Chapter I Introduction

1.1 Background of the Study

1.1.1 Commercial Banks in China

Commercial bank is different from central bank and investment bank, it is a kind of profit-oriented bank with credit creation function. It deals in financial assets and it is financed through debt.

In China, banking supervision is carried out by the China Banking Regulatory Commission (CBRC). Established in 2003, it is authorized by The State Council to formulate operating rules for the banking industry and conduct off-site supervision analysis and evaluation of the business activities and risk status of banking financial institutions (CBRC, 2020).

The core capital of commercial banks includes paid-in capital, capital reserve, surplus reserve, undistributed profit, etc. Core capital should account for at least 50% of total funds. While subsidiary capital includes loan bad debt provision, bad debt provision, investment risk provision and long-term bonds with a maturity of more than five years. The proportion of the debt capital shall not exceed 50%.

Moreover, China Banking Regulatory Commission (2020) stipulates that China's commercial banks' capital adequacy ratios at all levels shall not be lower than the following minimum requirements:(1) Core tier 1 capital adequacy ratio shall not be less than 5%. (2) The tier 1 capital adequacy ratio shall not be lower than 6%. (3) The capital adequacy ratio shall not be lower than 8%.

According to China's National Bureau of Statistics (2019), China's GDP slowed from 6.9 percent in 2015 to 6.1 percent in 2019 due to factors such as the development of sino-US trade frictions, but China's banking sector still grew steadily:

1. The total assets and liabilities of commercial banks grew steadily:

    By the end of 2019, the total assets of commercial banks were 239.5 trillion yuan, compared with 155.8 trillion yuan in 2015, increased 34.94%.

And the total liabilities of commercial banks were 220.1 trillion yuan, compared with 144.3 trillion yuan at the end of 2015, increased 34.43%.

2. The profits of commercial banks are basically stable and their risk offset capacity is sufficient:

    In 2019, commercial banks achieved a cumulative net profit of 2.0 trillion yuan, up 20% from 1.6 trillion yuan in 2015. Commercial banks' loan loss reserve balance was 4.5 trillion yuan, an increase of 49.3 billion yuan from the end of the previous quarter. And the core tier 1 capital adequacy ratio of commercial was 10.92%, up 0.08 percentage points from the end of the previous quarter. Tier 1 capital adequacy ratio was 11.95%, up 0.11 percentage points from the end of the previous quarter; Capital adequacy ratio was 14.64 percent, up 0.10 percentage points from the end of last quarter.
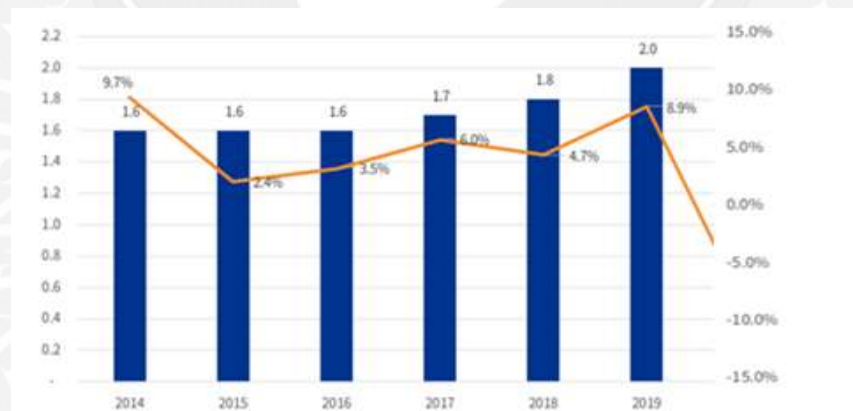

Figure 1 Net profit
Source: China Banking Regulatory Commission, 2020

3. The liquidity level of commercial banks remains stable. At the end of the fourth quarter of 2019, the ratio of deposits and loans (in RMB) was 75.40%, up 1.04 percentage points from the end of last quarter. Liquidity ratio was 58.46%, up 1.44 percentage points from the end of last quarter.

1.1.2 Commercial Banks in Indonesia

Like the CBRC, Indonesia's commercial banking regulator is Otoritas Jasa Keuangan (OJK). The regulation is same with Chinese.

Indonesia's GDP was 5.02% in 2019, after 4.88% in 2015, ending the country's three-year (slow) accelerating economic expansion.

