	89.18	20.39	78.53
2019	84.45	20.59	77.91
2020	85.55	21.64	76.36
2021	84.33	25.71	70.12

Source: Statistik Perbankan Indonesia, OJK 2022 (processed)

In table 1.2 ratio Operational efficiency ratio, CAR, FDR in Islamic commercial bank is more consistent than conventional commercial banks, the Operational efficiency ratio has decreased every year where the lower the Operational efficiency ratio owned by the bank shows that the operational costs incurred are used very efficiently. Therefore, the high or low Operational efficiency ratio of a bank will affect the non-performing credit risk/non-performing financing risk that occurs. In addition, the CAR ratio has increased every year the greater the amount of CAR, the bank has sufficient ability to cover the risk of existing losses

(Ismaulina et al., 2020). Therefore, CAR will affect the occurrence of Non-Performing Loan. The FDR ratio also decreases every year, the FDR ratio owned by Islamic commercial banks has very healthy criteria because the lower the FDR value, the lower the probability that the level of bad debts ratio will be. According to (Firmansyah, 2014), a high FDR ratio indicates that more funds are disbursed for customer financing, and vice versa. NPL or NPF are not only influenced by bank specific factors but are also influenced by macroeconomic factors. In this study the factors that affect the level of NPL or NPF are GDP Growth and Inflation.

Figure 1.2 GDP growth in Indonesia



Source: Badan Pusat Statistik (processed)

Based on Figure 1.2, the GDP ratio in June 2017 to December 2019 GDP growth in Indonesia was very stable, but in June 2020 it decreased quite drastically to reach a minus value of -1.26% and in December 2020 GDP growth decreased again compared to the previous figure -2.07. In 2021 GDP growth begins to increase, the GDP growth rate in 2021 is better than in 2020. This is because if sales and income of individuals or companies decrease, it will affect the ability of individuals or companies to return their obligations. If the GDP ratio is low, it will have a negative impact on the level of Non-Performing Loan or Non-Performing Financing.

Table 1.3 Inflation ratio in Indonesia (%)

Year	Inflation
2017	3.61
2018	3.13
2019	2.72
2020	1.68
2021	1.87

Source: Bank Indonesia

Inflation is an increase in the price of goods that occurs in general and continuously. When a country's inflation rate increases, it will have an impact on decreasing people's purchasing power which can make sales decrease So that companies that make credit loans to banks will have difficulty paying off these loans So that the NPL/NPF ratio will increase. Table 1.3 shows that Indonesia's inflation has decreased every year. The development of low inflation was influenced by well-managed aggregate demand, the strengthening rupiah exchange rate.

The following are Some of the results of previous research that examines what factors can influence Non-Performing Loan and non-performing financing. As for including research conducted by Prastowo & Usman (2021), conducted research on 10 Islamic banking and 10 conventional commercial banks from the first quarter of 2019 to the third quarter of 2020. The results of the study show that the NPL/NPF is significantly and positively influenced by LDR/FDR. These results are supported by research conducted by (Wood & Skinner, 2018) which shows that the LDR ratio has a positive effect on NPL. But this is contrary to research conducted (Isnaini et al., 2019) which shows that LDR and FDR have a significant negative effect on NPL and NPF. While in the research conducted (Juliani, 2022) shows that LDR has an insignificant effect on NPL. Research conducted by Prastowo & Usman (2021) BOPO has a significant positive effect on NPL. These results are in accordance with research conducted by Isnaini et al. (2019) shows that BOPO has a positive effect on NPL and NPF. This is contrary to the research conducted Juliani (2022) shows that BOPO has an insignificant effect on NPL. Research conducted by Prastowo & Usman (2021) CAR is positively significant to NPL. These results are in accordance with research conducted by Isnaini et al. (2019) shows that CAR has a positive effect on NPL and NPF. In contrast to this study, research by Retnowati & Jayanto (2020) shows that CAR has a negative and significant influence to NPF. Meanwhile, in (Juliani, 2022) shows that CAR have insignificant effect on NPL. Research conducted by Prastowo & Usman (2021) show that inflation has a significant negative effect on NPL. The results of this study are supported by research conducted by Isnaini et al. (2019) which shows that inflation has a negative significant effect on NPLs. Meanwhile, according to research conducted (Wood & Skinner, 2018) Inflation has insignificant effect on NPL.

