

# CHAPTER 1

## INTRODUCTION

### 1.1 Background of the Study

Banking companies are financial institutions that are considered vital in the economy. It is the center of the financial system by acting as a financial intermediary which makes economical activities a lot more efficient and easier. In Indonesia itself, the meaning of bank is written in *UU RI No. 10 Tahun 1998: Bank adalah badan usaha yang menghimpun dana dari masyarakat dalam bentuk simpanan dan menyalurkannya kepada masyarakat dalam bentuk kredit dan atau bentuk-bentuk lainnya dalam rangka meningkatkan taraf hidup rakyat banyak*. All banking companies in Indonesia are under the supervision of Bank Indonesia and those registered companies must report directly to Bank Indonesia regarding any information of the business including the annual financial statements.

For holding such a large role in the economy, the profitability of banking companies is expected to be in a good number to keep the business going. Based on the data derived from *Otoritas Jasa Keuangan (OJK)*, it's stated that the profitability ratio per March 2019 was 2.6%. There's an additional increase of 0.05% from the year before. This number is calculated using the Return of Assets (ROA) as an indicator (Sitanggang, 2019). In 2018, the total profits of banking companies reached 150.01 trillion Rupiah, an increase of 14.37% from the year prior. As per September 2019, the total profits accumulated are 117.59 trillion Rupiah (Sahara, 2019).

It's a general knowledge that there's no company with zero balance on its liabilities account. Leverage is an internal aspect of a business, as it's basically the utilization of borrowed capital to improve the prospective return of the business's investments (Hayes, 2020a). Banking companies are highly leveraged institutions and the leverage of the banking sector is higher compared to other sectors. It happens because banks play an important role in allocating the savings of the people, with cost as low as possible, for investments and consumptions (Ingves, 2014).

Bambang Haryo Soekartono, the advisory committee of Gapasda dan Iperindo, stated his concern of bankruptcy of state-owned enterprises back in 2019. Bambang said that the 10 state-owned enterprises with the highest liabilities are prone to bankruptcy assuming extreme conditions strike Indonesia. As of December 2018, out of those 10 state-owned enterprises with the highest liabilities, 4 of them are banking companies. Those companies are BRI, BNI, BTN, and Bank Mandiri. Bambang also claimed that the high leverage ratio of state-owned enterprises is the reason why they're having difficulty in expanding (Aryanto, 2019).

Several studies had been conducted regarding the relationship between these two variables. After conducting research on the impact of leverage on profitability, Ahmad et al. (2015) claimed that financial leverage has a significantly negative impact on the profitability of the manufacturing firms in Pakistan. The similar result has also been reckoned by Olang (2017) in Kenya and by Mochi & Dani (2018) in India.

When leverage is an aspect that the bank firms' can actually manage and control, the inflation rate on the other hand, is out of the banks' control. Inflation is an increase in the general level of prices that happens in a country's economy. It's impossible for everyone but the central bank and government to control this by the issuance of policy. Even the Bank Indonesia once stated that their ability to control the inflation rate is very limited since the inflation can also be influenced by some "shocks" like how the abrupt increase in the fuel oil price back in 2005 and 2008 causes a spike in Indonesia's inflation rate (*Inflasi*, n.d.).

When inflation happens, it raises interest rates. The increase of interest rate might give a boost to the bank's profitability. But on the other hand, inflation also increases cost of funds which can reduce the profitability (prof. jeevitha R, 2019). In 2018, when Rupiah weakened by more than 9% since the beginning of that year, the profitability of banking companies in Indonesia seemed to be doing just fine. OJK stated that there's an increase in the banking companies' net profit as per July 2018 (Agustio, 2018).

The study conducted by prof. jeevitha R (2019) shows that there is a negative correlation between inflation rate and profitability of banking companies in India. The similar result has also been reckoned by Hooshyari & Moghanloo (2015) in Iran. On the contrary, Gikombo & Doris (2018) finds that inflation rate positively influences the profitability of commercial banks in Kenya though they stated that it is only significant toward ROA and is insignificant toward ROE.

