CHAPTER II

THEORITICAL FRAMEWORK AND HYPOTHESIS

A. Theories

1. Rural Bank (BPR)

The Bank as it has been known by many to be known as a financial institution whose main activity accepts demand deposits, savings and deposits. In addition the bank is also known as a place to borrow money (credit) for the people who need them. Bank is also known as the place to exchange money, move money or accepting all forms of payment and deposit such as payment of electricity, telephone, water, taxes, tuition and other payments.Based on the Law of the Republic of Indonesia Number 10 of 1998 (PPSK,2003) bank consist of two types, are commercial banks and rural banks (RB). Commercial Banks and rural banks is different in its own activities which commercial banks may provide services in payment traffic, while rural bank may not provide services in payment traffic.

Bank has a very important role in helping business customers who require funds, either investment funds and funds for working capital and the expected increase in development in many sectors. In the Yogyakarta area is controlled sector of the economy, namely tourism, agriculture, industry and services. The growth of each of the leading sectors had been fluctuating due to the security crisis. The hospitality sector and processing industry almost have fluctuation indicating that both sectors are the

sectors that go hand in hand. Up to this time the four sectors of the economy began to grow very rapidly. Judging from the increasing number of objects several new tourism, the construction of several new hotels or inns, many businesses mushrooming in the field of trade and services, micro and medium scale.

The existence rural bank in the Yogyakarta area is very supportive to the capital of 4 sectors of the economy. Rural Bank's role in this is to help capital in the form of credit or loans to support the operational of the business areas. Rural Bank of financing procedures are still simple an alternative choice of the debtor either micro and intermediate businesses.In addition the process is very fast in terms of credit disbursement also be hallmarks of Rural Banks. Increasing number of loans disbursed by the Rural Bank, the higher the ability of banks in generate income in the form of interest income from loans disbursed by the given asset of the most productive in the Rural Bank are the in the form of loans extended to the debtor so that the profit generated Rural Banks also higher.

a. The target of Rural Banks

Serving the needs of farmers, ranchers, fishermen, traders, small businessmen, employees, and a retired because this goal cannot be reached by commercial banks and to further realize the equitable distribution of banking services, equal opportunity seeks, income

distribution, and in order that they do not fall into the hands of the release money (loan sharks).

b. The effort of rural bank

Rural Bank's efforts include efforts to raise and distribute funds with the aim of getting profit. Rural Bank's advantages obtained from the spread effects and interest income.

c. The efforts of Rural Bank are :

1) Collects funds from society in the form of deposits in the form of time deposits, savings, and / or other equivalent form with it.
2) Give credit
3) Provider of financing for customers based on the principle of profit sharing in accordance with the provisions stipulated in Government Regulation.
4) Placing funds in Bank Indonesia Certificates (SBI), time deposits, certificates of deposit and / or savings in other banks. SBI are the offered by Bank Indonesia certificates to the Rural Bank when the Rural Bank experienced a liquidity.

d. The Businesses which don't be done of Rural Bank

1) Accepting deposits comprising of demand deposits
2) Conducting of business activities in foreign currencies.
3) Conducting of insurance business.
4) Conducting other businesses outside of business activities as stipulated in the Rural Bank.

e. Rural Bank of Credit Allocation

In allocating of credit, there are some things that must be considered by Rural Bank, namely:

1) In providing of credit, Rural Bank required to have belief in the ability and willingness by debtor repay its debts in accordance with the agreement.
2) In giving of credit, Rural Bank shall comply with the provisions of Bank of Indonesia concerning lending limits, guarantees, or other things that are similar, which can be done by the Rural Bank to the borrower or a group of related borrowers, included for companies in the same group with Rural Bank. The maximum limits are the not exceeded 30% of capital in accordance with the provisions stipulated by Bank Indonesia.
3) In giving of credit, Rural Bank is required to comply with the provisions of Bank of Indonesia regarding the legal lending limit, provision of guarantees, or other things that are similar, which can be done by Rural Bank to shareholders (and families) who have 10% or more of the paid-up capital, by commissioners (and family), directors (and the family), officials of Rural Bank other, as well as companies in which there are the interests of the shareholders (and families) who has 10% or more of the paid-up capital, the commissioners (and family), members of directors (and the family), officials of the other Rural Bank. The maximum

limit does not exceed 10% of the capital conform with the provisions stipulated by Bank of Indonesia.

