Financial Performance and Ownership Structure: A Comparison Study between Community Development Banks, Government Banks and Private Banks in Indonesia

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ABSTRACT

A unique characteristic of Indonesian banking system is the existence of community development banks, which is owned by local governments. This study examines the performance of this type of banks compared to private and federal government banks. The sample of this study consists of 15 community development banks, 56 private banks, and 3 federal government banks from 1995 to 2006. Using the independent t-test appropriate methodology. The financial performance of banks is measured in terms of profitability, capital structure, banks risk, efficiency, size and deposits measures. Government banks are about 11 times larger than community development banks and private banks. Subsequently, they have the greatest amount of current assets, debt, deposit, financing, and operational costs. However, in term of profits, either operational or net, their amount is not statistically different from the other two types of banks. In fact, in term of net profit, only community development banks show positive amount. Net profit between community development banks and private banks is significantly different. Community development banks have better ROA than government or private banks but the different is only significant between community development banks and private banks. In term of ROE, government banks have the highest ROE but it is not statistically significantly different to community development banks. ROE of either

community development banks or government banks is significantly higher than that of private banks.

Key Words: Financial Performance, Ownership Structure, Community Development Banks, Government Banks, Private Banks.

1. INTRODUCTION

Bank institution in Indonesia have three form of ownership structure are private, government and community development banks. Government bank established and owned by the government. Government bank was divided into two are central government and regional development banks. One of the unique of banking systems in Indonesia are the existences of community development banks (BPD), which govern and owned by local government. BPD categorized as focused bank, ie the bank with regional focus. Thus, BPD able to create a healthy banking structure and able to meet the needs of the community and promote the ongoing economic development in Indonesia.

According to Li and Simerly (1998), the ownership structure of bank affect the level of oversight of effort manager in order to improve bank's performance. Those who own majority of stock disposed to conduct more monitoring in management and influence the managers to improve the performance of company. Pedersen and Thomsen (2000) found that the form of ownership of company has significances influence toward performance of company. The administrative structure of government which is too bureaucratic caused government as principle difficulties in monitoring manager work as agent in the course of managing bank. Inefficiency government banks happened because of every policy must be considered to political interest and using of resources to support them (Shleifer & Vishny, 1986, Shleifer, 1998)

Several studies have documented that government banks have lower assets, higher cost and lower quality asset rather than private banks (Berger et al., 2004; Micco et al., 2004; Berger et al., 2005). In addition, Cornett et al. (2010) state that the government banks earn lower profits, have small capital and high risk of loan, so as reduce the bank's performance. They found that in financial crisis, the government banks have performed better than private banks in term of cash flow, capital base and loan quality. And after financial crisis, private bank have performed better than government banks in terms of capital adequacy ratio, asset quality and management efficiency.

The objective of this paper is to examine the relationship of the different attributions of the performance measures of Indonesian banks in their ownership structure. Considering the nature and objective of the present study, we have used analytical measures of financial performance of banks measured of profitability, capital structure, banks risk, efficiency, size and deposits measures. This paper will add knowledge on the limited available literature as there is no an extensive study on the government and private banks. Where government banks which operating in developing countries tend to have lower profitability, lower margins, and higher overhead costs than comparable private banks. When the focus on industrial countries, we find a much weaker relationship between performance and ownership (Micco et al, 2007).

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2. LITERATURE REVIEWS

The issue of literature was explained of comparison private bank performance and government banks (Barry et al., 2011). This shows that the government has a different bank in determining the bank manager. Agency cost of government bank is agents in the government bureaucracy that could give rise to weak incentives and fault management in resource allocation. According to the explanation of agency costs, managers use a little effort compared to divert resources for personal gain such as career purposes, political purposes of the government's bank owners. Inefficient goverment banks as a political and policy consider the use of resources to support them (Shleifer & Vishny, 1986; Shleifer, 1998).

Farazi et al. (2011) examine the comparison government banks and private banks in the Middle East and North Africa region. From his research found those differences to ROA, ROE, total assets and the loans. Private Banks have higher of ROA and ROE compared to the government banks but the government banks have higher total asset than private banks. The government banks more efficient in cost rather than private banks. The study related to Valahzaghard et al . (2012) which found that ROA and ROE of private banks is higher than government banks for case study in Iran.

Kapur and Gualu (2012) study about eight Ethiopian commercial banks from 2001 to 2008 period. The results revealed that private sector banks had better profitability, asset quality and capital adequacy performance. The government banks were better in cost management measures. In terms of liquidity, no difference was observed between the private and government banks.

