The International Journal of Business Management and Technology, Volume 3 Issue 6 November–December 2019
ISSN: 2581-3889

How Does Financial Performance Boost Indonesian Bank Stock Returns?

Arni Surwanti [*]; Wahyu Agustianata
**Department of Magister Management*
Faculty of Economic & Business
Universitas Muhammadiyah Yogyakarta
Brawijaya Street 55183, Tamantirto, Kasihan, Bantul, Yogyakarta Special Region, Indonesia

Abstract
This study aims at analyzing the impact of banks' financial performances based on the RGEC factors on their performance in the Indonesian capital market. The RGEC stands for Risk Profile, Good Corporate Governance, Earning, and Capital. To increase their stock prices, banks need to pay attention to certain banking characteristics, especially risk control and profitability.

Keywords: Bank Performance, RGEC, JEL Classification: G10 General.

I. Introduction

Financial performance assessment is an important aspect of investing that concerns stakeholders the most. Banks mainly serve as an intermediary institution for the community in general. Such an assessment usually presents a signal for investors to make an investment decision. Strong performance will attract investors, and will drive an increase in the stock price.

There have been a number of studies in many countries that try to find the determinants of stock prices. A previous study [22] shows that financial performance helps investors make investment decisions. A financial performance analysis is the process of determining the operating and financial characteristics of a firm based on their financial statements. The goal is to determine the efficiency and performance of the management, as reflected in the reports. The analyst will attempt to measure the firm's liquidity, profitability, and other business indicators, in a rational and objective manner, ensuring enough returns for shareholders and maintaining their market value.

A study has investigated the relationship between banks' financial performance and the corporate governance principles [19]. Bank performance is related to capital management, which involves capital sufficiency, capital quality, profitability, capital efficiency, dynamics, risk management, shareholders, disclosure and transparency, stakeholders, and the board of directors. The study found that there is a correlation between capital management and the corporate governance principles.

Research in multiple countries shows that certain factors indeed affect bank stock prices. A study on Indian banks discovers a relationship between macroeconomic factors and their stock prices. The findings reveal that economic activities, interest rates, and exchange rates can determine stock prices. Economic activity levels and exchange rates affect stock prices, but an increase in interest rates will weaken bank stock prices [23]. Another study examines the relationships between banks' financial performance indicators and their stock prices in the Nigeria banking sector [16]. Based on the multiple regression model employed, Nigerian bank stock prices are shaped by the bank's age, earnings per share (EPS), and return on assets (ROA). The stock prices are found to be positively and significantly influenced by the earnings per share. That said, a bank's return on assets and age exert a positive effect on their stocks. Earnings per share, therefore, has a fairly strong relationship with stock prices in the market.

One of the studies develops a unified framework to assess how regulation, supervision, and other institutional factors may affect the performance of a banking system [2]. Cross-country efficiency studies on the banking industry point out the different impacts of bank financial performance. For banks, efficiency implies improving profitability, greater amount of funds channeled in, better prices and service quality for consumers, and greater safety in terms of an

improved capital buffer in absorbing risks. Studies on the impact of deregulation upon banking efficiency reveal different results. Evidences from Taiwan, Korea, Norway, Turkey, and Thailand indicate improvements in efficiency, while in Spain and the US, deregulation has had a negative impact. As a result, efficiency will support profitability and enhance stock returns.

The research that examines the factors of stock prices of 10 banks traded in the Istanbul stock market [16] uses a panel causality test to see the relationship between variables. The analysis shows that the industrial production index and several macroeconomic factors determine bank stock prices.

In Indonesia, the bank performance assessment has been designed with the Bank Indonesia (BI) regulations in mind. The BI regulations on bank financial performance have changed several times. In 1999 the bank performance assessment in Indonesia was based on CAMEL (Capital, Assets Quality, Management, Earnings, and Liquidity). Then in 2004 [3] the performance rating components were changed to CAMELS (Capital, Assets Quality, Management, Earnings, Liquidity, and Sensitivity). In 2011 there was a new regulation specifying new determinants, i.e. the RGEC. The method assesses several aspects that include Risk Profile, Good Corporate Governance, Earning, and Capital [4].

This research will test whether a bank's performance as measured against their Risk Profile, Good Corporate Governance, Earning, and Capital (RGEC) can increase their stock return. It looks into factors that determine stock returns, with the hope that the findings can help investors make investment decisions. This research also results in information that should be useful for Indonesian banks wanting to maximize profits for their stockholders, which they can do by observing the main factors that can increase their stock returns.

