

POLICY BURDENS OF DEVELOPMENT BANKS: EVIDENCE FROM INDONESIA

Hasan Almutahar*, **Muhammad Agung Prabowo****, **Tulus Haryono****, **Asri Laksmi Riani****, **Irwan Trinugroho****

Abstract

We take the social or development perspective of government banks on the Indonesian regional development banks. We find that those banks have more employee burden and small scale loans burden than other banks. Excessive employment in the regional development banks is positively associated with the degree of poverty in their regions and negatively related to the regional economic capacity. In the regions with high degree of poverty, those banks have to channel excessive small scale loans.

Keywords: Regional Development Banks, Policy Burdens, Employee Burden, Small-Scale Loans, Regional Economic

*Faculty of Social and Political Sciences, Universitas Tanjungpura, Indonesia, Jl. Prof. Dr. H. Hadari Nawawi, Pontianak, Indonesia

**Faculty of Economics and Business, Universitas Sebelas Maret, Indonesia, Jl. Ir. Sutami 36A, Surakarta 57126, Indonesia

1 Introduction

The grabbing hand theory contends that state-owned enterprises may perform inefficiently because they are subject to politicians and bureaucrats (Shleifer and Vishny, 1994, 1998). Focusing on state-owned banks (government banks), there are two main theories related to those banks based on such two opposing theories. According to the social or development theories, state-owned banks are often inefficient because they play a role as agent of development. Sometimes they are assigned to fund unprofitable investments. The political theory of government ownership of banks explains that state-owned banks are less profitable because they have to serve the interest of politicians (La Porta *et al.*, 2002), particularly through their lending behavior (Sapienza, 2004; Dinc, 2005; Micco *et al.*, 2007).

This study is aimed at examining the social or development view of state-owned banks on the Indonesian regional development banks (henceforth RDBs), the banks which are owned by regional government². A regional development bank in Indonesia commonly is the largest firm controlled by a regional/provincial government. To examine this theory, we have to identify and disentangle the channel of social and development activities of such banks. We consider two following policy burdens of

the RDBs. First, we argue that the RDBs are assigned to help reduce the unemployment by recruiting more employees than the industry average or surplus labor (Bai *et al.*, 2006; Liao *et al.* 2009; Wu *et al.*, 2010, Prabowo *et al.*, 2014). Second, we contend that the other policy burden comes from the fact that RDBs have to conduct development activities through granting small scale loan more than the industry average. Those banks have to channel more loans to micro and small enterprises which tend to be risky.

To confirm the social or development view of the Indonesian RDBs, we first investigate whether those banks have more policy burdens than other banks. Second, we go further by examining the impact of regional economies where the RDBs located on the policy burdens of those banks. Supposedly, in the less developed regions, the degree of policy burdens is higher than in the developed regions.

2 Methodology and data

We consider two measures of policy burdens which are employee burden and small scale loans burden. We follow the logic to calculate the employee burden as used by Bai *et al.* (2006), Liao *et al.* (2009), Wu *et al.* (2010), Prabowo *et al.* (2014). However, we use salary cost (personnel cost) instead of number of employees. The formulation of employee burden is as follows:

² State-owned (government) banks in Indonesia consist of state-owned banks (*bank BUMN/Persero*) which are controlled by central government and regional development banks (*Bank pembangunan Daerah/BPD*) which are owned by regional government. Currently, there are 4 state-owned banks and 26 regional development banks.

$$\text{Employee burden} = \left(\text{Salary cost} - \text{Industry average on salary cost} * \frac{\text{Income}}{\text{Industry income}} \right) / \text{Salary cost}$$

We introduce small scale loans burden which is the excess small scale loans that should be released by the RDBs compare to the industry average. Therefore,

the method to measure the small scale loans burden can be seen in this following formula:

$$\text{Small scale loans burden} = (\text{Small scale loans to total loans}) - (\text{Industry average on small scale loans to total loans})$$

109 commercial banks which consist of state-owned banks, regional development banks, foreign banks, and domestic-private banks are used to reflect the industry.

First, we examine whether the RDBs have more policy burdens than other banks. We use data from

2001-2010. We control for several variables which are dummy foreign banks (FOB), dummy listed banks (LISTED), natural log of total assets (LNTA), and the ratio of equity to total assets (EQTA) following the work of Prabowo et al. (2014). The equation can be written as:

$$\text{Policy burdens}_{i,t} = \alpha_0 + \alpha_1 \text{RDB}_{i,t} + \alpha_2 \text{FOB}_{i,t} + \alpha_3 \text{Listed}_{i,t} + \alpha_4 \text{LNTA}_{i,t} + \alpha_5 \text{EQTA}_{i,t} + \varepsilon_{i,t} \quad (1)$$

Second, we deepen our study by looking the effect of regional economies on policy burdens of the RDBs. We use two proxies of the regional economies. The degree of poverty (POVERTY) could be considered to reflect the social condition as well as the development of the regions. Then, the proportion of a region's GDP to country's GDP (REG GDP) represents the economic capacity of the region. Two control variables are performed in the empirical model. First, we take into account dummy of regional development banks which are located in the Java Island (JAVA). Java is the most populous island and could be considered as the most developed island in

Indonesia. Second, we include a bank specific variable which is the ratio of equity to total assets (EQTA). We exclude bank size (total assets) because it has high correlation with the proportion of regions' GDP to country's GDP. There is only one publicly traded regional development bank and just listed since 2010, therefore we do not incorporate dummy for listed bank.