Micco et al. (2007) study about the relationship between bank ownership and performance of banks in 179 countries. They found that government bank is negatively related to developing countries and no effect on industrialized countries. Government bank in developing countries tends obtained a little more income and higher costs compared with private bank. They did not find evidence of a difference between the performance of government banks and domestic private sector in industrialized countries. The study related to Cornett et al. (2010) which found that during financial crisis, the government banks are better than private banks in terms of cash flow, capital base and loan quality. After the financial crisis, banks are private banks have performed better than the government in terms of the ratio of bank capital adequacy, asset quality and management efficiency.

Fu and Heffernan (2008) investigate bank in China for the period 1985-2002. The results shows that the private banks are more profitable than government banks, because of private bank have higher growth and higher profitability and efficiency rather than government banks, despite having a market share which is smaller than the government bank. The study related to Iannotta et al. (2007) which study about three forms of bank ownership are private banks, Government banks and government bank mixture with a sample of 181 banks in 15 European countries for the period 1999-2004. Bank performance is measured using the gross profit. The results showed that the government banks have a smaller profit rather than private banks because government bank have lack of capital, lower deposit, small amount of lending to banks and highly liquid so as government bank cannot work optimally. The study related to Jia (2009) which found that government bank have lower deposit to loan and higher ratio of loan to total assets compare to the form of bank ownership combined private and foreign banks in China.

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Reaz (2005) found that government ownership of banks is negatively related to bank performance in Bangladesh. The study related to Demirgüç-Kunt et al. (2008) which found that government ownership of banks is negatively related to bank performance in the survey by Moody's. Taboada (2011) found that private banks have performed better than the benchmark government bank loan growth in countries with low corruption rate.

Berger et al. (2005) using data from the country of Argentina in 1990 and found that government banks have not performed well before privatization. After the privatization, the bank performance has increased. Results of this study related to Omran (2007) who investigate 12 banks in Egypt for the period 1996-1999. At that time, many government banks to be privatized form of ownership change. The results showed that the private banks have advantage and greater efficiency of bank ownership by the majority coalition government. This study contrasts with the findings Althasoglou et al. (2008) which find that private banks did not lead to better performance.

3. DATA AND METHODS

Data employed for the purpose of this study were obtained from financial statements of 74 commercial banks that operated in the Indonesia banking industry. The time period of the study was from 1995 to 2006, the data are taken from banks' annual reports of the fiscal year ends on December 31 of each year. In this study using panel data and the data set consists of 56 private banks, 3 government banks, and 15 community development banks, a total of 74 banks altogether.

To empirically compare performance parameters of government, Community development bank (CDB) and private sector banks in Indonesia, this research used the independent t-test appropriate was adopted. The financial performance of banks is measured in terms of profitability, capital structure, banks risk, efficiency, size and deposits measures. Each measure has different variables within it. The financial parameters are computed from the balance sheet and income statement of the banks taken in to account for study period. Measurement variable are :

1) Profitability : Traditionally, two types of measures of bank performance are taken in the literature. The first one is ROA, which is a general measure for bank profitability reflects bank ability to achieve return on its sources of fund. ROA can be estimated by dividing net income on total assets. The second measure is ROE, which measures the return on equity capital, can be estimated by dividing net income on equity capital
2) Capital structure: A bank that carries a high level of debt may face the problem of not being able to service the debt in the future, hence affecting the performance. Capital structure is measured by equity to total assets.
3) Banks risk: The smaller is the risk, the higher would be the profit, hence the higher the performance. Risk is measured by liquid assets or current assets to total assets and loans to total assets.
4) Efficiency: The more efficient is the bank, the higher will be the profit. The higher the cost the less profitable banks are. To counter this effect, banks would charge a higher cost of intermediation. Efficiency is measured by operating cost to total assets.

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5) Size: Size also plays a role in performance. The bigger is the size of a bank, the better would be the performance of a bank. Size is measured by natural log of assets.
6) Deposits: Deposits given by depositors to a bank can increase the banks profit since they are being serviced by a lower cost of interest. Deposits are measured by deposits to total loan.

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4. FINDING AND DISCUSSION

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For the purpose of this study, the ownership structure of bank in Indonesia divide into three categories are government bank, private banks and community development bank (BPD). The private banks overseen by individuals, the goverment bank owned and supervised by the central goverment while the BPD monitored by the local goverment. In Table. 1 which divide banks into three form of wonership structure and provide a brief description of them. This study found that among the three form of bank, goverment bank have a highest value in their assets, total debt, total deposits, total loans and operating expenses, and follwed by second highest is private bank, and the lower value for BPD. The result showed the total asset of goverment bank is IDR 65.1 trillion compared with BPD only IDR 2,7 trillion and IDR 5,9 trillion for private banks. Its mean that goverment banks are much larger than other banks in Indonesia and this difference is significant at level one percent. BPD has a small total asset because they only focus on certain areas only.