II. Theoretical Framework and Hypotheses

2.1. Stock Returns

When making an investment, people want to gain as much as possible without being oblivious of the inevitable risks [29]. The ultimate motivation for investing is to get returns. It is a reward for an investor for taking the risk of an investment.

It comprises two main components, i.e. yield and capital gain. Yield represents the cash flow received periodically from an investment. In the context of bonds, yield is reflected by interests on investment whereas with stocks, it is dividends. Capital gain is an increase or decrease in the price of a security. A capital gain can also be interpreted as a change in a stock price. In this case, the capital gain on a stock is its price fluctuation. It is whether a stock goes up or down in the stock market. This fluctuation takes place following the law of demand and supply. When a stock is oversubscribed, the price will go up and vice versa.

Investors can conduct a company analysis to inform their investing judgment. The results can give them an idea of the company's value, its internal characteristics, quality and management performance, and prospects for the future.

There are usually two kinds of security analysis, i.e. technical and fundamental [29]. Technical analysis is a technique to predict the direction of stock price movements and other stock market indicators, based on historical market data such as price and volume of shares traded. Observers of technical analysis argue that prices move in a certain trend, and will occur repeatedly, in which it can be used to predict stock prices. Technical analysis can also be defined as the study of an entire market or securities based on demand and supply. Fundamental analysis is a company analysis. The stock price is determined by fundamental data. Such data usually provides information on a company's sales, growth, profit, industry conditions, dividends, and financial prospects.

2.2. Bank Financial Performance

Bank performance in Indonesia [5] can be assessed through the RGEC method. The method conducts an assessment based on several aspects. The first of which is risk profile, an assessment on the quality of risk management implementation inherent in the operational activities of a bank. The second factor is good corporate governance, which requires analyses on several elements: the implementation of the good corporate governance principles; the adequacy of the good corporate governance implementation by taking into account the structure, processes, and results; and other information based on relevant data related to good corporate governance. Coming as a third factor is earnings. This is used to measure the level of a bank's business efficiency and profitability or to indicate a bank's ability to produce profits in each financial period. Lastly, the fourth factor is capital. Capital is a ratio that represents a bank's capability to provide minimum capital to cover the possibility of risks in their credit activities.

2.3. Financial Performance Boosts Bank Stock Returns

Bank financial performance can determine stock returns as explained by the Signaling Theory. The Signaling Theory [26]

maintains that a strong financial statement is a signal that a company has been running well. A manager reports their company's business state to the owner as part of their responsibility. The Signaling Theory describes the information or signal provided by a company for use by external parties. It is important that a company provides such information to external parties because there are often discrepancies between what the company actually reports and what others think they know. Misinformation can affect the company's management and also their stock price.

Investment, financing, and other external decisions are highly dependent on the signals given out by the company. Good companies send clear signals to external parties. These signals may be good or bad news depending on the company's financial performance. The Bank Rating based on RGEC reflects the financial performance of banks as a signal to investors or other external parties to inform their investment decisions, which will ultimately determine the movement of bank stock prices. A bank's strong performance will encourage investors to invest in their stocks and boost their stock returns.

III. Hypotheses Development and Empirical Research Model

3.1. Sample Selection and Data Collection

This research is an attempt to verify the causality between variables through hypothesis testing. We look into a number of banks with stocks that are listed in the Indonesia Stock Exchange.

Furthermore, this study uses data from the banks' financial statements. Samples are collected by a "non-probability sampling" with the purposive method, specifically the "sampling by judgment" method. The samples are selected against certain criteria: the banks operate in the conventional banking industry and are listed in the Indonesia Stock Exchange between 2014 and 2016 [8], [9], [10], [11], [12], [13], [14], and [15]. The financial statements are accessed from the documents published by the Indonesian Stock Exchange. The data are retrieved from the annual reports and the Indonesian Capital Market Directory as published by the Indonesia Stock Exchange.

3.2. Testing Hypothesis

We examine the impact of financial performance indicators on bank stock returns by a multiple regression analysis [6]. Accordingly, multiple regression techniques have been employed to study the impact of the selected ratios indicating a bank's financial position and performance on their stock return, while the regression coefficients have been tested with the help of a 't' test. The regression model employed here is as follows:

$RTN = a + \beta 1\ LDR + \beta 2\ GCG + \beta 3\ ROA + \beta 4\ CAR + e$

Where RTN is stock return, LDR is risk profile as measured by Loan to Deposit Ratio, GCG is good corporate governance, ROA is earnings, CAR is capital, and e is error.