1. The total assets and liabilities of commercial banks were increasing:

   By the end of 2019, the total assets of commercial banks were 8068346 billion Rupiah, compared with 6,095,980 billion Rupiah in 2015, increased 24.4%. And the total liabilities of commercial banks were 2,771,777 billion Rupiah, increased 30 % compared with year 2015.

2. The profits of commercial banks are basically stable and their risk offset capacity is sufficient:

   In 2019, commercial banks achieved a cumulative net profit of 200 billion Rupiah, up 33% from 133 billion Rupiah in 2015. Capital adequacy ratio was 23.4 percent, up 8.5 percentage points from year 2015 with 21.39%. And return on asset are increasing one by year.

Figure 2 return on asset
Source: www.ceicdata.com, 2019

3. The liquidity level of commercial banks remains stable. At the end of the 2019, Loan to deposit ratio was 94.43%, up 2.4 percentage points from 2015 with 92.11%.

1.1.3 Commercial banks performance

Financial system is important in every country, usually it includes the government, financial institutions, corporate, and individuals and so on. Moreover, no matter in Indonesia and in China, commercial banks occupy a vital position in financial system and play an important role in providing financial intermediary services. The performance of a commercial bank refers to its profitability during a certain period of operation.

Compared with enterprises, commercial banks are special in that they operate with currency and liabilities. However, the own capital of commercial banks is

relatively simple, including subsidiary capital and core capital. Therefore, the capital structure of commercial banks is the composition of equity capital and debt capital, as well as their proportion (Kuria, 2013).

Managers of an enterprise need to balance proportion of equity and debt to achieve the optimal capital structure of the enterprise, to maximize the interests of shareholders and the value of the company. For the banks, since the funds that each bank operates are all from non-deposit liability, which means that deposits liability are no longer part of the debt capital of the bank, their capital structure seems to have been at a specific and stable level, and it is hard to states their optimal capital structure (Kuria, 2013).

Therefore, whether in enterprises or banks, their managers need to maintain a good capital structure to ensure the normal operation and profitability of the company.

Many scholars in academic circle have discussed how does the commercial banks' DTA, LTD, CAR and AS influence its performance.

Previous studies by Titman & Wessels (1988) showed that debt ratio had a negative significant effect on its performance. Banks will use less external debt if they have enough internal reserves to finance them. At the same time, as banks' profitability improves, the more capital they have internally, the less dependent they are on external debt to make profits. This research result also just validates the pecking order theory, that banks will give priority to internal financing when investing projects.

Jensen's (1986) study showed that the developing enterprises or banks would need more financing, so in order to expand enterprises, managers would use more external debt financing in the case of interest fee exemption. The maturity of debt and interest payments will increase the pressure on enterprises to promote their full use of capital, efficient work, and efficient performance.

Louati, et al. (2016) found in his study that the higher of a bank's capital adequacy, the higher its security is, which may increase its non-performing loan ratio and reduce its performance.

The reason for this study is that the researchers are interested in commercial banks performance in different countries and want to learn more about the determinants

that influence banks' performance. Therefore, this paper explores how will the LTD, DTA, CAR and AS influence Chinese commercial banks performance and Indonesian commercial banks performance, with four independent variables. According to the final research results, some suggestions are putting forward to improve the performance of commercial banks. I hope to have a more comprehensive understanding of commercial banks through this study.

1.2 Problem Identification

When Chinese researchers study the banks performance, the researchers mainly discuss the influence of the components of the capital structure, which mixes core capital with subsidiary capital, on commercial banks financial performance. Li (2014) had studied the impact of capital structure (core capital and subsidiary capital and capital adequacy ratio) on banking performance; Yao (2020) had studied the impact of capital structure (Shareholding ratio of top five shareholders, core capital and subsidiary capital and capital adequacy ratio) on commercial banking performance. When Indonesian researchers looked at bank performance. It mainly explores the impact of capital structure on the company's performance, or the determinants of capital structure. Nini and Patrisia (2020) had studied how will the capital structure influence the firms' performance. Fauziah and Iskandar (2015) had studied What will determine the capital structure in Indonesian Banking Sector.

The main goal of commercial banks is to maximize profits. Therefore, in this research, we will use the same dependent variables as the previous studies, which represented by ROA and ROE. In addition, in terms of independent variables, capital adequacy ratio will ensure that banks can use their own funds to reduce the losses of depositors and creditors in the event of losses. Debt to asset ratio and total assets are often used in previous studies. As well as the bank's loans to deposits ratio, which rarely appear in previous studies, it greatly affects the core business and profitability of banks.