Based on Some of the research results previously mentioned, there are varied results and indicate a research gap of these variables which fluctuate from year to year with various problems encountered in that year. Besides that, based on empirical studies of previous research, it was found that there were several research gaps in these variables which still need to be re-examined. Researchers chose Conventional Commercial Banks and Islamic Banking because the NPL level has increased every year in the 2017-2021 period. While the level of NPF has decreased every year. NPL and NPF are important matters for financial stability and bank management which are used to anticipate banking crises. Therefore, the ratio of NPL and NPF must be considered because banking is a sector that is expected to have bright prospects in the future.

Based on the explanation and description above, researchers are interested in conducting research with the title "**The Influence of Bank Specific Factors and Macroeconomics on Non-Performing Loan and Non-Performing Financing** (Study of Conventional Commercial Banks and Islamic Commercial Banks for the 2017-2021 Period)"

1.2 Problem Statements

From the background described above, the formulation of the problem in this study is:

1. How does Operational efficiency ratio effect on Non-Performing Loan and non-performing financing?
2. How does CAR effect on Non-Performing Loan and non-performing financing?
3. How does LDR/FDR effect on Non-Performing Loan and non-performing financing?
4. How does GDP growth effect on Non-Performing Loan and non-performing financing?

5. How does inflation effect on Non-Performing Loan and non-performing financing?

1.3 Objective of the Research

Based on the background and problem formulation that has been stated previously, the objectives of this research are as follows:

1. To find out and analyze the influence of Operational efficiency ratio on Non-Performing Loan and non-performing financing.
2. To find out and analyze the effect of CAR on Non-Performing Loan and non-performing financing.
3. To find out and analyze the effect of LDR/FDR on Non-Performing Loan and non-performing financing.
4. To find out and analyze the effect of GDP growth on Non-Performing Loan and non-performing financing.
5. To find out and analyze the effect of the inflation on Non-Performing Loan and non-performing financing.

1.4 Contributions of the Research

This research is expected to provide benefits for interested parties as follows:

1. For Writers

   As input to add insight and understanding on the influence of Bank Specific Factors and Macroeconomic Effects on Non-Performing Loan and Non-Performing Financing

2. For Companies

   It is hoped that this research can be used as a work evaluation in banking and provide an overview of the influence of Non-Performing Loan and non-performing financing.

3. For Academics

   This research can be used as a reference in the field of similar research and as a reference for further research development.

1.5 Scope of the Research

The scope of the research aims to make the research focus on the subject matter. The object of research used is conventional commercial banks listed and Islamic Commercial Banks on the OJK for the period 2017-2021 which has issued financial reports.

1.6 The Writing system

The systematics of writing in this study consists of five chapters which have their respective functions and purposes of writing. The systematics of writing are as follows:

CHAPTER I: INTRODUCTION

This chapter is an introductory chapter which contains the background, problem statement, objectives of the research, contributions of the research, scope of the research and writing system.

CHAPTER II: LITERATURE REVIEW

This chapter contains the theoretical basis consisting of a literature review, framework of thought, previous research and hypotheses.

CHAPTER III: RESEARCH METHODS

This chapter describes the data and data Sources, data collection methods, population and research samples, research variables, and data analysis techniques that will be carried out by the author.

CHAPTER IV: RESULTS AND DISCUSSION

This chapter contains an explanation of the research results which will be described by the author based on the results obtained from data that has been processed using the system and hypotheses that have been made.

CHAPTER V: CONCLUSION

This chapter is a closing which contains the conclusions from the results of the analysis and puts forward Some suggestions as improvements for further research.