

Risk, Corporate Strategy, Capital Structure and Financial Performance: Empirical Evidence of Bank Listed in Indonesia Stock Exchange

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ABSTRACT: *The purpose of this study are : (i) examining effect of risk on assets growth, income diversification, capital structure and financial performance, (ii) examining effect of assets growth and diversification on capital structure (debt to assets ratio) and financial performance (Return on Average Assets), (iii) examining effect of capital structure (DAR) on financial performance (Return on Average Assets). Research was conducted at bank listed on Indonesia Stock Exchange with observation period 2006-2010. There are 20 banks samples are determined based on population criteria. Analysis method used is Path Analysis. The study found that credit risk does not determine assets growth, income diversification, capital structure and financial performance. Assets growth does not determine capital structure, income diversification but determining capital structure. Asset growth determines capital structure and financial performance, while income diversification does not determine financial performance. Lower credit risk indicates higher quality of go public bank management so they more trusted by investors (public). The findings of this study provide support that funding decision of go public banks follow the signaling theory and pecking order theory. This research makes two novelties. First, this study seeks to put together the previous research in a model built from previous studies, which are expected become novelty currency of this research. Second, empirical evidence shows the risk that managed effectively and actually have a positive effect and more favorable for shareholders or investors. These findings demonstrate novelty of this research.*

Keywords: *credit risk, asset growth, income diversification, capital structure and financial performance.*

I. INTRODUCTION

Generally, banks performance are an achievements picture of bank management in their operational, in this case is banks management on asset and liability. Bank's performance demonstrates success of policies implementation in capital management (equity), funds accumulation (funding) and funds usage (assets), which are interrelated each other to achieve optimal profit levels with risk level has been calculated [57]. Financial performance provides clues whether company's strategy, implementation and execution, contribute to higher corporate profits or not [37].

Executive senior of bank always actively involved in strategic planning to forecast profitable alternative growth for banks and considering the need to improve capability to compete, create new capabilities, or to divest existing capabilities [43]. Increase competitive capabilities and creating new capabilities is an excellent implementation of corporate strategy and diversification growth strategy. Company (bank) with planning system which adopts strategic management theory exhibit better long-term financial performance [21]. This opinion states that corporate strategy is one determinants of financial performance.

Implementation of a successful strategy requires funding, both internal and external. Diversification will also depend on financial resources available to company [18]. Funds needed to invest in diversification are great. Companies often require external funding sources [18]. Diversification can increase debt, reduce chances of bankruptcy by entering into product/new market [30.52].

Banking business is a business that accepts and manages risk assets, after receiving deposits (from public) then allocated to productive assets. Banks that have risky assets will give bank a higher income, when it is productive, but when it is not productive, bank management has failed [45]. Therefore, high risks could undermine bank's ability to interact with its environment to face competition. Higher NPLs describes a high credit risk, it make bank tend to reduce lending and their assets value decline [61]. This condition will have a

direct effect to investors who need funds to develop their business, and will have a negative effect on economic growth.

Under deregulation package of 29 February (Pakfeb 1991) which refers to Bank for International Settlements (BIS) Standard, Bank Indonesia requires each commercial bank provide minimum capital (Capital Adequacy Ratio-CAR) of 8%. This provision confirms that bank owners are only required to deposit a minimum 8% capital of total assets, which is demonstrated by capital adequacy ratio or CAR. Although owner only has capital of Rp 100 billion, bank owners are allowed to manage customer funds up to Rp 1.25 trillion. In this case 92% of total bank assets come from debt. Successful banks will accelerate economic growth, while fail banks will hamper economic growth. Domino effect of risk systemic banking, where one bank collapse could topple other banks, even lead to economic crisis for a country.

Business development activity of go public bank during five years (2006-2010) show a higher trend every year, except capital adequacy ratio (CAR) and non-performing loans (NPLs) in 2010 decreased.

Table 1 Business development activity of go public bank 2006-2010 (Trillion rupiah)

No	Keterangan	Tahun				
		2006	2007	2008	2009	2010
1	Total Assets	1.162,04	1.411,84	1.620,74	1.905,37	2.298,91
2	Third party deposits	880,23	1.126,50	1.562,81	1.562,81	1.830,15
3	Loans	504,85	671,94	871,73	1.044,57	1.296,73
4	Capital	115,54	136,28	143,97	183,17	209,95
5	CAR	18,78%	20,08%	15,88%	18,38%	16,34%
6	LDR	58%	60%	56%	67%	71%
7	NPLs	4,2%	3,3%	4,3%	4,2%	3,9

Sources: Indonesian Banking Statistics Vol. No. IX. 3 and Indonesian Capital Market Directory 2008-2011

During 2006-2010 periods, NPL of go public bank showed an average of 4%, higher than NPL of national commercial bank that only 3.8%. Capital adequacy ratio showed average of 15.29%, above the regulatory minimum requirement of 8%. Global financial crisis effect of 2008 to based-markets country, where capital dominates economic activity, banks generally suffered a serious shock to capital and liquidity, and even some banks have shutdown operations [8]. It is different from financial performance profit go public bank in Indonesia that actually showed capital growth, assets and positive earnings. Interestingly, market (investors) tend to react positively to banks, especially go-public bank, because most of stock performance of go public bank during 2009 showed a positive movement and some even jumped [73].

