World Journal of Advanced Research and Reviews
eISSN: 2581-9615 CODEN (USA): WJARAI
Cross Ref DOI: 10.30574/wjarr
Journal homepage: https://wjarr.com/

(Research Article)

Village credit institution: Does business risk effect on profitability?

Putu Sri Arta Jaya Kusuma * and Intan Maulyda

Universitas Pendidikan Nasional, Indonesia.

World Journal of Advanced Research and Reviews, 2023, 20(03), 1066–1072

Publication history: Received on 05 November 2023; revised on 16 December 2023; accepted on 18 December 2023

Article DOI: https://doi.org/10.30574/wjarr.2023.20.3.2574

Abstract

Profitability is a ratio to assess the company's ability to seek profit. Every company is certainly competing to make a profit. The purpose of this study was to determine the significance of credit risk, liquidity risk, and operational risk partially affecting profitability at Village Credit Institutions in Denpasar District. The sample used in the study was 11 Village Credit Institutions with multiple linear regression analysis methods. The results showed that credit risk had a negative and significant effect on the profitability of the Village Credit Institution in South Denpasar District. Liquidity risk has a positive and significant effect on the profitability of the Village Credit Institution in South Denpasar District. Operational risk has a negative and significant effect on the profitability of the Village Credit Institution in South Denpasar District. Credit risk, liquidity risk and operational risk have a significant effect on the profitability of the Village Credit Institution in South Denpasar District.

Keywords: Profitability; Credit Risk; Liquidity Risk; Operational Risk

1. Introduction

Every company that runs business activities is inseparable from the problems most often faced, closely related to the need for funds or capital to finance its business. Funds are needed both for newly established companies and those that have been around for years. Along with the increasing economic growth, there are various kinds of companies engaged in finance that play an important role in meeting the need for funds (Kasmir, 2013:2). Economic growth is closely related to financial institutions, according to Law Number 14 of 1967 concerning Banking Principles, what is meant by financial institutions are all entities that through activities in the financial sector withdraw money from the public and channel the money back to the public. The role of financial institutions in society can indirectly increase production activities, services and even the economy in a country. The financial institutions sector has an important role in economic development, but the financial institutions sector is also inseparable from the risks faced like other sectors.

Financial institutions have various financial services for the welfare of the people, such as: credit deposits, insurance protection, pension programs, provision of payment mechanisms, and fund transfer mechanisms. Basically, financial institutions, banks and non-banks have the same important task, namely, saving funds and channeling them. This makes financial institutions an intermediary for those who need funds and those who experience surplus funds. Pakraman villages in Bali generally have a financial institution, namely the Village Credit Institution, which carries out financial functions and manages financial resources in the Pakraman village in the form of savings and loans. Mayor of Denpasar The presence of the Village Credit Institution in Bali as a village economic institution has many positive impacts on the village community. Based on the Bali Province Regional Regulation No.3 of 2007 concerning Village Credit Institutions, it states that the Village Credit Institution is a financial institution owned by the Pakraman Village which is domiciled in the Pakraman Village. Rural economic development often experiences ups and downs, so it requires support to deal with problems in the economic field. The opersational infrastructure of the Village Credit Institution is based solely on

* Corresponding author: Putu Sri Arta Jaya Kusuma

Balinese customary law and the *awig-awig* of Pakraman villages in improving family ties and the spirit of *gotong royong* between residents.

It is known from the assets that have been generated of more than IDR 1.1 billion, with a profit of more than IDR 31 million in 2019 but in 2020 there was a decrease of 20% in total assets and a very significant decrease in profits, namely by 54%, behind the decline in total assets and profits there is an increase every year in loans given to the community by the South Denpasar Village Credit Institution (LPLembaga Pengkreditan Desa, 2018). Data on the performance of the Village Credit Institution (LPL Lembaga Pengkreditan Desa, 2020) shows unstable asset growth from 2018 to the end of 2020, this shows that the Village Credit Institution has difficulty maintaining the stability of its profit growth in each year due to asset growth that fluctuates in the 2018-2020 period. One of the reasons is due to the increasing ratio of non-performing loans (NPL) during this pandemic. Loans continue to increase because many rural communities are starting to have economic difficulties due to the impact of the COVID-19 pandemic. With the existence of Village Credit Institutions that have a leading role to contribute to village economic development. In doing business, the Village Credit Institution has a short-term goal of maximizing profits and the welfare of the surrounding villagers and a long-term goal of maintaining business continuity.