2. Profitability

The financial performance of the bank is a picture of the financial condition of banks in a given period either covering aspects of fund raising and channeling funds. Assessment of the performance of a bank can be done by analyzing the it's financing report. Banking profitability is a measure of the success of a bank in gain (spread).

Profitability of a bank can be measured by using ROA. ROA is used as a measure of good or poor performance of the bank, the bank managed to make a profit from the business essentially mean capable as an intermediary institution that collect funds from the public and then distribute to those in need, so that it can be a motivator and a dynamic increase in economic activity, and increasing the efficiency of money for productive activities.

According to Dendawijaya (2005), Return On Assets (ROA) is a ratio used to measure the ability of bank management to make a profit overall. ROA focused on the company's ability to earn profits in the company's operations. While Taswan (2010), ROA indicates the bank's ability to generate profits by using their assets. The greater this ratio indicates better performance based bank with Bank of Indonesia Circular

Letter No.6/23/DPNP dated 31 May 2004. The Bank said profit high enough when the ROA ratio in the range between 0.5% up to 1.25%.

Factors which affect the profitability of the bank can be sourced from a variety of performance indicators indicated profitability. (Nasser & Aryati, 2000). Important profitability ratio for banks is the Return On Asset (ROA). ROA is important for banks because of ROA is used to measure the effectiveness of the company in generating profits by exploiting its assets. ROA is the ratio between profit after tax to total assets. Mathematically ROA can be formulated as follows:

$$ROA = \frac{Net\ Income\ after\ Taxes}{Total\ Assets}$$

3. Capital Adequacy Ratio (CAR)

Capital Adequacy Ratio is the ratio used to measure the bank's ability to maintain sufficient capital and the ability of banks to identify, measure, monitor, and control risks that arise that could affect the amount of capital banks (Mudrajad Kuncoro and Suhardjono: 2002).

The influence of Capital Adequacy Ratio of Financial Performance (Return on Assets). Capital Adequacy Ratio is the ratio used to measure capital adequacy and capacity of banks in sustaining capital for its operations. With the existence of sufficient capital, the bank will not be difficult both in terms for lending purposes or to maintain the level of bank liquidity. So that banks will be better prepared to meet the goal of short-term or long-term goals. According to the provisions Bank

Indonesia, the Capital Adequacy Ratio (CAR) has a value of at least 8%. Bank capital consisted of two components: core capital and supplementary capital. The core capital is capital that comes from the owners of the bank, which consists of the capital subscribed by the shareholders, reserves and retained earnings. Where as supplementary capital consisted of revaluation reserves of fixed assets, allowance for uncollectible accounts, loan capital, and subordinated loans.

Minimum capital requirement is calculated based RWA (Risk Weighted Assets) which is the sum risk weighted assets risk weighted assets balance sheet assets and administrative assets. Risk weighted assets (RWA) balance sheet assets is obtained by multiplying the nominal value of the related assets with a risk weighting of each asset. risk weighted assets administrative assets obtained by multiplying the nominal value of off-balance sheet concerned with risk. The higher the CAR, the better the condition of a bank (Achmad, 2003). If the CAR high means that the bank is able to finance the operations of bank, the bank's favorable circumstances will contribute significantly to the profitability (Kuncoro and Suhardjono, 2002).

CAR rising capital means that companies use will increase, and the increase in capital is also increasing sales, the profits will increase, thereby increasing ROA. This suggests that the CAR has a unidirectional relationship on ROA in accordance with the results of research by Defri (2012) and Azam (2012) . However, if the CAR capital employed rose

means the company will increase but the increase in capital will not increase sales mean no profits also experienced an increase.

Capital adequacy ratio (CAR) where capital by (Darmawi: 90, 2012) can be used for:

1. Protecting Depositors, the primary function of the bank's capital is to protect depositors against loss and protection of depositors when banks in liquidation.
2. Nurturing Depositors Trust, the function of bank capital used to keep banks remain open and operating so that the time and income to cover bank losses and boost confidence of depositors and bank supervisors have regard to the bank.
3. Functions of Operations, is used as the provision of funds for the purchase of land, and machinery as well as equipment and supplies buffer to absorb operating losses occur.
4. Regulator Function Indirectly, the bank's capital is used as the minimum requirements necessary to obtain a permit the establishment of a new bank and branch out, limiting bank lending, investments and takeover.