Several empirical studies have shown that risk makes negative effect on corporate strategy. Previous studies of [35,38,61] found negative effect of credit risk on bank growth, whereas other studies [20,26] found a positive effect of credit risk on bank growth. In context relationship between credit risk and income diversification, found by [51] that credit risk has positive effect on income diversification. Adversely, study [14] show negative effect of credit risk on income diversification.

Some studies indicate that risk determines funding decisions in capital structure. Empirical studies [3,5,6,8,16,19,67] found risk has negative effect on capital structure. Adversely, [55] found a positive effect of credit risk on capital structure. Study [53] showed that risk does not determine capital structure.

Studies relationship corporate strategy on capital structure of [9, 10, 19,48, 66] found growth strategy has a positive effect on capital structure. Study [44] showed growth strategies have negative effect on capital structure. Diversification studies [15,18] found that diversification has a positive effect on capital structure. Adversely, studies [2,15,27] showed a negative relationship between diversification and capital structure. A number of studies the relationship between corporate strategy and financial performance [4,31,34,48,64] found a positive effect of growth strategies on financial performance. Study [16] showed that growth strategy does not determine financial performance. Associated with the study of diversification strategies, studies [14, 27, 51] found a positive relationship between income diversification and financial performance. Adversely, Studies result [23, 28] found a negative effect the income diversification on financial performance. Several other studies of relationship between risk and financial performance [14,25,61] found a negative relationship between credit risk and financial performance.

Inconsistent results of previous studies indicate a research gap. This makes opportunity to conduct further test the relationship of risk, corporate strategy, capital structure and financial performance. This study was conducted to explain the inconsistent results, with partial test model. This study seeks to put together the previous research in a model built from previous studies, which are expected become novelty currency of this research.

This study aims to: (i) examining effect of risk on asset growth, income diversification, capital structure and financial performance, (ii) examining effect of asset growth and income diversification on capital structure, (iii) examining effect of asset growth, income diversification and structure capital on financial performance. Theoretical contribution of this research is to develop financial management science, especially through model development the relation of strategy, structure and performance [16]. Practically, this research also contributes to bank leadership in an effort to improve risk management capabilities, corporate strategy implementation and funding decisions that improve financial performance. Another practical contributions are creditors and investors that placing their funds in banks with management credibility.

II. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

2.1. The relationship between risk and asset growth

Risk is a concept that closely related to uncertainty. Risk is uncertainty of adverse outcomes that did not reach the expected profit rate [11, 29]. Credit risk is a loss for bank because debtor can not pay interest and principal installments in accordance with a predetermined time period. High credit risk reflects lower asset quality, increasing non-performing assets [60]. Conversely, a low credit risk reflects adequate asset quality, and efficiency of performing assets is likely increase. This phenomenon will be responded positively by investors. Therefore market value of equity (MVE), also market value of asset (MVA) tends to increase.

Empirical studies [20, 35,61] showed a negative relationship between credit risk and bank growth. Bank with High NPLs have to make an allowance for uncollectible accounts. This will lead to cost inefficiencies, lower asset quality [59] and subsequent lower bank growth.

H1. The lower risk, the higher bank asset growth.

2.2. The relationship between risk and income diversification

One strategy to reduce risks magnitude is income diversification. Income diversification help banks to reduce risk and stabilizing profit [14], particularly credit risk (NPL). Bank credit risks that exceeding maximum limit (5%) tend to reduce volume of loans. This could decrease interest income and profitability. This condition forces banks to increase income diversification, through fee-based service activities. Diversification is a reasonable choice if high risk is lower than high profit levels (high return, high risk). It means that new diversification is proper when strategy is able to provide more value to shareholders [29].

Empirical evidence of [51] shows a significant positive effect of credit risk on income diversification for banks in ASEAN countries. Adversely, Bush and Kick [14] found a significant negative effect of credit risk on income diversification for banking industry in Germany. Hypotheses formulation in this study is:

H2. The higher risk, the higher income diversification.

2.3. The relationship between risk and capital structure

Effective risk management can reduce business risk, so management can increase financial risk associated with high debt usage (leverage) [7]. In addition, risk management capabilities can effectively reduce risk of bankruptcy and increasing financial leverage [47]. Inability to manage existing risks make business will face adverse factors and uncertainties that could undermine company ability (bank) to raise funds at a reasonable cost [43].