Therefore, this paper is mainly to study the how will the banks' DTA, LTD, CAR and AS in China and Indonesia influence their performance, hoping that the

conclusions can provide bank management with potential knowledge of performance, and maximize profits.

1.3 Research Questions

Based on the above statement of the problems studied in this paper, we put forward the following questions and demonstrate them in the following chapter to achieve the purpose of this study:

1. Is there a significant impact of loan to deposit ratio on ROA of commercial banks;
2. Is there a significant impact of debt to asset ratio on ROA of commercial banks;
3. Is there a significant impact of capital adequacy on ROA of commercial banks;
4. Is there a significant impact of asset size on ROA of commercial banks;
5. Is there a significant impact of loan to deposit ratio on ROE of commercial banks;
6. Is there a significant impact of debt to asset ratio on ROE of commercial banks;
7. Is there a significant impact of capital adequacy on ROE of commercial banks;
8. Is there a significant impact of asset size on ROE of commercial banks;
9. Is there a simultaneous significant impact of Loan to deposit ratio, debt to asset ratio, capital adequacy and asset size on ROA of commercial banks;
10. Is there a simultaneous significant impact of Loan to deposit ratio, debt to asset ratio, capital adequacy and asset size on ROE of commercial banks?

1.4 Research Objectives

Through the research problems mentioned above, the research objectives of this paper are as follows:

1. To find out if there is a significant impact of loan to deposit ratio on ROA of commercial banks;
2. To find out if there is a significant impact of debt to asset ratio on ROA of

commercial banks;

3. To find out if there is a significant impact of capital adequacy on ROA of commercial banks;

4. To find out if there is a significant impact of asset size on ROA of commercial banks;

5. To find out if there is a significant impact of loan to deposit ratio on ROE of commercial banks;

6. To find out if there is a significant impact of debt to asset ratio on ROE of commercial banks;

7. To find out if there is a significant impact of capital adequacy on ROE of commercial banks;

8. To find out if there is a significant impact of asset size on ROE of commercial banks;

9. To find out if there is a simultaneous significant impact of Loan to deposit ratio, debt to asset ratio, capital adequacy and asset size on ROA of commercial banks.

10. To find out if there is a simultaneous significant impact of Loan to deposit ratio, debt to asset ratio, capital adequacy and asset size on ROE of commercial banks.

1.5 Scope and Limitation of the Study

1. This paper mainly uses four independent variables (loan to deposit ratio, debt to asset ratio, capital adequacy ratio and asset size) and two dependent variables (return on assets and return on equity) to study the impact of DTA, LTD, CAR and AS on the performance of Chinese commercial banks and Indonesian commercial banks respectively due to the insufficient of time.

2. The study used the secondary data, which from the banks' annual report from period 2015 to 2019, so the results were only valid for that period. Due to authors wanted to study bank performance under the same circumstances, and Coronavirus started in the world in 2020, affecting the development of the bank, so the author will remove the data for 2020.

3. In addition, this study takes two countries (Indonesia and China) as our research objects due to the limited time of this study.

4. Moreover, in this study, the researcher only chooses 12 Chinese commercial banks and 13 Indonesian commercial banks due to the limited by the accuracy of results and insufficient of time.

1.6 Significance of the Study

The research respectively explores the correlation between DTA, LTD, CAR and AS of Indonesian commercial banks and their performance and the correlation between DTA, LTD, CAR and AS of Chinese commercial banks and their performance. Through this study, we hope to help some relevant parties:

1. This will help those who manage banks to get a clearer perceive of how the DTA, LTD, CAR and AS of the bank affects the performance, hoping to be helpful to the future development of banks.

2. Future researchers can use the results of this study as a reference to study and explore related studies.

3. Through this research, the author has a deeper understanding of banks performance, and with the help of the professor, author can complete the postgraduate degree course.

1.7 Thesis Structure

The structure of this study is:

The chapter one mainly describes the research background, research problems and research objectives of this paper;

The chapter two mainly summarizes the previous literature and determines the variables of this study;

The chapter three mainly describes the research methods used in this research, and how to collect data and analyze data;

The chapter four is mainly to collect the data according to the methods mentioned in the chapter three to carry out the actual operation, and get the research results.

The chapter five is a summary and suggestion of this study.