The value of a bank's CAR can be calculated by the formula:

$$CAR \frac{Modal}{Atmr} 100\%$$

4. LDR (Loan to Deposit Ratio)

The liquidity ratio or Loans to Deposit Ratio (LDR) is the ratio of loans to deposits. The greater this ratio indicates that more aggressive bank of its liquidity, whereas the smaller the ratio is also greater third-party funds that are not used for the placement of credit (much idle funds) (Taswan, 2010). Loan to deposit ratio states how much of the bank's ability to repay the withdrawal of funds by depositors by relying on loans as a source of liquidity (Dendawijaya, 2003).

Loan to deposit ratio (LDR) describe the amount of third party funds are distributed in the form of credit or in other words, the liquidity ratio shows the ability of banks to make credit as a source of liquidity, the higher this ratio, the lower the liquidity of banks (Dahlan, 1993). The high LDR shows the bank's ability to distribute the funds in the form of loans that will increase the profitability of banks, but on the other hand the liquidity level decreases (unsafe). Meanwhile, if the low LDR mean banks are not able to market its credit so many unproductive idle funds and thus reduce the level of profitability of banks on the other hand the high of liquidity of security is maintained.

Based on PBI No. 12/1/PBI/2010 Date October 4th, 2010 under the limit of the LDR target by 78% and the upper limit of the LDR target of 100%. LDR adjust the amount of the economic conditions of the development of Indonesia. It means that banks do not meet the minimum LDR (Suyono, 2005).

5. BOPO (Operating Income Operating Costs Against)

BOPO is the ratio between operating expenses to revenues operating. Cost surgery is the cost incurred by the bank in order to run its core business activities such as interest expenses, marketing costs, labor costs and other operating costs. Operating income is the main income of the bank that is the income earned from the placement of funds in the form of credit and other operating income. The smaller the bank's BOPO indicates more efficient in carrying out its business activities.

According by Dendawijaya (2000) argued that the ratio of operating expenses are used to measure the efficiency and ability of banks to carry out operations . BOPO indicate the operational efficiency of the bank. The higher this ratio indicates more inefficient the operational costs of the bank (Taswan, 2010), so the chances of getting bank profitability is getting smaller. Through Circular Letter No.3/30 DPNP dated December 14, 2001, BI makes provision that BOPO maximum of 90%. Therefore in order to obtain a high profitability of banks to make efficiency against operating costs.

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6. NPL (Non-Performing Loans)

One of the risks that arise due to the increasing complexity of banking activities was the emergence of non-performing loan (NPL) is the greater. The other words the greater scale of operations of a bank, the oversight of decreases, so the greater the NPL or the greater credit risk (Vishnu Mawardi, 2005). NPL is the ratio of nonperforming loans to total NPL credit. NPL good is that has a value of less than 5%. Non-performing loan (NPL) reflects the credit risk, the smaller the NPL the less the credit risk borne by the bank. Banks with high NPL provisioning will increase the cost of both productive assets and other costs, so the potential for bank losses (Wishnu Mawardi, 2005). According by Tri Basuki (2014) Effect of Non-Performing Loans to Financial Performance (Return On Asset) is variable or non-performing loan ratio of default loans with loans had a negative and significant effect on financial performance (return on assets) RBs in DIY.

B. Previous Studies

Study about profitability had one times by several researchers. Each research comes with different analysis tools and results. Here some research on Profitability.