Table 1: Comparisons of mean (standard deviation) of selected variables between different types of banks

Variables	Private banks (n=672)	Community development banks (n=180)	Government banks (n=36)	Significant difference
Total assets	5,888,263,308,119 (17,216,649,359,33)	2,705,277,110,697 (3,388,437,285,49)	65,075,719,062,671 (47,834,105,072,59)	a, d, g
Total equity	325,201,955,434 (2,471,358,412,290)	223,679,169,368 (291,013,420,157)	2,051,270,550,874 (11,089,950,599,00)	ts1, ts2, ts3
Total debt	5,563,061,352,685 (16,148,294,740,00)	2,481,597,941,329 (3,117,959,152,00)	63,024,448,511,797 (42,831,945,446,45)	a, d, g
Total deposit	6,101,843,953,800 (27,396,327,296,33)	1,873,817,998,063 (2,865,820,804,829)	55,903,735,104,231 (45,279,184,243,146)	a, d, g
Total loans	2,301,946,832,554 (5,962,466,543,665)	1,101,807,508,874 (1,624,482,045,201)	29,362,901,495,626 (22,071,834,129,449)	a, d, g
Total costs	705,859,540,863 (2,472,108,470,777)	117,898,818,331 (144,081,534,062)	9,194,995,073,540 (11,753,955,768,503)	a, d, g
Operating income	720,426,127,403 (2,475,831,402,165)	187,708,216,487 (250,221,517,324)	1,868,839,009,171 (10,843,820,994,740)	a, ts2, ts3
Net income	-121,599,584,877 (2,118,300,115,365)	49,304,411,726 (83,151,837,810)	-1,213,154,933,578 (10,079,114,101,965)	b, ts2, ts3

Table 1: (Continue)

Variables	Private banks (n=672)	Community development banks (n=180)	Government banks (n=36)	Significant difference
ROA	0.293% (9.146%)	1.723% (2.537%)	-6.638% (31.070%)	a, ts2, ts3
ROE [1]	5.825% (77.400%)	15.540% (45.356%)	41.186% (108.022%)	a, f, ts3
EQUITY	12.237% (12.755%)	9.181% (3.904%)	-5.427% (35.430%)	a, f, h
LOANS	54.598% (62.572%)	41.704% (16.425%)	52.583% (31.601%)	ts1, ts2, i
COST	8.049% (11.066%)	6.920% (12.149%)	19.320% (30.163%)	ts1, ts2, h
LIQUID	91.618% (18.441%)	92.211% (16.693%)	87.461% (20.843%)	ns1, ns2, ns3
DEPOSITS	246.159% (302.216%)	214.261% (210.891%)	267.151% (465.144%)	ts1, ts2, ts3
LNASSET	27.3755 (1.88338)	27.8574 (1.37877)	31.5069 (0.81903)	a, f, g

[1]For ROE, 19 bank-years are dropped since these banks have negative total equity. For ROE, the sample for private banks, community development banks dan government banks are respectively 659, 179 and 29 respectively.

ROA is net income to total assets, ROE is net income to total equity, EQUITY is equity to total assets, LOANS is loans to total assets, COST is operating costs to total assets, LIQUID is Current assets to total assets, DEPOSITS is deposits to total loans, LNASSET is natural logarithm of total assets.

a, b,c, or ns1 shows that the mean difference of a variable between private and community development banks is significant at either 1%, 5%, 10%, or not significant at all.

d,e,f, or ns2 shows that the mean difference of a variable between private and government banks is significant at either 1%, 5%, 10%, or not significant at all.

g,h,i, or ns3 shows that the mean difference of a variable between community development and government banks is significant at either 1%, 5%, 10%, or not significant at all.

Total assets are divided into two parts, are equity and debt. for govermant bank, the amount of equity is IDR 2,05 trillion or equity fund as much 3,15% of the total assets while the total equity of private banks is IDR 325,2 billion and for BPD is IDR 223,7 billion. However the difference in the amount of equity for the three types of banks is not significant but based on the ratio of equity to total assets (EQUITY) for the three types of bank are significant, where equity of goverment bank, PBD and private bank are respectively -5.427%, 9.181% and 12.23%. this indicates that private banks have the highest equity ratio. This is caused if the private banks have a problem, the shareholders who are individuals or families responsible to resolve the problem to increase the equity held by them. This is occoured because their invenstment are not well diversified. Therefore, to avoid the financial problem, shareholder of privet banks will increase the use of equity. Another posibility why equity ratio of private bank is higher because sample selection bias. Because of this study did not obtain data for the private banks that are not in operation, so sample for private bank in this study only for the bank which still operating, in which the banks my not face financial problem. This is one reason why equity ratio for private banks is higher than the goverment bank and BPD.