Study [67] found that a low credit risk can increase loan. Adversely, high credit risk creates lower debt usage. Studies [5,6,8] find a positive relationship between credit risk and capital ratio (CAR). The higher the risk then the higher capital ratio (CAR). It means banks with high credit risk tend decrease debt financing. Study [55] found a significant negative effect of credit risk on leverage usage (debt). Hypotheses effect of risk on capital structure for go-public banks in Indonesia is:

H3. The higher risk, the lower bank's capital structure.

2.4. Relationship between asset growth and capital structure

One essential concept of financial/accounting in strategy implementation is insistence on capital. Successful strategy implementation often requires additional capital [21]. Financial decisions (funding) and financial resources have strategic role to corporate strategy [10, 18, 40]. Therefore, the precise determination between debt and equity in company capital structure is very important in strategy implementation [18].

Empirical evidence in studies [3,44] found a negative relationship between growth and capital structure. However, empirical study results of [10] shows that growth strategy has a positive effect on capital structure. These findings support evidence with wide support. Study results of [9, 19,48,66] found that growth has positive effect on capital structure. Therefore, hypotheses formulation in this study is:

H4. The higher assets growth, the higher bank's capital structure.

2.5. Relationship between Diversified Income and Capital Structure

Successful strategy implementation often requires additional capital [21]. Excluding net income from operations and asset sales, two major capital sources for an organization are debt and equity. Related diversification prefers equity financing, while unrelated diversification prefer debt financing [40]. Studies result of manufacturing industry [15,18] found a strong association between debt usage and unrelated diversification. Another study found a positive relationship between related and unrelated diversification on leverage [15], while studies [2,44] found a negative relationship between debt usage and unrelated diversification. In banking industry [27] found a negative relationship between debt usage and income diversification (leverage). Because income diversification is dominant non-interest income, in this case outside of core business strategy (unrelated diversification), hypotheses formulation in this study are:

H5. The higher income diversification, the higher bank's capital structure.

2.6. Relationship between Risk and Financial Performance

Risk is adverse outcomes uncertainty because does not achieve expected profits level [11.28]. Risk is a loss due to unexpected events. Most productive assets positions initially are not at risk, in a subsequent period the position may bring big risks.

Empirical evidence suggests that risk has negative effect on financial performance [34]. Similarly, studies [14,25,61] found a significant negative relationship between credit risk and bank financial performance. The hypothesis in this research stated that:

H6: The higher risk, the lower bank's financial performance.

2.7. Relationship between Assets growth and Financial Performance

There are three economic objectives that guide strategic direction of decision making, ie survival, growth and profitability [54]. Company growth is determined by business continuity and profitability. Even market share growth correlates with profitability [52].

Empirical studies of [4,31,34] found a positive relationship between strategic planning to financial performance. Empirical studies the effect of growth strategy on performance produced inconsistent findings. Studies [48, 64] showed a positive effect the growth strategy on financial performance. While studies [2, 16] find financial performance does not affect growth strategy. Based on theoretical review and empirical studies, the hypothesis in this study is:

H7. The higher assets growth, the higher financial performance.

2.8. Relationship between income diversification and Financial Performance

Higher ability to compete and create new capabilities is an implementation of bank's corporate strategy and growth strategy through diversification strategy [42]. Furthermore, banks can get economic scope through diversification to get higher profitability [43].

Empirical evidence the effect of diversification strategy on financial performance produced mixed findings. Studies result of [52, 59] found a positive effect of diversification on financial performance. Specifically in banking industry [14, 27, 51] also found a positive relationship between income diversification and financial performance. It is in contrast to studies [24,26,28] that income diversification has a negative effect on financial performance. Based on theoretical study and results of these empirical studies, hypothesis in this study are:

H8. The higher income diversification, the higher bank's financial performance.

2.9. The relationship between capital structure and financial performance

Company value (including financial performance) will depend on growth opportunities, which in turn will depend on the company's ability to attract capital [13]. Therefore, determining the right mix between debt and equity for company (bank) to get optimal capital structure is very important in successful strategy the company [21]. One measure of optimal capital structure is shown by small financial leverage. With a little financial leverage firms tend to reduce their business risk or unsystematic risk [40]. This suggests that firms with little financial leverage more able to improve its profitability. Adversely, firms with high leverage are likely to increase insolvency risk or financial distress because of higher interest cost of debt. The next effect is profitability (financial performance) of companies become lower. Empirical studies [2,3,9,10,16,33,48,49,64] showed a negative effect of capital structure on financial performance. Bank is an industry that uses high financial leverage, so hypothesis in this study are:

H9. The higher capital structure, the lower bank's financial performance.