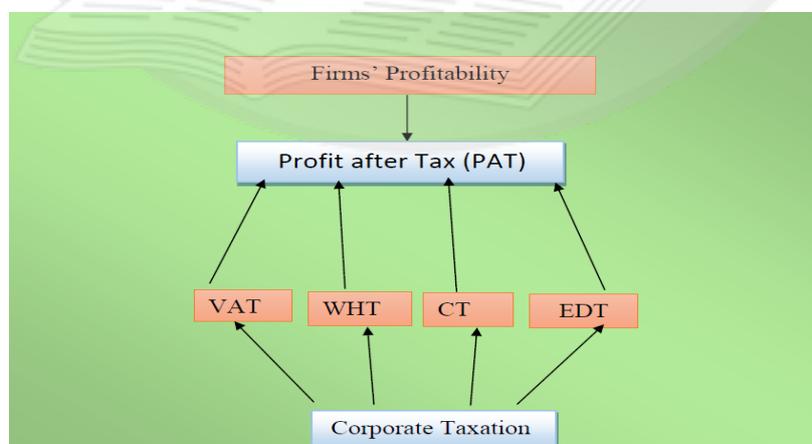
There's also another variable that is impossible to be ignored by every individual and entities, and bank institutions are no exception: tax. As stated in UU

*KUP No. 28 Tahun 2007*, tax is defined as *kontribusi wajib kepada negara yang terutang oleh orang pribadi atau badan yang bersifat memaksa berdasarkan Undang-Undang, dengan tidak mendapatkan imbalan secara langsung dan digunakan untuk keperluan negara bagi sebesar-besarnya kemakmuran rakyat.*

Tax is one of the income sources for a country. Corporate tax is imposed on the income of the company and is considered as an expense. Hence, tax will surely reduce a corporation's income (Olaoye & Alade, 2019).

In March 2021, the Corruption Eradication Commission or more widely known as KPK, did an investigation on Bank Panin's main office regarding the allegation of tax evasion. The documents that were found during the investigation was claimed to be the proof of tax evasion done by Bank Panin for the year 2016 and 2017 by the act of bribery (Kamil, 2021).

According to Kusuma (2018), corporate tax has no influence on the profitability of mining companies in Indonesia. However, Chude & Chude (2015) claimed that corporate tax has a significant positive influence on the profitability of breweries in Nigeria.



**Figure 1.1 Structure of Relationship between Corporate Taxation and Profitability of Manufacturing Firms**

Source: Olaoye & Alade(2019)

From the figure above, Olaoye & Alade (2019) explained that the Withholding, Corporate, and Education Tax as well as VAT are some proxies that made up the corporate taxation based on the regulation that applies in Nigeria. They claimed that all of these four proxies have a positive significant impact on profitability.

**Table 1.1 Total Liabilities, Current Price Index, Tax Expenses and Total Assets of Banking companies in 2015-2019**

Company	Year	Total Liabilities (amount in thousands Rupiah)	Current Price Index	Tax Expenses (amount in thousands Rupiah)	Total Assets (amount in thousands Rupiah)
<b>PT. Bank Pembangunan Daerah Jawa Timur Tbk</b>	2015	36,508,170,000	91.91	376,750,000	42,803,631,000
	2016	35,823,378,000	94.69	423,912,000	43,032,950,000
	2017	43,702,607,000	98.11	477,571,000	51,518,681,000
	2018	54,217,182,000	101.18	493,390,000	62,689,118,000
	2019	67,529,638,000	103.93	487,628,000	76,715,290,000
<b>PT. Bank Maspion Indonesia Tbk</b>	2015	4,495,929,673	91.91	14,463,820	5,343,936,388
	2016	4,369,906,804	94.69	23,841,587	5,481,518,940
	2017	4,892,687,894	98.11	23,663,171	6,054,845,282
	2018	5,493,283,082	101.18	24,200,444	6,694,023,677
	2019	6,340,648,554	103.93	20,693,447	7,569,580,138
<b>PT. Bank CIMB Niaga Tbk</b>	2015	210,169,865,000	91.91	142,119,000	238,849,252,000
	2016	207,364,106,000	94.69	768,991,000	241,571,728,000
	2017	229,354,449,000	98.11	1,177,282,000	266,305,445,000
	2018	227,200,919,000	101.18	1,368,390,000	266,781,498,000
	2019	231,173,061,000	103.93	1,310,962,000	274,467,227,000

Source: prepared by the researcher with data from Indonesia Stock Exchange (2020)

The writer selected Bank *Pembangunan Daerah Jawa Timur (BJTM)*, Bank *Maspion Indonesia (BMAS)*, and Bank *CIMB Niaga (BNGA)* from the list of banking companies registered on *Indonesia Stock Exchange*.