Meanwhile, debt finance 96.85%, 94.47% and 92.73% of the total assets of the government banks, private banks and RDB. Total debt to government banks, private banks and RDB each is IDR 63.02 trillion, IDR 2.48 trillion and IDR 5.56 trillion. The difference of total debt for the three types of banks is significant at the level one percent. This shows that government bank have the highest debt. Because of the size of the government is very large banks, the predicted using of debt is even greater. The high of using debt will not cause any problems because the government will not let government banks bankrupt because it will give a great influence on investors' confidence in the banking system in Indonesia.

Total deposits of government bank are IDR 55.9 trillion compared with BPD (1.9 trillion) and private banks (IDR 6.1 trillion). This shows that government banks are much larger than other banks in Indonesia and this difference at the level one percent. The results showed that BPD acquires small deposits because they are focused on their own area. However, the government bank has branches throughout Indonesia and people more believe to savings in government banks.

Total deposit to be influential to lending where the loan amount to the government bank is IDR 29.4 trillion compared to BPD is IDR 1.1 trillion and IDR 2.3 trillion for private banks. This shows that lending by government banks is much higher than others bank in Indonesia and this difference is significant at the level one percent. The government banks may grant loans to customers higher because it has branches throughout Indonesia. BPD provides the lowest loan due to the lower number of customer and focused on government employee and their respective district. However, when standardized loans to total asset (LOAN) value become not significant except for the differences between BPD and government banks where the difference is significant at the level 10 percent. The difference in the amount of deposit to loans (DEPOSITS), for the three types of banks is not significant. DEPOSITS for government banks, private banks, and BPS are respectively 267.152%, 246.159% and 214.261%. This indicates that the three types of banks have total deposits to loans is not different.

Total operating cost of the government banks is only IDR 9.2 trillion compared to BPD is IDR 117.9 trillion and IDR 705.9 billion for private banks. This difference is significant at the level one percent. When see on the ratio of operating cost to total assets (COST). COST of

government banks has the highest average is 19.320% compared to private bank as much 8.049% and BPD as much 6.92%. However, the difference COST for the three types of banks is not significant except for the difference between BPD and private banks and government banks where the difference is significant at the level five percent.

The net profit of government banks is IDR -1.2 trillion, IDR 49.3 billion for BPD and IDR -212.6 billion for private banks. This shows that the federal government suffered total losses far greater than other banks in Indonesia, especially during the financial crisis. However, this difference was not significant when compared with BPD or private banks. When net profit of BPD compared with private banks on notice that the difference is significant at the level five percent. One of the main customer groups for BPD is civil servants in the RDB will aggressively market their products to the group. This is due to the government employees have the ability to repay their loans even during the financial crisis because it is difficult to stop them. Thus, the loans granted by the BPD will not experience significant problems and this collection will increase the profitability of BPD.

When performance is measured by using the ROA, the results shows ROA for government banks, private banks and RDB are respectively -6.638% , 0.293 % and 1.729%. This indicates that the government banks have the lowest performance and BPD have the best performance. However, the difference between the three types of banks is not significant except for the difference between private banks and BPD in which the difference is significant at the level one percent. When performance is measured by using the ROE, government banks have the highest performance (41.186%), followed by BPD (15.5402%) and private banks (5.825%). The differences ROE for the three types of banks is significant.

5. CONCLUSION

The result of study that in term of size, government banks are the largest followed by second largest is private banks. Government banks are about 11 times larger than community development banks and private banks. Subsequently, they have the greatest amount of current assets, debt, deposit, financing, and operation costs. The result also found that government banks have larger deposits, but it is not statistically significant different to community development banks and private banks. The private banks have larger capital structure and banks risk. However, in term of deposits community development banks have larger than private banks and government banks. And in term of profits, either operation or net, their amount is not statistically different from the other two types of banks. In fact, in term of net profit, only community development banks show positive amount. Net profit between community development banks and private banks is significant different at 5%. Community development banks have better ROA than government and private banks but the different is only significant between community development banks and private banks at 1%. In term of ROE, government banks have the highest ROE but it is not statistically significant different to community development banks. ROE of either community development banks or government banks is significantly higher rather than private banks.

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