Maximizing profitability is the main objective of bank operations. Profitability is the most important indicator of a company's success. Return on Asset (ROA) is used as a measure of the Bank's profitability. According to Kasmir (2019:201) Return on Assets (ROA) is a ratio that shows the return on the number of assets used in the company. Researchers use Return on Assets (ROA) in calculating profitability in this study, because ROA calculates the Bank's performance in generating overall profit. The higher the Bank's ROA level, the higher the profit achieved by the Bank and the better the Bank's position in using assets.

The expected profitability of a company is easily affected by risk (Hallunovi and Berdo, 2018).Risk can happen at any time, and to anyone, because everything is basically associated with risk. Usually, companies take risks to maximize the benefits behind the risks experienced. Risk is the uncertainty that something will happen that will affect the company's goals. Village Credit Institutions face various types of risks, including credit risk, capital risk, liquidity risk and operational risk. Among these risks, credit risk, liquidity risk, and operational risk are risks that are occasionally encountered in banking companies. During this pandemic, many problems have arisen, such as non-performing loans that have caused a decrease in assets, liquidity difficulties for Village Credit Institutions, because many people have withdrawn capital, causing shrinkage of profits. The Village Credit Institution's human resources do not master good financial management mechanisms, and there are several legal cases experienced by the Village Credit Institution that need to be raised (Saskara et al., 2020). This makes the Village Credit Institution more attentive and a lesson for future managers of the Village Credit Institution to be more careful. Making local governments more attentive to the availability of liquidity to fulfill their obligations to citizens. By limiting credit expansion amid the risk of economic uncertainty at this time. As well as the Village Credit Institution in order to improve coordination with traditional villages to urge residents to fulfill their obligations, including helping the Village Credit Institution to increase liquidity by fulfilling obligations to pay credit or savings, to minimize and anticipate future problems, management is needed in managing these risks, this is why researchers take credit risk, liquidity risk, operational risk and profitability in this study and the Village Credit Institution as the object of research.

The main operational activity of the Village Credit Institution, lending, is the basis of the Village Credit Institution. Credit activities are the source of income and profitability for the Village Credit Institution, and not only that, credit activities are the main trigger for financial institutions to face a major problem, namely the inability of customers to fulfill their responsibilities. Credit risk arises because the borrower is unable to fulfill his obligations to the Village Credit Institution in accordance with the agreement between the Village Credit Institution and the borrower concerned, which results in a loan being classified as substandard, doubtful, or bad (Suardika and Dewi, 2021). Credit risk is related to the core business of the Village Credit Institution itself and is a normal risk. By using Non-performing loans (NPL) to calculate the level of credit risk encountered by researchers at the Village Credit Institution. Non-performing loan is a proxy that shows the proficiency of Bank management in servicing non-performing loans allocated by a Bank.

Liquidity risk is the risk that the Village Credit Institution cannot fulfill or pay its obligations in the short term and must seek loans at high interest rates or sell assets / assets of the Village Credit Institution by suffering losses (Susanti et al., 2022). Proxy measures can be measured to calculate liquidity risk with Loan to deposit ratio (LDR). Loan to Deposit Ratio is a ratio that measures the composition of the amount of credit with the total funds received. If the LDR value is higher, it shows that more funds are channeled by the Bank to finance its credit, thus the Bank will get profit from loan interest.

Operational risk is the risk of inadequate internal processes. Comparing operating costs with the operating income earned by the industry, this can drive the financial performance of the industry. In order to minimize those arising in these operational activities, researchers use the proxy Operating costs / Operating income (BOPO) to calculate the level of operational risk experienced. According to P. Hasibuan (2017:101) Operating cost of operating income (BOPO) is the ratio of operating costs to operating income (BOPO) formulated as a comparison or operating costs to operating income in the same period.