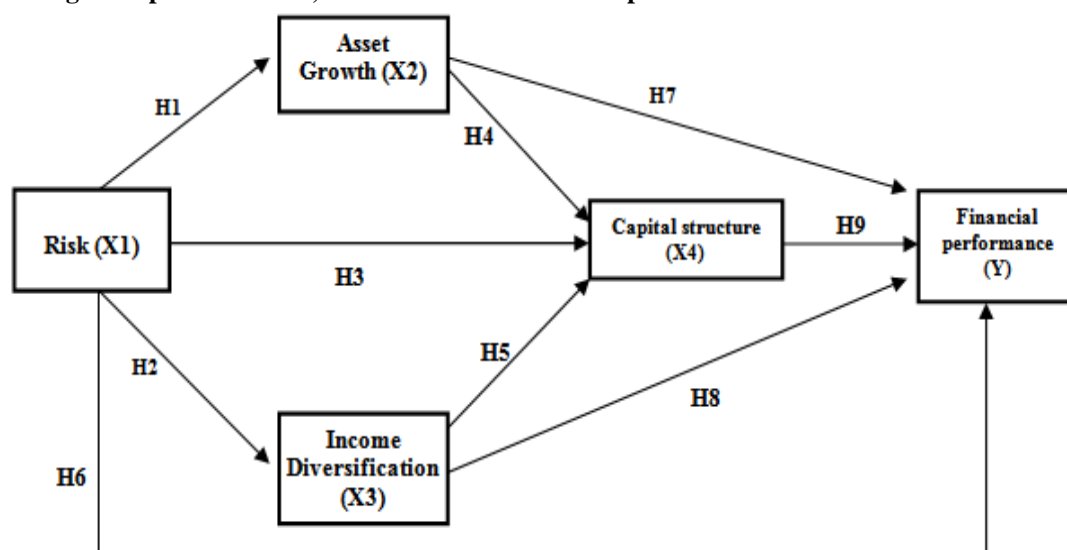


Figure 1: Research Concept Framework

III. RESEARCH METHODS

This study uses a quantitative approach (positives) supported by in-depth interviews. This research was conducted at bank listed on Indonesia Stock Exchange (IDX) for 2006-2010. The study population was 29 go-public bank banks, 4 state-owned commercial banks and 25 private national banks. Population who serve as research objects were selected using following criteria: (i) bank continuously publish financial statements for five consecutive years, it means that bank never delist in 2006-2010 period, (ii) financial statements of go-public banks do not have negative retained earnings and equity. Banks that suitable with these criteria are 20, so number of cases or observations are 100 (5 years x 20 banks). This study is conducted using census (saturated sample). Data type required is secondary and primary data. Secondary data obtained from: (a) bank's financial statements published by Indonesia Stock Exchange; (b) Indonesian Capital Market Directory 2006-2011, (c) bank's financial statements published by Bank Indonesia ([www. bi.co.id](http://www.bi.co.id)). According to time dimension, data this study is pooling, which is a combination of time series and cross section. Primary data is data obtained from in-depth interviews with informants who are used to support results of quantitative analysis. Method of data analysis is path analysis with SPSS 11 for windows that are supported by qualitative information.

IV. ANALYSIS AND RESULTS

This study aims to explore and test the model and to analyze the influence of risk, corporate strategy and capital structure to financial performance. Hypothesis testing is done by using a path analysis model (path analysis). Summary of hypothesis testing results are presented in Table 2.

Table 2 Test Results of Direct Effect Hypothesis

Independent Variables	Dependent Variable	Prediction	Beta	t-count	p-value	Desc.
Risk	Asset Growth	-	-0.085	-0,844	0.401	No Sign
Risk	Income Diversification	+	0.064	0,634	0.527	No Sign
Risk	Capital Structure	-	0.084	0,854	0.395	No Sign
Asset Growth	Capital Structure	+	-0.072	-0,735	0.464	No Sign
Income Diversification	Capital Structure	+	0.267	2,717	0.008	Sign
Risk	Financial Performance	-	-0.025	-0,255	0.800	No Sign
Asset Growth	Financial Performance	+	0.209	2,141	0.035	Sign
Income Diversification	Financial Performance	+	0.188	1,866	0.065	No Sign
Capital Structure	Financial Performance	-	-0.205	-2,028	0.045	Sign

Note : p-value = significant at $\alpha < 0.05$

Hypothesis 1: Hypothesis test results in Table 2 shows that path coefficients of credit risk on asset growth is -0.085 with p-value of 0.401 ($p > 0.05$). This analysis provides decision that the path is not significant.

It means that data does not support research hypothesis 1. Negative path coefficient means relationship between credit risk and asset growth is in opposite direction.

Hypothesis 2: Hypothesis test results in Table 2 shows that path coefficients of income diversification on credit risk is 0.064 with p-value 0.527 ($p > 0.05$). This analysis provides decision that not significant. It means data does not support research hypothesis 2. Positive path coefficient means relationship between credit risk and income diversification is unidirectional.

Hypothesis 3: Hypothesis test results in Table 2 shows that path coefficients of credit risk on capital structure is 0.084 with p-value 0.395 ($p > 0.05$). This analysis provides decision that path is not significant. It means data does not support research hypothesis H3. Positive path coefficient means relationship between credit risk and capital structure is unidirectional.