To test the impact of regional economies on policy burdens, we then write the specification of the empirical model in the equation 2. We use panel least square with time-fixed effect to estimate this empirical model.

$$\text{Policy burdens}_{i,t} = \alpha_0 + \alpha_1 \text{Poverty}_{i,t} + \alpha_2 \text{Regional GDP}_{i,t} + \alpha_3 \text{Java}_{i,t} + \alpha_4 \text{EQTA}_{i,t} + \varepsilon_{i,t} \quad (2)$$

Banks' financial statements over the periods 2001-2010 come from Bank Indonesia (the Indonesian Central Bank) and Ekofin Konsultindo. These financial statements also provide us with the information on small scale loans. Data on the regional economies are obtained from Indonesia Statistics Bureau (BPS). However, the regional economies data are only available for 2007-2010.

The statistics on policy burdens of RDBs and non-RDBs are reported in the appendix. The descriptive statistics and correlations of all variables used in the second empirical model are presented in the appendix as well.

3 Regression results

The results which are presented in the Table 1 obviously show that the RDBs have more employee burden and small scale loan burden than other banks. Then, the negative and significant coefficients of FOB, LISTED, and LNTA indicate that foreign banks, listed banks, and large banks have lower employee burden and small scale loans burden than

domestic banks, non-listed banks, and small banks, respectively.

We then examine the impact of regional economies on policy burdens of Indonesian RDBs. Column 1-3 of Table 2 presents the regression results of the impact of regional economy variables and control variables on employee burden. Consistent with what we expect, the result suggests that the employee burden of RDBs is higher in the regions with high levels of poverty. Then, the coefficient of proportion of regional's GDP to country's GDP (REG GDP) has a negative and significant sign on employee burden. This may be attributed to the fact that economically small regions have less developed private sectors, less formal employment and finding jobs is difficult. To help reduce unemployment, regional development banks are assigned to absorb the excess workforce. The positive and significant coefficient of RDBs located in the Java Island on employee burden is supposedly caused by the high population in this island which may correlate with high degree of unemployment. The ratio of equity to assets has negative and significant effect on employee burden.

Table 1. Regressions results (all banks: 2001-2010)

	EMPLOYEE BURDEN		SMALL SCALE LOANS BURDEN	
	1	2	3	4
CONSTANT	1.121*** (0.213)	1.102*** (0.197)	0.161** (0.068)	0.134** (0.063)
RDB	0.208*** (0.052)	0.211*** (0.052)	0.138*** (0.016)	0.138*** (0.016)
FOB	-0.443*** (0.055)	-0.443*** (0.055)	-0.188*** (0.018)	-0.191*** (0.017)
LISTED	-0.298*** (0.068)	-0.295*** (0.068)	-0.072*** (0.022)	-0.074*** (0.022)
LNTA	-0.069*** (0.014)	-0.068*** (0.013)	-0.009** (0.004)	-0.007* (0.004)
EQTA	-0.003 (0.002)	-0.002 (0.002)	-0.0002 (0.0007)	-0.00004 (0.0006)
Time fixed effect	Yes	No	Yes	No
Number of banks	109	109	109	109
Observations	1046	1046	1042	1042
Adj-R ²	0.22	0.22	0.28	0.28

Note: The value in the parentheses is standard error. *, ** and *** indicate significance at the 10%, 5%, and 1% levels, respectively

The regression results of the explanatory variables on small scale loans burden are found in the column 4-6 of Table 2. The result indicates that the percentage of poverty in the regions positively impact on small scale loans burden of RDBs. Such banks have to help in the access to financing for a large number of micro enterprises, home industries, and

other informal sectors which are prevalent in the less developed regions. The insignificant result of regional GDP on small loans burden could be interpreted that RDBs release small scale loans more than the average of industry even in the economically large regions. Further, we do not find evidence on the effect of our two control variables on small scale loans burden.