IV. Result and Discussion

This section presents descriptive statistics, the results of the research, the hypothesis testing, and the discussion.

4.1. Descriptive Statistics

The variables used in this research are elements of bank performance that affect stock returns. It includes risk profile, good corporate governance, profitability, and capital.

Table 1
Descriptive Statistics

	N	Minimum	Maximum	Mean	Std Dev
LDR	96	53	112.54	85.0866	11.66593
GCG	96	1	4	3.0267	0.50669
ROA	96	-11.15	4.73	1.0051	2.56934
CAR	96	8.02	48.38	18.7943	5.09106
RTN	96	-50.67	349.01	17.9827	60.62721
Valid N (listwise)	96				

4.2. The Impact of Risk Profile on the Stock Returns of Banks Listed on the Indonesia Stock Exchange

The impact of the independent variables, i.e. risk profile, good corporate governance, earnings, and capital, on stock returns can be seen in Table 2. This research revealed that risk profile has a negative, significant effect on stock returns.

A high LDR means low liquidity for banks, and a higher risk for investing in them. Based on the Signaling Theory, it is bad news and will impact investor preference in whether or not to invest in the banking industry. Investors will be apprehensive to invest their money into such a high-risk business, as they assume that banks with a high liquidity risk will also be prone to bankruptcy [7]. In this situation, investment interests in banks will dwindle, and this will in turn lead to lower stock prices and stock returns. This research supports the finding of a previous study [25] that all the other risk factors have a significant impact on excess returns. Bank stocks are highly volatile. Banks have high exposure to market due to their high leverage nature and less liquidity. Smaller banks have produced more returns compared to larger banks due to their difference in risk levels. Banks with a high level of risk provide less returns.
On the other hand, this research does not support the study by [21]. Their study found that board size, board composition, and risk management disclosure have a significant positive effect on a firm's performance, as measured by profitability. It can be explained with the high risk, high return principle. The finding of this study is essential to both corporate authorities and other corporate stakeholders in Nigeria.

4.3. The Impact of Good Corporate Governance (GCG) of Banks on Stock Returns
Various theories have been employed in explaining corporate governance, including the Agency Theory. The Agency Theory [18] sees this relationship as an agreement involving at least two parties. Usually, these two are the principal and the agent. The principal (shareholders) may employ the agent (usually manager) to perform and run their company on their behalf. The agency issue may arise when a manager runs the firm for their selfish interests, as it is possible that individuals become opportunistic.

Table 2
Analysis on the Impact of Risk Profile, Good Corporate Governance, Earnings/Rent ability, and Capital on Bank Stock Returns in Indonesia

Variable	Coefficient	Std. Error	t-Statistic		Prob.
C	73.51981	47.72470	1.540498		0.1272
LDR	-0.581201	0.323390	-1.797216	*)	0.0759
GCG	3.059365	10.00762	0.305704		0.7606
ROA	5.428526	2.196147	2.471841	***)	0.0155
CAR	-1.668410	1.087344	-1.534389		0.1287
R-squared	0.102213				
Adjusted R-squared	0.058947				
F-statistic	2.362399				
Prob (F-statistic)	0.059727				

The manager may not always have the best interest of the owner [28]. As a result, an agency issue comes up. The principal must then consider the agency costs. These agency costs are a value loss to the shareholders and usually involves the cost of monitoring the manager' activities to make sure their goal is achieved. The agency costs include monitoring cost, bonding cost, and residual loss. The monitoring cost is required to implement good corporate governance.
If a firm has good corporate governance, it is impossible for its managers or significant shareholders to abuse their resources. They will have better management and performance. Investors will then be attracted to invest in a company with good management, strong performance, and effective governance practices like them. In fact, this may lead to lower capital costs, which can further improve the company's performance. Good governance practices tend to attract potential stakeholders as well, such as employees. People will want to be associated and work with them, seeing them as healthy, profitable, and sustainable [24].
The analysis on the impact of GCG on stock returns shows that GCG positively but not significantly affects stock returns. A positive sign indicates that the higher a bank's GCG sits, the better their corporate governance is. According to the Signaling Theory, good corporate governance of a bank is good news for investors. They will assume that good governance means a guaranteed return on their investment. In short, investors are confident in investing in companies with good corporate governance. Investors will respond positively to companies that have good corporate governance. Their stock price will consequently increase, and investors will receive better returns. The finding of this research that GCG has a positive effect on stock prices is in line with several previous studies that have a similar conclusion [1].