Hypothesis 4: Hypothesis test results in Table 2 shows that path coefficients of asset growth on capital structure is -0.072 with p-value of 0.464 ($p > 0.05$). This analysis provides decision that path is not significant. It means that data does not support research hypothesis 4. Negative path coefficient means relationship between asset growth and capital structure is in opposite direction.

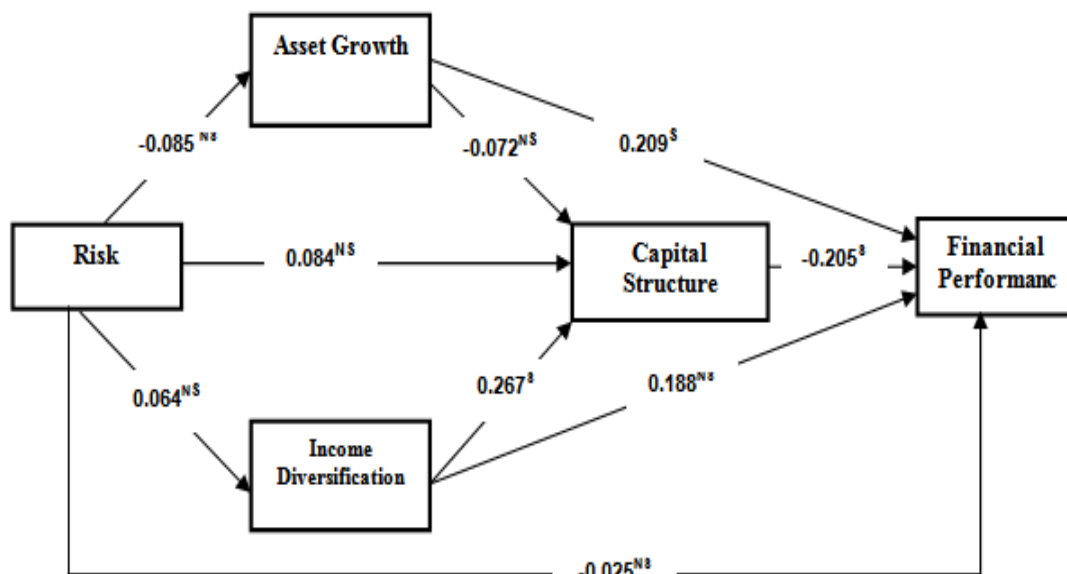
Hypothesis 5: Hypothesis test results in Table 2 shows that path coefficients of income diversification on capital structure is 0.267 with p-value of 0.008 ($p < 0.05$). This analysis provides decision that path is significant. It means that empirical evidence support research hypothesis 5. Positive path coefficient means relationship between income diversification and capital structure is unidirectional.

Hypothesis 6: Hypothesis test results in Table 2 shows that path coefficients of credit risk on financial performance is -0.025 with a p-value of 0.800 ($p > 0.05$). This analysis provides decision that path is not significant. It means that data does not support research hypothesis 6. Negative path coefficient means that relationship between credit risk and financial performance (Return on Average Assets) is in opposite direction.

Hypothesis 7: Hypothesis test results in Table 2 shows that path coefficients of asset growth on financial performance is 0.209 with a p-value of 0.035 ($p < 0.05$). This analysis provides decision that path is significant. It means that empirical evidence support the hypothesis 7. Positive path coefficient means relationship between asset growth and financial performance is unidirectional.

Hypothesis 8: Hypothesis test results in Table 2 show that path coefficients of income diversification on financial performance are 0.188 with a p-value of 0.065 ($p > 0.05$). This analysis provides decision that path is not significant. It means that data does not support research hypothesis 8. Positive path coefficient means that relationship between income diversification and financial performance is unidirectional.

Hypothesis 9: Hypothesis test results in Table 2 shows that path coefficients of capital structure on financial performance is -0.205 with a p-value of 0.045 ($p < 0.05$). This analysis provides decision that path is significant. It means that empirical evidence support research hypothesis 9. Negative path coefficient means that relation between capital structure and financial performance is in opposite direction.



Description: S = significant; NS = non significant
 Figure 2: Path Diagram of Hypothesis Testing Results

V. DISCUSSION OF RESEARCH FINDINGS

5.1. Effect of Risks to Assets growth

Based on analysis, credit risk does not effect asset growth, as shown in Table 2. It means that research hypothesis, the lower credit risk then the higher asset growth, is not enough evidence to be accepted. These results imply that credit risk as measured by non-performing loan (NPL) is not able to explain variance in asset growth changes. Asset growth is not determined by lower credit risk, but rather is determined by investor's response to go-public bank in Indonesia. Investors more interested in risk management capabilities (including credit risk) as principal basis to buy shares of go-public banks, because investors buy banks shares with better risk managers [57]. Low credit risk indicate efficiency and high quality assets, so during period 2006-2010 the business activities of go-public bank makes profit growth on average 26% per year. Study [26] found that cost and revenue efficiency positively relate to profit or shareholder value. Efficiency and high profit growth led to assets growth (market value asset) to increase go-public banks.

