CHAPTER I

INTRODUCTION

1.1.Study Background

The economy of a country cannot be separated from the role of the bank. The main activity of banks is to absorb funds from the public. Bank has a very important meaning in capital formation through savings and money creation, bank deposit funds from the public in the form of savings and distribute to the people who need funds for additional capital from its business improvement. Bank is a firm that both accepts demand deposits and market commercial loans (Koch & MacDonald, 2014). It is in accordance with the main activities of a bank that is buying money from the community (raising funds) through savings and then selling money obtained from fund collectors by way of channeling funds to the public in the form of credit or loans.

Credit means obtaining money by paying in installments or installments in the future or obtain a loan of money in which payments are made at a later date with installments or installments in accordance with the agreement. The word credit comes from the Latin word *credere* means trust. The main definition of credit is reliance on and confidence in the truth, worth, reliability of a person or thing (Gower, 2004).

In the activity of lending, the bank has a purpose to obtain profit, where the profit is generated from the difference between the interest generated from the funds lent to parties who need funds with interest that the bank provides to third parties or to the party surplus funds. Before obtaining credit, the customer must go through several stages of credit that must be fulfilled as the stage of the crediting process which includes the credit preparation stage, credit analysis or assessment stage, credit decision stage, credit administration and implementation stage, credit disbursement stage, supervision and credit settlement stage (Kasmir, 2010).

In Indonesia there is a financial institution that accepts deposits only in the form of time deposits, savings or other equivalent form, and distribute the funds as a business that is called Rural Banks (BPR). Rural Bank has become a part of the economy that is very accepted by the community as a financial institution that helps financial matters. Based on the Banking Principal Act Number 7 of 1992 and the Law of the Republic of Indonesia Number 10 of 1998, it is stated that village banks, market banks, village barns and employee banks have become rural banks. Rural banks are much narrower if they are compared to commercial banks (Muchtar, Rahmidani, & Siwi, 2016). Rural Banks by Act No. 10 of 1998 are banks that carry out business activities conventionally or based on sharia principles which in their activities do not provide services in payment traffic.

In accordance with the explanation of Act No. 7 of 1992 on the banking sector, it has been stated that the credit provided by the bank contains risks. Therefore, in its implementation the bank must be able to pay attention to sound credit principles. Banks must be able to anticipate credit risk and it can be seen through asset quality ratio. Asset quality ratio shows the quality of assets owned by a bank, in relation to credit risk faced by banks due to credit and investment in bank funds in different portfolios. This ratio can be measured using several ratios, one of them is using a Non-Performing Ratio (NPL).

NPLs have a serious effect on both parties at the end of the deal that is lenders (banks) and borrowers (domestic corporations or public). NPL category is bad loans, default loans, and distressed debt (Molyneux, 2017). NPL also can be defined as impaired while in others can mean that payments are past due. Bank NPL problems tend to appear after credit booms or protracted periods of low growth in structurally weak financial systems. Besides that, bank NPL problems can be influenced by external factors such as changes in the era of globalization. NPLs crowd out new lending, eroding both the profitability and solvency of banks. When high NPL levels affect a sufficiently large number of banks, the financial system stops functioning normally, and banks can no longer provide credit to the economy (Baudino & Yun, 2017).

Profitability ratio is important to know the extent to which the ability of a bank to generate a profit, either from operational activities of the bank as well as from non-operating activities. Bank performance and the profitability, efficiency, and liquidity can be measured by Return on Asset (ROA). ROA captures the aspect of performance of a bank in terms of its profitability, it is the ratio of net income to total assets. It is a ratio that is directly affected by internal factors of a bank (financial conditions), as well as external factors to a bank (economic conditions and government policies) (Kapaya & Raphael, 2016). If the profit level of a bank is higher, it will have an impact on increasing capital. An increase or decrease in the capital of a bank measures the efficiency of a business and the profitability achieved by the bank.

The Liquidity has different meaning with Profitability Principle because there is a differentiation between liquidity and profitability. Liquidity is a financial term that means the amount of capital that is available for investment. Bank Liquidity simply means the ability of the bank to maintain sufficient funds to pay for its maturing obligations. It is the bank's ability to immediately meet cash, and other withdrawals obligations and legitimate of new loan demand while abiding by existing reserve requirements (Ibe, 2013). In addition, the ratio of liquidity means the used within the support of liquidity management inside each organization within the form of current ratio. Liquidity ratios work with cash and near-cash assets or it can be called current asset of a business on one side, and the immediate payment obligations or current liabilities on the other side. The liquidity ratio of a banks can be determined through several ratios such as Loan to Deposit Ratio (LDR) and Net Loan to Asset Ratio (NLTA).