According to a research conducted in [1], most investors in Malaysia show their willingness to pay more for the shares of a well-governed company. Poor corporate governance tends to beget fraudulent activities and in the long run leads to corporate failures, with stock prices almost certainly dropping [17]. This study also supports another research [19]. Banks implement different strategies to overcome losses in responds to new capital standards, choosing models that can help attract more capital and investors. Nowadays it is necessary to have an integral model in banks, which should include corporate governance and management to help achieve the positive indicators that can improve their stock returns.

4.4. The Impact of Earnings on Stock Returns of Banks Listed on the Indonesia Stock Exchange

This study found that earnings positively and significantly affect stock returns. It can be concluded that earnings or a company's ability to generate profits have a positive and significant impact on bank stock fluctuation listed on the Indonesian Stock Exchange.

The results show that the higher a bank's earnings are, the better their stock returns will be. A high earning means a higher possibility of a dividend distribution, something investors would be very interested in. Based on the Signaling Theory, this will be good news for investors. Investors will go into stocks of high-earning banks. Eventually, this will raise stock prices as well as stock returns.

This research is consistent with a previous study [16] in the Nigerian banking industry, which reveals that an increase in earnings could lead to an improved stock price. Hence, to boost their stock prices, banks should apply critical cost reduction strategies, aggressive marketing, and diversification strategies to improve their net earnings, which later on could lead to better dividend payouts. Based on the Signaling Theory, when the dividend becomes larger in amount, it serves as an indication that the bank is stable. This is good news for investor, who will be interested in investing and bumping up the company's stock price.

4.5. The Impact of Capital on Stock Returns of Banks Listed on the Indonesia Stock Exchange

The result shows that the capital variables measured by CAR have a negative and insignificant effect on stock returns. Negative signals indicate that capital is not only an important source of funding in a bank, but it also affects the management's decision making to achieve profits and take risks. If the capital is too large in proportion, it will burden the management because when the capital cannot be distributed effectively, the company will not be productive and achieve profits.

The factor that determines the CAR is capital and Weighted Assets Based on Risks. The asset category with the greatest risks in banking is receivables. Loans have a very big contribution to a bank's income. This means that a bank's receivables will increase their income. Increasing receivables will raise the values of their weighted assets based on risks, as part of the capital, and it will reduce the value of CAR. On this basis, it can be concluded that the increase of a CAR value will decrease a bank's profitability. Investors will avoid investing in banks with a high CAR value. Less interests in bank stocks will result in declining stock prices. This is why CAR can have negative effects on stock returns.

V. Conclusion

Indonesian investors' confidence in the banking industry lies in the ability of banks to manage their risks and maintain their profitability. Therefore, to increase stock prices, the banking industry needs to pay attention to the rating criteria for bank soundness, especially the factors that are related to risk control and profitability. This research stands as a verification for the Signaling Theory that bank ratings based on the RGEC reflect banks' financial performance as a signal for investors in making investment decisions.

Acknowledgements

This research was conducted as a requirement for the author to complete studies at Universitas Muhammadiyah Yogyakarta. The results of this study may be useful for academics who will develop further research and for practitioners who use online shopping as an evaluation material in making purchases and sales online. The author highly appreciates the editors and anonymous reviewers who provide criticism and suggestions on this paper. The authors hope this paper will be useful for readers and all errors remain ours.

References

[1] Adams, R. and Mehran, H. (2003). Is Corporate Governance Different for Bank Holding Companies? Federal Reserve Bank of New York. Economic Policy Review 9, pp. 123-142.

[2] Andries, Alin Marius, Bogdan Capraru. (2013). Impact of Financial Liberalization on Banking Sectors Performance from Central and Eastern European Countries. Plos One. March. Volume 8. Issue 3.

[3] Bank Indonesia No. 6/23/DPNP. 2004. Circular Letter: Bank Commercial Bank Financial Performance Assesment System. Dated 31 May 2004.

[4] Bank Indonesia (2011). Bank Indonesia Regulation No. 13/1/PBI/2011 on Asessment of Performance of General Banks. Dated 5 January 2011.

[5] Bank Indonesia. (2011). Circular Letter No. 13/24/DPNP regarding the Rating of Commercial Bank Rating. Dated 25 October 2011.