This is suitable an interview with Mr. SM who argued that:

"If the non-performing loan (NPL) only 3.1%, then it suggests that go-public banks have very good productive asset quality (PAQ), because the NPL still under regulatory requirements (maximum 5%). PAQ is very good and this is important potential for banks to achieve profit growth.

Interview results imply that most important thing to improve asset growth (growth in asset market value) is income growth. Profit growth in income statement for investor become signal the banks have effective risk management capabilities. Study [22] found that cost efficiency has positive effect on asset quality. Lower credit risk reduces funds for loss reserves deletion. In same period, the condition is followed higher interest income due customer ability as debtor to pay interest and principal installments. Higher interest income is a key factor to achieve profit growth. It condition makes credit risk factor does not determine asset growth of Indonesia go-public bank.

These study findings are not consistent with studies result of [20,28,35] that credit risk (NPL) has negative significant effect on assets growth. It means the higher credit risk, the lower productive asset quality (PAQ) owned. In this case bank was forced to reduce credit volume (loans) for businesses. Further negative effect is a decrease in income and assets growth. Research results are different with [20] who found a positive significant relationship between credit risk with bank growth. Banks with higher credit risk does not deter them to implement growth strategy because supported by capital strength.

Lower credit risk is an improvement indication of asset quality and interest income, it is accompanied by a lower cost (funding) allowance for losses (credit losses). Improved asset quality, interest income and efficiency make go-public banks have high earning growth and market value of assets [26]. Empirical evidence shows the risk that managed effectively and actually have a positive effect and more favorable for shareholders or investors. These findings demonstrate novelty of this research.

5.2. Effect of Risk on Income diversification

Based on analysis, credit risk does not affect on income diversification, as shown in Table 2.. These results imply that credit risk can not explain the variance in income diversification changes proxied by share fee earnings (portion of non-interest income). Higher income diversification is not determined by lower credit risk, but rather is determined by higher banks activities outside core business to meet customer's needs in various ranges of payment transactions. This strategy tends to increase because it has a dual function. Banks activities outside core business (fee-based services), beside become alternative sources of non-interest income (fee income) also become a strategy to maintain customer loyalty.

This finding is supported by results of interviews with Mr. BC who argued that:

"... Revenue diversification is a necessity for bank management because it strongly associated with efforts to improve services to customers. Banks always offered a various banking services to enable customers to make payment transactions. Costs of various services become additional income other than bank interest (fee-based income)".

The interview results imply that income diversification is determined by higher activity of fee-based banking services. This is part of market penetration strategy in order to maintain or increase market share, both from lending (credit) or deposits (deposits) aspect. Banking core business is good risk management from assets and liabilities side, which is always inherent with service activities to increase income diversification. These study findings are not consistent [14,23, 28, 50], they found a significant and positive relationship between credit risk and income diversification.

5.3. Effect of Risk on Capital Structure

Analysis shows that credit risk has no effect on capital structure, as shown in Table 2. These results imply that credit risk can not explain variance in capital structure changes of Indonesia go-public bank. This

phenomenon indicates that capital structure change is not determined by low credit risk, but rather determined by investor or third party (public) confidence on management ability and quality of go-public banks. This is indicated by leverage ratio (DAR) during five-year average of 89%, it means bank is entrusted to manage third-party funds by 89%, despite only have an average equity of 11%.

This is suitable to an interview with Mr. SM who argued that:

"..... Trust (beliefs) factor become base and decisive judgment of third party or investor to keep or give up their funds to bank. Moreover, third-party currently deposits at banks with following Deposit Guarantee Program, up to maximum Rp 2,000,000,000 per customer on bank guaranteed by Deposit Insurance Agency (LPS) ".

The interview results show that bank funding decisions are determined by level trust of third party (investor). This belief must be given to banks with good quality management and more efficient. In addition, all banks in Indonesia are participant of Deposit Guarantee Program that will receive guarantee, for a given interest rate on deposits to depositors that do not exceed a reasonable interest rate of LPS. Efficiency and quality of bank management that deposit insurance that supported by loan guarantee lead to higher investor or third party (public) confidence on go-public bank.

This finding is inconsistent with the findings of [12,46] that credit risk has significant and negative effect on capital structure. It means the higher credit risk then the lower debt usage in capital structure. This finding is also inconsistent with findings of [6,55] that credit risk has significant and positive effect on capital structure. It means the higher the credit risk then the higher debt usage (capital structure).