1. Adyani&Sampurno,MM (2011). This research used multiple regression analysis, The result of research showed variable CAR and FDR did not have a significant positive effect on profitability (ROA) of banks. And variable BOPO, NPF and significant negative effect on profitability (ROA) of banks.
2. Murdiyanto (2012), This research used multiple regression analysis CAR significant positive effect on the variable ROA. NPL significant negative effect on ROA. BOPO significant negative effect on the variable ROA. Influence LDR to ROA negative effect.
3. Fauzia(2014) ,This research multiple regression analysis The third-party funds a not effect on the profitability banking companies,Non Performing Loan a significant negative effect on the profitability of the banking,Operation Efficiency a significant negative effect on the profitability of banking.
4. Febriyono (2015) This research used purposive sampling and From the research simultaneously affect the significance of the five variables Return on Assets (ROA). While partially shows that the Assets Quality (KAP), Non Performing Loan (NPL), Loan to Deposit Ratio (LDR) not direct influence over Return on Assets (ROA). Indirectly Non Performing Loan (NPL) no effect bassed on Return on Assets (ROA) through Capital Adequacy Ratio (CAR), but Non Performing Loan (NPL) effect bassed on Return on Assets (ROA) through Operating Expenses Operating Income (BOPO)

5. Wibowo & Syaichu (2013) This research multiple linear regression analysis, The results of this study indicate that the interest rate variabel has no effect on ROA, inflation had no effect on ROA, CAR had no effect on ROA and neither did NPF. While BOPO variabel had significant influence with negatif direction.
6. Narayana (2013) This research used proporsive sample from this study, can be discerned that the cash flows, loan-to-deposit ratio and the level of capital has a positive effect on profitability, while leverage has no effect on the profitability of BPR in the Denpasar
7. Wulandari & Sudjarni (2013). This research used Panel Multiple Regression, The conclusion from the testing shows the independent variable, capital adequacy ratio and the cash ratio has no effect on profitability, while the non-performing loan has a negative and significant impact on profitability.
8. Agustini1 & Budiasih (2014) This research used Multiple linear regression analysis The results obtained that CAR has a positive effect on ROA, LDR has a positive effect on ROA and NPL negative effect on ROA.
9. Negara & Sujana (2014) This research used proporsive sample and the results showed that partially CAR and NPL not affect the profitability, while lending positive effect profitability. While NPL negatively affect the profitability of the relationship between CAR and NPL positive effect on relationship between the profitability of lending.

10. Pertiwi1 & Suardikha (2015) This research used purposive sampling and The result of the analysis get credit turnover rate and growth of the amount of credit customers partially positive effect on profitability at BPR in Gianyar Regency.

The previous studies provide relevant information and motivate future research as enrichment of the empirical study to rural bank. Therefore, the author distinguishes this study by offering these following particular differences:

1. Case study of research

   This study will cover the rural bank in Yogyakarta from 2012 - 2015 that consist from 5 district/city in Bantul, Gunung kidul, Kulon progo, Sleman, Yogyakarta.

2. Variables

   Independent variables that used in this study are profitability that projected with ROA (Return On Assets), Capital Adequacy Ratio(CAR), Loan to Deposit Ratio (LDR), Operating Expense To Operating Income (BOPO), Non-Performing Loan(NPL).

3. Research Period

   The data that will be used in this study derived from rural bank of Yogyakarta since 2012 until 2015.

C. Theoritical framework and Hypothesis

1. Influence Of Capital Adequacy Ratio (CAR) to Profitability

Capital adequacy ratio is the ratio that takes into account how far the entire assets of the bank that contain risks (credit, investments, securities, bill on other banks). Join funded bank's own capital in addition to obtaining funds from sources outside the bank, such as the public loans (debt), and others (Dendawijaya, 2005). Increasingly high CAR means demonstrating the ability of the bank, the better the risk of each loan/assets at risk. If the high CAR means the bank is able to finance its activities for the benefit so as to contribute to improved profitability. The results of previous studies conducted by Suyono (2005), Sudiyatno and Jati Suroso (2010) showed that CAR is positive and significant effect on ROA.

H1: CAR predicted positive effect on credit ROA.

2. Influence Of Loan to Deposit Ratio (LDR) to Profitability

Increased LDR(Loan to Deposit Ratio) means channeling funds so that the borrower the greater the profit will increase profits. Increasing of LDR resulted in the bank's performance as measured by ROA higher. Standardized good LDR is 85% up to 110%. Therefore, management must be able to manage the funds raised good LDR is 85% up to 110%. Therefore, management must be able to manage the funds raised from the public and then channeled back in the form of credit. The logic of this theory is supported by Desfian (2005) which states that in partial LDR positive effect on ROA. This means that the higher the LDR up to a

certain limit, the more funds are channeled in the form of credit will increase interest income so that the higher the ROA. Desfian (2005) stated that in accordance with the theory that an increase in LDR due to an increase in lending or withdrawals by communities where this may affect the liquidity of banks to the level of public trust.