The purpose of this study is to determine the impact of credit risk, liquidity risk and operational risk simultaneously affecting profitability at Village Credit Institutions in South Denpasar District.

2. Literature Review and Hypothesis Development

According to Kasmir (2013) When the costumer is unable to pay all or some of his agreed-upon payments to the bank, the loan is considered non-performing. The performance of a bank is further lowered by the higher NPL ratio, which indicates worse credit quality and may lead to an increase in the quantity of non-performing loans. When extending credit, the bank must first assess the debtor's ability to meet its obligations. The bank is subsequently required to monitor the credit issued and the debtor's capacity to meet its commitments. Lending is one of the activities of the Village Credit Institution. The occurrence of bad credit risk requires complete attention from management in order to not negatively impact the bank's health. The results of research conducted by Khamisah et al., (2020) there is a negative and significant relationship between NPL and ROA, similar to the results of research Setyarini (2020), also obtained the same results where there is a negative and significant relationship between NPL and ROA.

H1: Credit risk has a negative and significant effect on profitability.

Loan to deposit ratio is a proxy used by researchers in measuring the level of liquidity risk. According to Budisantoso and Nuritomo (2014) explains that the ratio to measure the amount of third-party funds channelled in the form of credit. So LDR is a ratio used to measure how much funds received by the bank to be channelled back to the community in the form of credit" A high ratio level indicates that the bank is in an illiquid condition, on the other hand, a low ratio level indicates a bank that has excess capacity to lend funds. The results of research conducted by Setyarini (2020) where LDR has a positive and significant effect on ROA, Korompis et al., (2020) also get the same results between LDR and ROA where LDR has a positive and significant effect on ROA.

H2: Liquidity risk has a positive and significant effect on profitability.

Operational risk is the risk of loss caused by system failure, errors due to human factors, or weaknesses in operational procedures in a process (Suartana, 2009: 75). BOPO is a proxy used by researchers in measuring the level of operational risk. According to P. Hasibuan (2017: 101) operational cost operating income (BOPO) is the ratio of operational cost operating income (BOPO) formulated as a comparison or operating costs to operating income in the same period.

Measurement using BOPO is expected to provide a value that shows the operational efficiency of the Village Credit Institution. A high BOPO level illustrates that the operating costs that the company must pay are greater than the operating income it earns. The use of BOPO in this study as one of the variables that affect profitability in the Village Credit Institution, because in BOPO there are costs and revenues obtained, indirectly related to profitability in the company. The results of previous research conducted by Syah (2018) where he obtained the results, there was a significant negative relationship between BOPO and ROA, Setyarini (2020) also got the same results where BOPO had a negative and significant effect on ROA.

H3: BOPO has a negative and significant effect on ROA.

Based on previous research on credit risk on profitability according to Indra Pangesti and Hazmi (2023) that simultaneously credit risk (NPL), liquidity risk (LDR) and operational risk (BOPO) have a significant effect on profitability (ROA). According to Setyarini (2020), it shows that the LDR variable has a positive and significant effect on ROA. Previous research conducted by Syah (2018) showed that the BOPO variable on ROA obtained results, there was a significant negative relationship. From the statement of previous research, the following hypothesis can be formulated:

H4: Credit risk, liquidity risk, and operational risk simultaneously have a significant effect on profitability.

3. Methods

Researchers conducted research on Village Credit Institutions (Village Credit Institutions) in South Denpasar District, using data obtained from the financial statements of Village Credit Institutions. This study focused on 11 Village Credit Institutions in South Denpasar District. The quantitative data in this study includes financial reports on Village Credit Institutions in South Denpasar District from 2018 to 2020. This study uses of secondary data from a recapitulation of the Village Credit Institution's financial statements for the 2018–2020 period in South Denpasar District. The data was collected through observation and documentation, and the data was analysed using multiple regression analysis.