The bank cannot hold or store any capital, because the bank returns the capital to the public through loans. Banks that provide credit to the public need to understand what type of credit will be given, it can use the loan to deposit ratio (LDR). LDR is one of the basic indicators that are given from the deposits thus determining what consumption and investment areas will be funded. LDR indicates the level of the bank's ability to provide capital, because the amount of credit given by the bank influences the bank's interest income. Therefore, monitoring loan to deposit ratio is very important in the banking sector to find out the potential risks and take necessary actions, so that it can maintain the financial stability of the bank (Celikkol & Elevli, 2016).

A rural bank needs to determine their ability to meet credit demand, and it can be determined by using the total assets of the bank. Net Loan to Asset Ratio (NLTA) is the ratio used to determine the bank's ability to meet credit demand. In addition, the higher NLTA ratio indicates that the bank is loaned up and its liquidity is low. The higher the ratio, the riskier a bank may be to higher defaults. Therefore, the indicator of NLTA ratio can determine the performance of rural banks whether it is efficient or inefficient.

In the process of development and achievement to improve efficiency and profitability levels, banks often encounter obstacles. Bank management must try to deal with such situations by creating good cooperation between elements within the bank. All elements in the bank are very important because they have a relationship between one another.

In the current era of globalization, competition in the banking world in Indonesia is getting tighter. Therefore, every bank is required to improve the quality of its services to its customers. Beside the threat from the other banks, the current era of globalization has financial-based technologies, namely Fintech. The word of Fintech referred to the "Financial Services Technology Consortium," a project initiated by Citigroup to stimulate technological collaboration (Romānova & Kudinska, 2016). Fintech is growing very rapidly along with the development of technology. Fintech refers to every type of technology that enables solutions in the financial side of the economy (Arner, Barberis and Buckley, 2015). One of them is providing loan services.

Fintech can directly or indirectly affect the rural banks. The general chairman of the Indonesian Rural Bank Association (Perbarindo), Joko Suyanto, said that Fintech was not disruptive for rural banks (BPR). However, he acknowledged that competition was increasing. Fintech development requires rural banks to continue to innovate and keep abreast of the times in running their business. Improving the level of service and following the development of technology-based services is a necessity in order rural banks can maintain their financial stability.

In this research, researchers want to know about whether there is a difference caused by the emergence of Fintech in rural banks. Further testing is carried out through asset quality ratio analysis namely Non-Performing Loans (NPL), profitability ratios namely Return on Assets (ROA), and liquidity ratios namely Loan to Deposit Ratio (LDR) and Net Loan to Asset (NLTA). This research was conducted both before and after the emergence of Fintech in Indonesia to prove whether there are differences from the four variables before and after the emergence of Fintech.

Based on the description above, researcher is interested in conducting research with the title "The Disruption of Fintech on Rural Bank (An Empirical Study on Indonesian Rural Bank Period 2013 – 2018)". The object of this research are rural banks in Indonesia which has published financial data from 2013 to 2018. This object is used because there is no previous research using rural banks/BPR as an object in the impact of the emergence of Fintech in Indonesia. Therefore, researcher will provide new conclusions regarding the impact of Fintech on rural bank.

1.2. Problem Statement

Based on the background of study that has been explained, the formulation of the problem to be studied and identified are as follows:

1. Is there any difference before and after the emergence of Fintech on NPL in rural banks?
2. Is there any difference before and after the emergence of Fintech on ROA in rural banks?
3. Is there any difference before and after the emergence of Fintech on LDR in rural banks?
4. Is there any difference before and after the emergence of Fintech on NLTA in rural banks?

1.3. Research Objective

Based on the problem statement, the research objectives are:

1. To identify and analyse the difference before and after the emergence of Fintech on NPL in rural banks
2. To identify and analyse the difference before and after the emergence of Fintech on ROA in rural banks
3. To identify and analyse the difference before and after the emergence of Fintech on LDR in rural banks
4. To identify and analyse the difference before and after the emergence of Fintech on NLTA in rural banks

1.4.Research Contribution

By doing this research, the researcher hopes this research can be useful for:

1. Rural Bank

   The results of this study are expected to provide benefits for rural bank in confronting the emergence of Fintech. Therefore, it can be used as an object for innovation and evaluation in developing their business.
2. Fintech Company

   The results of this study are expected to provide benefits for Fintech in order to get new innovation for developing their business and it can be considered that the emergence of Fintech companies not to disrupt with other relevant institutions such as rural banks but to be a solution in solving the problems that was confronting by rural banks.
3. Writers

   This research provides knowledge to the author in analysing factors such as Non-Performing Loan (NPL), Return On Asset (ROA), Loan to Deposit Raito (LDR), and Net Loan to Asset Ratio (NLTA). To know the benefits of the theories which has been gained during study Bachelors' degree at Universitas Islam Indonesia by implementing it in this research.
4. Academics

   This research is expected to contribute ideas and information about the impact of the emergence of Fintech on rural banks. Therefore, academics get an overview of the effectiveness or ineffectiveness of the emergence of Fintech and know new things that must be prepared by rural banks in anticipating this disruption to be used as an understanding in the teaching and development of economics.