5.4. Effect of Assets growth to Capital Structure

Based on analysis, asset growth does not affect on capital structure, as shown in Table 2. These results imply that asset growth can not explain variance in capital structure changes of Indonesia go-public bank. This is because bank funds to finance growth more rely on internal funds source, because earnings growth during 2006-2010 period higher than third-party funds that followed by growth of market value of equity. In addition, go-public banks have idle funds because LDR is low (62.4%). Earnings growth and equity market value becomes mainstay to finance asset growth. This study result support pecking order theory which states that company will prioritize internal cash resources usage. If it is not reasonably available, bank will use debt funding sources, and then issuing shares.

This is consistent with interview of Mr. SM who argued that:

"..... Third party funds (deposit) are debt to bank with fund cost risk. Therefore, third party funds are generally invested in productive assets (earning assets) and to comply with the reserve requirement (GWM) of Bank Indonesia. In order to finance business expansion or assets growth, bank tend to use retained earnings. "

The interview results imply that funds source to finance assets growth of go public bank is internal funds from net income. Internal funds source has cost (risk) relatively low than external sources of debt financing and or stock issuance. Debt from party funds is also used to keep bank liquidity (reserve requirement) that invested in productive assets (earning assets) such as Bank Indonesia Certificates (SBI), Government Securities (GS), Treasury Bills or investments in other securities.

This finding is inconsistent with findings of [9,10,19,44,48,66] that growth strategy has positive significant effect on capital structure. It means the higher asset growth, the higher bank capital structure. This finding is also inconsistent with [3, 16, 17] who found that growth strategy has significant negative effect on capital structure. It means debt reduced, because average debt ratio of go public manufacturing company has exceeded the optimum point. Addition another debt will increase the cost of financial distress.

Previous research generally conducted at the manufacturing industry as a unit deficit. It means companies are always faced with funds shortage to finance their growth. This research was conducted in financial industry, in this case financial intermediary where in this study period likely have idle funds. However, most of these funds are deposits from public or third party funding (TPF), which has interest cost (cost of funds). These findings suggest that source of funding to finance banks growth as financial intermediaries are from internal funds instead debt. Internal funds source (retained earnings) is more efficient than cost of funds deposits (debt), although go-public bank has idle funds. This finding also shows the novelty of this research.

5.5. Effect of Income diversification on Capital Structure

Based on analysis, income diversification has a significant positive effect on capital structure, as shown in Table 2. These findings support hypothesis. These results imply that income diversification can explain variance in capital structure changes for Indonesia go-public bank. This is because capital structure (debt to assets ratio-DAR) is determined by income diversification proxied by share fees earning (SHFEE) which describes portion or share magnitude of non-interest income (fee earning) to total income. This phenomenon

indicates that capital structure is determined by an increase of non-interest income of go public bank. Results are supported by empirical facts of descriptive analysis. Trend change in non-interest income (SHFEE) for 2006-2010 show an association with variations in capital structure changes (DAR).

This is consistent with interview of Mr. SM who argued that:

"..... Services quality with a wide range of services to public (customers) becomes critical success factors of banks in current tougher competition. Improving quality of services, especially fee-based services, beside increases fee base income (income diversification) also become an effort to direct public funds as deposits, savings and or other loans ".

The interview results imply that income diversification is imperative for banks in order able to survive in business, especially to achieve growth. One indicator used to assess management bank success is growth of third party funds (deposits). Deposits or third party funding (TPF) is dominant fund source in banking business, which in turn invested in productive assets (earning assets) as a source of bank income. Therefore, service quality in order to increase customer loyalty is very important in banking business. Offering a wide range of service, repairing services in terms of information technology, and various things related with excellent service is intended to increase fee-based services. This is intended to meet customer's needs and increase customer loyalty, which ultimately able to attract third-party funding in form of deposits (demand deposits, savings and time deposits) or other loans.

This finding is consistent with studies [15,18] which found a significant positive effect of diversification on debt usage in capital structure. It means the higher diversification, the higher debt usage. This finding also supports findings of [14,51] that there is a significant positive relationship between income diversification and savings (deposits). Adversely, these findings do not support [26] that income diversification has significant negative effect on capital structure.

5.6. Effect of Risk to Financial Performance

Based on analysis, credit risk does not affect on financial performance, as shown in Table 2. It means the hypothesis is rejected. These results imply credit risk that measured by NPL can not explain the variance in financial performance changes proxied by return on average assets (ROAA). This is because lower credit risk (NPL) is not able to consistently improve Return on Average Assets. Increased Return on Average Assets is not determined by lower credit risk, but rather is determined by high effectiveness of asset utilization and profit efficiency, because effect of credit risk losses on financial performance (Return on Average Assets) is relatively small. It occurs because rate of interest on loans (credits) granted has included a risk premium over cost of funds and loss from this risks is guaranteed by insurance company.

This result is consistent with interview of Mr. SM who argued that:

"..... Non-performing loan (NPL) of Indonesia commercial banks today are on average quite low because it is still under regulation provisions (5%). Credit risk in banking business can not be avoided, so banks always try to improve efficiency to achieve profit growth from year to year. Moreover, the important thing is to increase fee-based income through higher fee-based services to reduce credit risk effect".