4. Result and Discussion

Table 1 Multiple Regression Analysis Results

		B	Std. Error	Beta	t	sig
1	(Constant)	13.014	0.877		14.844	0.000
	Credit Risk	-0.005	0.002	-0.041	-2.730	0.023
	Liquidity	0.004	0.002	0.031	2.585	0.026
	BOPO	-0.133	0.009	-0.963	-15.223	0.000

Secondary Data, 2023

Based on Table 1, a multiple regression equation is obtained as follows.

$$Y = 13.014 - 0.005X1 + 0.004X2 - 0.133X3$$

4.1. Credit Risk on Profitability

Based on the results of testing the significance of the effect of credit risk on profitability, partially carried out by conducting a t test, namely by comparing the significance value of t with α (0.05). The t count of the credit risk variable (X1) with a sig value of 0.023 < α (0.05) means rejection of H0 so that H1 is accepted. Which means credit risk (X1) has a negative and significant effect on profitability (Y). The results of the study mean that the higher the credit risk, the lower the profitability, and vice versa, the lower the credit risk, the higher the profitability of the Village Credit Institution in South Denpasar District.

According to Kasmir (2013) non-performing loan is a situation where the customer is unable to pay all or part of obligations to the bank as agreed. The performance of a bank is further lowered by the greater NPL ratio, which indicates worse credit quality and may lead to an increase in the quantity of non-performing loans. The bank must first assess the debtor's capacity to pay its debts before granting credit. The bank is therefore required to keep an eye on the credit that has been given and the debtor's capacity to pay its debts. The Village Credit Institution engages in lending as one of its operations. Bad credit risk is something that needs to be managed with the utmost care in order to prevent harm to the bank's overall health.

The results of this study are in line with those conducted by Khamisah et al (2020) there is a negative and significant relationship between NPL and ROA, similar to the results of research Setyarini (2020) and Maulana et al (2021), also obtained the same results where there is a negative and significant relationship between NPL and ROA.

4.2. Liquidity Risk on Profitability

Based on the results of testing the significance of the effect of liquidity risk on profitability, partially carried out by conducting a t test, namely by comparing the significance value of t with α (0.05). The t count of the liquidity risk variable (X2) with a sig value of 0.026 < α (0.05) means rejection of H0 so that H2 is accepted. Which means that liquidity risk (X1) has a positive and significant effect on profitability (Y). The results of the study mean that the higher the liquidity risk, the higher the profitability, and vice versa, the lower the liquidity risk, the lower the profitability of the Village Credit Institution in South Denpasar District.

Loan to deposit ratio is a proxy used by researchers in measuring the level of liquidity risk. According to Budisantoso and Nuritomo (2014) explains that the ratio used to calculate the amount of third-party funds channeled in the form of credit. So LDR is a ratio used to determine how much funds a bank receives and allocates to providing credit to the community. A high ratio level implies that the bank is in an illiquid position, on the other hand, a low ratio level indicates a bank that has excess capacity to lend funds. The results of research conducted by Setyarini (2020) and Wiranthie et al (2022) where LDR has a positive and significant effect on ROA, Korompis et al., (2020) also get the same results between LDR and ROA where LDR has a positive and significant effect on ROA.

4.3. Operational Risk on Profitability

Based on the results of testing the significance of the effect of operational risk on profitability, partially carried out by conducting a t test, namely by comparing the significance value of t with α (0.05). The t count of the operational risk variable (X3) with a sig value of 0.0000 < α (0.05) means rejection of H0 so that H3 is accepted. Which means that operational risk (X3) has a positive and significant effect on profitability (Y). The research results mean that the higher the operational risk, the lower the profitability, and vice versa, the lower the operational risk, the higher the profitability of the Village Credit Institution in South Denpasar District.

Operational risk is the risk of loss caused by system failure, errors due to human factors, or weaknesses in operational procedures in a process (Suartana, 2009: 75). BOPO is a proxy used by researchers in measuring the level of operational risk. According to P Hasibuan (2017: 101) operational cost operating income (BOPO) is the ratio of operational cost operating income (BOPO) formulated as a comparison or operating costs to operating income in the same period.

It is anticipated that measurement using BOPO would yield a result that illustrates the Village Credit Institution's operating efficiency. When a company's BOPO level is high, it means that its operating expenses outweigh its operational revenue. Because BOPO involves expenses and revenues that are indirectly connected to the company's profitability, it is used in this study as one of the variables affecting Village Credit Institution's profitability. The results of previous research conducted by Syah (2018) where he obtained the results, there was a significant negative relationship between BOPO and ROA, Setyarini (2020) also got the same results where BOPO had a negative and significant effect on ROA.