Table 2. Regression Results (Regional development banks: 2007-2010)

	EMPLOYEE BURDEN			SMALL SCALE LOANS BURDEN		
	1	2	3	4	5	6
CONSTANT	0.223** (0.101)	0.546*** (0.092)	0.416*** (0.101)	-0.149 (0.099)	-0.001 (0.102)	-0.199* (0.108)
POVERTY	0.012*** (0.003)		0.008*** (0.003)	0.011*** (0.003)		0.012*** (0.003)
REG GDP		-0.039*** (0.007)	-0.033*** (0.007)		-0.0006 (0.008)	0.009 (0.008)
JAVA	0.019 (0.063)	0.365*** (0.089)	0.325*** (0.088)	0.015 (0.062)	-0.001 (0.099)	-0.064 (0.094)
EQTA	-0.019** (0.008)	-0.023*** (0.007)	-0.024*** (0.007)	0.006 (0.007)	0.009 (0.008)	0.008 (0.008)
Time fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Number of RDBs	26	26	26	26	26	26
Observations	104	104	104	101	101	101
Adj-R ²	0.13	0.23	0.28	0.09	0.02	0.10

Note: The value in the parentheses is standard error. *, ** and *** indicate significance at the 10%, 5%, and 1% levels, respectively

4 Conclusion

This research note shows that Indonesian regional development banks serve the development purposes as indicated by the high degree of employee burden and small scale loans burden compare to other banks. We also conclude that regional economies contribute to determine the policy burdens that should be borne

by those banks. First, we find that the degree of poverty positively associated with the employee burden. Second, we document that the degree of employee burden are also affected by the regional economic capacity. As expected, in the economically small regions, the degree of employee burden of those banks is high. Third, the results conclude that RDBs are burdened to channel more small scale loans

particularly in the less developed regions which are reflected by high degree of poverty. Overall, our findings confirm that regional development banks in Indonesia as a kind of government banks play roles as agent of development in which such banks are assigned to conduct development and social activities. Such developmental roles may make banks unprofitable and may lead to inefficiency.

References

- Bai, C., Lu, J., & Tao, Z. 2006. Divergent interests between central and local governments: Testing theories of public ownership. *Working paper, Tsinghua University and The University of Hong Kong*.
- Dinc, S. I., 2005. Politicians and banks: Political influences on government-owned banks in emerging markets. *Journal of Financial Economics* 77, 453–479.
- Huang, X., Li, P., Lotspeich, R. 2010. Economic growth and multi-tasking by state-owned enterprises: An analytic framework and empirical study based on Chinese provincial data. *Economic Systems* 34, 160–177.
- La Porta, R., Lopez-de-Silanes, F., Shleifer, A. 2002. Government ownership of banks. *Journal of Finance* 57, 256-301.
- Liao, G., Chen, X., Jing, X., Sun, J. 2009. Policy burdens, firm performance, and management turnover. *China Economic Review* 20, 15–28.
- Micco, A., Panizza, U., Yanez, M., 2007. Bank ownership and performance. Does politics matter?. *Journal of Banking & Finance* 31, 219–241.
- Prabowo, M.A., Untoro, W., Trinugroho, I., Angriawan, A. 2014. State-owned Enterprises, Efficiency and Performance: The Case of Indonesia. *International Business Management* 8(2), 153-158.
- Sapienza, P., 2004. The Effects of government ownership on bank lending. *Journal of Financial Economics* 72, 357-384.
- Shleifer, A., Vishny, R.W., 1994. Politicians and firms. *Quarterly Journal of Economics* 46, 995-1025.
- Shleifer, A., Vishny, R.W., 1998. *The grabbing hand: government pathologies and their cures*. Cambridge, Massachusetts: Harvard University Press.
- Wu, W., Wu, C., Rui, O.M., 2010. Ownership and the Value of Political Connections: Evidence from China. *European Financial Management* 17, 1-35.

Appendix A

Table A1. Descriptive statistics on policy burdens (all banks: 2001-2010)

	Banks	Obs	Mean	Median	Max	Min	Std. Dev.
Regional Development Banks (RDBs)							
EMPLOYEE BURDEN	26	257	0.2700	0.3113	0.7015	-1.1308	0.2652
SMALL LOANS BURDEN	26	257	0.1594	0.0408	0.8812	-0.2752	0.2830
Other Banks							
EMPLOYEE BURDEN	83	791	-0.1449	0.0487	0.8190	-4.0375	0.7089
SMALL LOANS BURDEN	83	791	-0.0522	-0.1096	0.7807	-0.2752	0.1760

Table A2. Descriptive statistics and correlations (Regional development banks: 2007-2010)

	Mean	St. Dev	1	2	3	4	5
1.EMPLOYEE BURDEN			1				
2. SMALL LOANS BURDEN	0.213	0.266		1			
3. POVERTY (%)	0.102	0.254	0.125		1		
4. REGGDP (%)	15.749	8.013	0.318	0.343		1	
5. EQTA (%)	3.804	5.070	-0.260	-0.046	-0.304		1
	11.102	3.357	-0.165	0.147	0.088	-0.267	