As seen on Table 1.1 above, it is known that the Current Price Index (CPI) keeps increasing from 2017 to 2019, with the average gap of 3 throughout the years. The lowest being 2.75 increase of CPI from the year 2018 to 2019 and the highest being 3.42 increase of CPI from the year 2016 to 2017. All of the companies mentioned above also have an increase in their total assets throughout 2015-2019.

However, from 2015 to 2016, all of them also have a decline in their total liabilities. Bank Pembangunan Daerah Jawa Timur has around 684.8 billion rupiah less of liabilities in 2016 compared to 2015, Bank Maspion Indonesia has around 126 million rupiah less, and Bank CIMB Niaga has around 2.8 trillion rupiah less. Bank CIMB Niaga also has another decline of total liabilities in 2018, around 2.2 trillion rupiah from the amount in 2017.

Another similar happening can also be seen in the declining of all these three companies' tax expenses. From 2018 to 2019, Bank Pembangunan Daerah Jawa Timur's tax expenses decreased around 5.8 billion rupiah, Bank Maspion Indonesia's around 3.5 billion rupiah, and Bank CIMB Niaga's around 57.4 billion rupiah. In 2017 though, Bank Maspion Indonesia also already had a total decrease of 178.4 million rupiah.

Through the many researches that had been conducted previously that showed various results as presented above, the writer is interested to conduct a research titled **“The Impact of Leverage, Inflation Rate and Corporate Tax on Profitability of Banking Companies Listed on Indonesia Stock Exchange.”**

## **1.2 Problem Limitation**

The research will only be conducted on selected banking companies registered on Indonesia Stock Exchange with the financial statements publicly reported as the research material. The financial statements used will be from the year of 2015 to 2019. The research will also be only revolving around leverage, inflation rate, and corporate tax's impact on the profitability.

### **1.3 Problem Formulation**

According to the background of the study above, the problem formulation of this paper is as follows:

1. Does leverage have a significant impact on profitability of banking companies listed on Indonesia Stock Exchange?
2. Does inflation rate have a significant impact on profitability of banking companies listed on Indonesia Stock Exchange?
3. Does corporate tax have a significant impact on profitability of banking companies listed on Indonesia Stock Exchange?
4. Do leverage, inflation rate and corporate tax have a significant impact on profitability of banking companies listed on Indonesia Stock Exchange?

### **1.4 Objective of the Research**

Conforming to the problem formulation stated above, the objective of the paper is as the following:

1. To find out if leverage has a significant impact on the profitability of banking companies registered on Indonesia Stock Exchange.
2. To find out if inflation rate has a significant impact on the profitability of banking companies registered on Indonesia Stock Exchange.

3. To find out if corporate tax has a significant impact on the profitability of banking companies registered on Indonesia Stock Exchange.
4. To find out if leverage, inflation rate and corporate tax have a significant impact on the profitability of banking companies registered on Indonesia Stock Exchange.

## **1.5 Benefit of the Research**

By conducting this research, some of the benefits that can be gained are:

### **1.5.1 Theoretical Benefit**

The theoretical benefits that can be gained from the research being conducted are:

1. This research can give further understanding on the theory of leverage, inflation rate, corporate tax, and profitability to readers.
2. This research can be used as additional information and reference for future research on the topic of leverage, inflation rate, and corporate tax on profitability.

### **1.5.2 Practical Benefit**

The practical benefits that can be gained from the research being conducted are:

1. This research is expected to give information regarding the impact of leverage, inflation rate and corporate tax on profitability of banking companies for investors.
2. This research is expected to give information regarding profitability for the importance of decision making by the companies.