Table 2 Simultaneous Hypothesis Test Results (F Test)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	70.728	3	23.576	89.781	0.000
	Residual	7.615	29	0.263		
	Total	78.343	32			

Secondary Data, 2023

4.4. Credit Risk, Liquidity Risk, and Operational Risk on Profitability

Based on the research results in the F test, it is known that the sig value of 0.000 is smaller than 5%, indicating that the independent variables, namely credit risk, liquidity risk, operational risk, simultaneously affect profitability (Y). This means that when credit risk and operational risk decrease and liquidity risk increases, profitability will increase at the Village Credit Institution in South Denpasar District.

Based on previous research, credit risk on profitability according to Halimah (2016) that Credit Risk has a significant negative effect on Profitability. According to Setyarini (2020) shows that the LDR variable has a positive and significant effect on ROA. Previous research conducted by Syah (2018) showed that the BOPO variable on ROA obtained results, there was a significant negative relationship.

5. Conclusions

Credit risk and operational risk have a negative and significant impact on the profitability of Village Credit Institutions in South Denpasar District. This indicates that profitability decreases with increasing credit risk and operational risk. The profitability of the Village Credit Institution in the South Denpasar District is positively and significantly impacted by liquidity risk. This means that the higher the liquidity risk, the higher the profitability. The profitability of the Village Credit Institution in the South Denpasar District is significantly impacted by credit risk, liquidity risk, and operational risk. This means that the higher the credit risk and operational risk and the lower the liquidity risk, the lower the profitability.

Compliance with ethical standards

Disclosure of conflict of interest

No conflict of interest to be disclosed.

References

[1] Budisantoso, T. and Nuritomo. 2014. Bank dan Lembaga Keuangan Lain (*Banks and Other Financial Institutions)*. Jakarta: Salemba Empat.

[2] Halimah, Devi Nur. 2016. Analisis Pengaruh Risiko Kredit Dan Kecukupan Modal Terhadap Profitabilitas Di Bank Umum Syariah Nasional (BUSN) Devisa Dan Non Devisa Periode 2010-2014 (Analysis of the Effect of Credit Risk and Capital Adequacy on Profitability in Foreign Exchange and Non-Exchange National Islamic Commercial Banks (BUSN) for the Period 2010-2014). Fakultas Ekonomi Dan Bisnis Islam Institut Agama Islam Negeri Salatiga.

[3] Hallunovi, Arjeta, and Miranda Berdo. 2018. "The Relationship between Risk Management and Profitability of Commercial Banks in Albania." *Asian Themes in Social Sciences Research* 1(2):44–49. doi: 10.33094/journal.139.2018.12.44.49.

[4] Indra Pangesti, Shikit, and Shadrina Hazmi. 2023. The Effect of Operational Efficiency, Credit Risk, Liquidity Risk on Profitability in Conventional Banking Listed on the Indonesia Stock Exchange Period 2020 – 2021. *International Journal of Humanities, Social Sciences and Business (Injoss)* 2(3):293–310. doi: 10.54443/injoss.v2i3.81.

[5] Kasmir. 2013. Bank dan Lembaga Keuangan Lainnya (*Banks and Other Financial Institutions)*. 2nd ed. Jakarta: PT Raja Grafindo Persada.

[6] Kasmir. 2019. Analisis Laporan Keuangan (*Financial Report Analysis)*. Depok: PT. Raja Grafindo Persada.

[7] Khamisah, Nur, Dhiona Ayu Nani, and Izza Ashsifa. 2020. *Pengaruh Non-Performing Loan (NPL), BOPO dan Ukuran Perusahaan Terhadap Return on Assets (ROA) Perusahaan Perbankan yang Terdaftar di Bursa Efek Indonesia (BEI)* (The Effect of Non-Performing Loan (NPL), BOPO and Company Size on Return on Assets (ROA) of Banking Companies Listed on the Indonesia Stock Exchange). *TECHNOBIZ : International Journal of Business* 3(2):18. doi: 10.33365/tb.v3i2.836.