[6] Gujarati, Damodar N., Dawn C Porter. (2009). Basic Econometric. Fifth Edition. Mc.Graw Hill. New York.

[7] Haque, Abdul. (2015). Systematic and Idiosyncratic Risk Analysis of Banking and Insurance Sector of Pakistan. Abasyn Journal of Social Sciences – Volume 9 – Issue 2. 442.

[8] Indonesia Stock Exchange. (2013). Indonesian Capital Market Directory. ECSFIN. Jakarta.

[9] Indonesia Stock Exchange. (2014). Indonesian Capital Market Directory. ECSFIN. Jakarta.

[10] Indonesia Stock Exchange. (2015). Indonesian Capital Market Directory. ECSFIN. Jakarta.

[11] Indonesia Stock Exchange. (2016). Indonesian Capital Market Directory. ECSFIN. Jakarta.

[12] Indonesia Stock Exchange. (2013). Annual Report. Jakarta

[13] Indonesia Stock Exchange. (2014). Annual Report. Jakarta

[14] Indonesia Stock Exchange. (2015). Annual Report. Jakarta

[15] Indonesia Stock Exchange. (2016). Annual Report. Jakarta

[16] Inyiama, Oliver Ike. (2015). Effect of Banks' Financial Performance on Share Prices: Evidence From Nigerian Banking Industry (2004 – 2013). European Journal of Research and Reflection in Management Sciences, Vol. 3 No. 3. ISSN 2056-5992.

[17] Iskander, Magdi R., and Chamlou, Nadereh. (2000). Corporate Governance: A Framework for Implementation. Washington. D.C., The World Bank Group.

[18] Jensen, Michael C. and William Meckling. (1976). Theory of the Firm: Managerial Behavior, Agency Cost, and Capital Structure. Journal of Financial Economics 3: 305-360.

[19] Kostyuk, Alex & Kateryna Ivanyi. (2015). The Effectiveness of Capital Management in Banks: Evidence from Ukrainian Financial Market. Risk governance & control: financial markets & institutions. Volume 5. Issue 4.

[20] Mahmud, Mohammed Kakanda, Basariah Salim, Sitraselvi Chandren. 2017. Corporate Governance Reform And Risk Management Disclosures: Evidence From Nigeria. Business and Economic Horizons. Volume 13 issue 3.

[21] Mahmud, Mohammed Kakanda, Basariah Salim, Sitraselvi Chandren. 2017. Do Board Characteristics and Risk Management Disclosure Have Any Effect on Firm Performance? Empirical Evidence from Deposit Money Banks (Dmbs) in Nigeria. Business and Economic Horizons. Volume 13 Issue 5.

[22] Megaladevi, P. (2015). A Study on Financial Performance Analysis of the Select Paper Company with Special Reference to Tamil Nadu Newsprint and Papers Limited. International Journal of Recent Research Aspects., ISSN: 2349-7688., Vol. 2., Issue 4., pp. 22-24.

[23] Narayan, P., Narayan, S., and Singh, H. (2014). The Determinants of Stock Prices: New Evidence from the Indian Banking Sector. Emerging Markets Finance and Trade, Vol. 50, No. 2, pp. 5-15.

[24] Ogege S, Boloupremo T. (2014). Corporate Governance and Financial Performance of Banks:Evidence from Nigeria. Hyperion Economic Journal. Year II, no.2(2).

[25] Ramos, Sofia B & Helena Veiga. (2009). Risk Factors in Oil and Gas Industry Return: International Evidence. Working Paper. Departamento De Estadística. Universidad Carlos Iii De Madrid.

[26] Ross, S.A. (1977). The Determination of Financial Structure: the Incentive-Signaling Approach. The Bell Journal of Economics. Vol 8 pp: 23-40.

[27] Saldanli, Arif., Mücahit Aydin., Hakan Bektaş. (2017). The Determinants of Stock Prices: Evidence from the Turkish Banking Sector. Theoretical and Applied Economics. Volume XXIV. No. 1(610), Spring, pp. 181-188.

[28] Sundaramurthy, C. (1996).Corporate Governance within the Context of Antitakeover Provisions. Strategic Management Journal, Vol.17, No.5, May, pp.377-394.NewYork: John Wiley & Sons.

[29] Tandelilin, Eduard. (2010). Portofolio and Investment: Theory and Aplication (Portofolio dan Investasi: Teori dan Aplikasi). First Edition. Kanisius. Yogyakarta.