H2 : Rasio LDR is positively and significant effect on ROA.

3. Influence Of Operating Income Operating Costs Against (BOPO)

According by Suyono (2005) showed that the BOPO (Operating Income Operating Costs Against) variable is the variable most dominant and consistent in affecting ROA. Besides, BOPO is also a variable that is able to distinguish between banks that have above-average BOPO and BOPO of banks that have below average. In the management of bank's operating activities efficient by minimizing operational costs of banks would greatly affect the level of bank profits is reflected in ROA as an indicator that reflects the company's effectiveness in generating profits by utilizing the entire assets owned.

This is supported by Desfian (2005) which shows that the effect on the efficiency of ROA. In accordance with the logic of the theory which states that the bank's efficiency can be achieved in several ways either by increase the operating income by reducing operating costs, or the cost of the same operation will be able to increase the operating income which in turn will increase the bank's profits, which in turn can improve ROA.

Mawardi (2005) argued that in line with the above two studies. Research results show that the greater comparison the total operating costs with operating income result in a decrease ROA. Thereby operating efficiency proxied by BOPO negatively affect bank performance proxied by the ROA. The hypothesis of this study on the effect of BOPO on the performance of the bank as measured by ROA is as follows:

H3: The ratio BOPO is negative effect on ROA.

4. Influence Of Non-Performing Loans (NPL) to Profitability.

NPL (Non-Performing Loans) is the ratio of total non-performing loans compared to total loans granted third party. Mawardi (2005), NPL is a proxy of the credit risk contained in the published financial statements. The Bank may conduct its operations properly if having NPL below 5%. Increase in NPLs of the higher causing reserves Allowance for Assets (PPAP) there is insufficient so that the credit crunch has to be taken into account as an expense (cost) that would directly affect bank profits and for profits or accumulated profits too exhausted, then it must be charged to capital (Z. Dunil, 2005).

Thereby rise in NPL (Non-Performing Loans) led to profit decline so ROA becomes smaller. In other words, the higher the performance of bank NPLs decreased and vice versa. NPL influence on ROA is supported by research Mawardi (2005) which shows that the NPL has a negative influence on ROA, meaning that any increase in the number of NPLs will result in decreased ROA.

He said this happens because Bank Indonesia regulation regarding NPL provides that any increase in this loan is granted, it should be covered by reserve assets produktif by debiting cost of reserve assets and crediting the reserve account is uncollectible, so any increase in outstanding loans granted will increase the cost of reserves assets which ultimately affect the bank ROA. The hypothesis of this study on the effect of NPL on the performance of the bank as measured by ROA is as follows:

H4: The NPL ratio is negatively affect on ROA.

D. Research framework

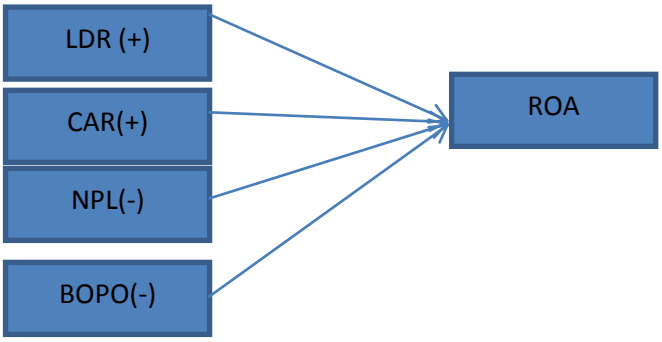

Figure 2.1
Research framework

E. Hypothesis

According to Hasan (2000) hypotheses is a statement that is still weak and needs to be proven true or conjecture that are still provisional. After specified then held testing hypotheses about the truth by using empirical data from research results. Based on the above framework, the author makes a hypothesis in this study are:

1. Suspected CAR positive effect on profitability (ROA).
2. Suspected LDR positive effect on profitability (ROA).
3. Suspected BOPO negative effect on profitability (ROA).
4. Suspected NPL negative effect on profitability (ROA).