[8] Korompis Ria Revianty Nevada, Murni Sri, and Untu Victoria N. 2020. Pengaruh Risiko Pasar (NIM), Risiko Kredit (NPL) dan Risiko Likuiditas (LDR) Terhadap Kinerja Keuangan Perbankan (ROA) Pada Bank yang Terdaftar di LQ45 Periode 2012-2018 (The Influence of Market Risk (NIM), Credit Risk (NPL), and Liquidity Risk (LDR), on Banking Financial Performance (ROA) in Banks Registered in LQ 45 for the 2012-2018 Period). *Junal EMBA* 8(1):175–85.

[9] Maulana, Panji, Sany Dwita, and Nayang Helmayunita. 2021. Pengaruh CAR, NPL, LDR dan BOPO terhadap Return on Assets (ROA) pada Bank Terdaftar di Bursa Efek Indonesia Tahun 2017-2019 (The Effect of CAR, NPL, LDR and BOPO on Return on Assets (ROA) in Banks Listed on the Indonesia Stock Exchange in 2017-2019). *Jurnal Eksplorasi Akuntansi* 3(2):316–28. doi: 10.24036/jea.v3i2.355.

[10] P. Hasibuan, Malayu S. 2017. Dasar-Dasar Perbankan (*Banking Basics)*. Jakarta: Bumi Aksara.

[11] Saskara, Ida Ayu, A. A. I. .. Marhaeni, and Ni Nyoman Yuliarmi. 2020. The Role of Village Credit Institution (LPD) to Realize The Economic Empowerment. *Journal Revista Espacios* 41(05):7–12.

[12] Setyarini, Adhista. 2020. Analisis Pengaruh CAR, NPL, NIM, BOPO, LDR Terhadap ROA (Studi Pada Bank Pembangunan Daerah di Indonesia Periode 2015-2018 (Analysis of the Effect of CAR, NPL, NIM, BOPO, LDR on ROA (Study on Regional Development Banks in Indonesia for the 2015-2018 Period). *Research Fair Unisri* 4(1):282–90. doi: 10.33061/rsfu.v4i1.3409.

[13] Suardika, I. Ketut, and Mertyani Sari Dewi. 2021. Effectiveness of Non-Performing Loans Management at the Penglatan Traditional Village Credit Institution (LPD). *International Journal of Social Science and Business* 5(4):599. doi: 10.23887/ijssb.v5i4.41125.

[14] Suartana, Wayan. 2009. *Arsitektur Pengelolaan Risiko Pada Lembaga Perkreditann Desa (LPD) (Risk Management Architecture in Village Credit Institutions)*. Denpasar: Udayana University Press.

[15] Susanti, Jeni, I. Gede Made Karma, and Ni Wayan Kurnia Dewi. 2022. “Design of Risk Rating Applications for Village Credit Institutions.” *Proceedings of the International Conference on Applied Science and Technology on Social Science 2021 (ICAST-SS 2021)* 647:633–39. doi: 10.2991/assehr.k.220301.104.

[16] Syah, Toufan Aldian. 2018. Pengaruh Inflasi, BI Rate, NPF, dan BOPO terhadap Profitabilitas Bank Umum Syariah di Indonesia. (The Effect of Inflation, BI Rate, NPF, and BOPO on the Profitability of Islamic Commercial Banks in Indonesia). *El-Jizya : Jurnal Ekonomi Islam* 6(1):133–53. doi: 10.24090/ej.v6i1.2051.

[17] Wiranthie, Intan Kusuma, and Hartri Putranto. 2022. Analisis Pengaruh Capital Adequancy Ratio (CAR), Loan To Deposit Ratio (LDR) dan Non Performing Loan (NPL) terhadap Return On Asset (ROA) (Analysis of the Effect of Capital Adequancy Ratio (CAR), Loan To Deposit Ratio (LDR) and Non Performing Loan (NPL) on Return On Asset (ROA)). *Jurnal Ekonomi, Manajemen Dan Perbankan (Journal of Economics, Management and Banking)* 6(1):13. doi: 10.35384/jemp.v6i1.229.