From these statements it can be concluded that actual credit risk theoretically has a negative effect on financial performance. However, the implementation of strict regulations, related to asset and liability management of banking, and risk management must be adhered to by bank manager, so average credit risk of go-public banks may relatively safe. It means credit risk does not become limiting factor (threats) to achieve bank profitability, because go public banks have profit growth during 2006-2010 averaged 26% per year. On other side, bank is quite successful in increasing fee-based services in order to increase income diversification. These findings support theory [14] that diversification reduces total risk, because diversification can stabilize operating profit. It is why credit risk does not determine financial performance (Return on Average Assets) of go-public bank.

This finding is not consistent with [6, 14,34,61] who found a significant negative effect of credit risk on financial performance. This finding is also inconsistent with studies result of [27,65] who found a significant and positive effect of credit risk on financial performance. It means the higher credit risk, the higher financial performance.

5.7. Effect of Assets growth to Financial Performance

Based on analysis, asset growth affect on financial performance, as shown in Table 2. It means research hypothesis is accepted. These results imply that asset growth is able to explain financial performance change (Return on Average Assets). This is due to an increase in asset growth which describes growth of market value of assets to improve financial performance of go public bank. Company's growth realization is shown in growth of assets value, sales, earnings and book value of company [36]. Among these four factors, earnings growth

become major concern for shareholders or investor, because it deals directly with ability to pay dividends, which will have an effect on stock price changes or owner property. Empirical evidence suggests that income growth during period 2006-2010 average of 26% per year, has been followed by a stock price increase of go-public bank so price-book value (PBV) reached average of 200% per year. Stock price increase about 2 times of price-book value makes market value has increased. The empirical evidence shows a relationship between assets growth that describing market value of assets with various financial performance changes (Return on Average Assets).

This finding is consistent with [4,31] that strategic planning has significant positive effect on financial performance. Likewise, [17,25,26,48,64] found significant positive effect of growth strategy on financial performance. But these findings do not support a finding [16] that growth strategy Desember not affect on financial performance.

5.8. Effect of Income diversification on Financial Performance

Based on analysis, income diversification does not affect on financial performance, as shown in Table 2. It means that research hypothesis is rejected. These results indicate that income diversification that measured by share fee earning (SHFEE) can not explain the variance in financial performance variation (Return on Average Assets). This is because financial performance is not determined by income diversification, but rather is determined by interest income. This is because the income from bank's core business is still dominated by interest income (interest earnings). Share interest earnings (SHIE) 2006-2010 average 89.6% per year of total income, while SHFEE average only at 10.4% per year. This indicates that ability of Indonesia go-public banks to exploit fee-based service activity is still very low.

This result is consistent with interview of Mr. SM who argued that:

"..... Fee base income that received during this time only reduce risk in banking business. Efforts to increase fee income base continuously improved because they relate to higher quality service to customers, although this has substantial fixed burden ".

This interview result implies that income diversification is one alternative strategy beyond its core business as a source of non-interest income (fee earning). This strategy is done through fee-based service activities in order to improve service quality to customers. For banks, improving service quality is more important because it will determine market strength (market share) in the industry than just makes non-interest income (fee income base). It is believed that income diversification helps reduce risk and stabilize total operating income [14]. However, fee income activity associated with a higher risk than interest income. This finding is consistent with findings of [28] that income diversification has no effect on financial performance (ROA). However, the findings support [14,27] that income diversification has significant positive effect on financial performance.

5.9. Effect of Capital Structure on Financial Performance

Based on analysis, capital structure has significant negative effect on financial performance, as shown in Table 2, it means research hypothesis is accepted. Research results imply that capital structure proxied debt to assets ratio (DAR) can to explain variance in financial performance changes of go-public banks. These findings indicate that the higher capital structure, the lower financial performance. This is because high debt usage led to higher cost of bankruptcy. Therefore, banks may reduce or avoid debt usage, if bank has sufficient internal funding from retained earnings. These findings support packing order theory [51] which describes the funding series. If there are investment opportunities, first must prioritize internal cash resources. Furthermore, if internal financial resources are not sufficient then the alternative is debt, and last alternative issue stock. These findings conclude that Indonesia bank decision to go public follows pecking order theory. This approach is very rational because banks are business entities that very high financial leverage in their activity.

This study finding is consistent with [3,7,9,15,16,19,66] that capital structure (DAR) has significant negative effect on financial performance (Return on Average Assets). This finding is also consistent with several previous studies in Indonesia [2,17,48] who found a negative relationship between capital structure and financial performance (firm's value) for manufacturing companies listed on Stock Exchange. This finding is contrast to [27] that found a positive and significant effect between leverage and financial performance (Return on Average Assets) European banks. It means that the higher debt usage in capital structure then the higher financial performance.

VI. IMPLICATIONS AND RESEARCH ORIGINALITY

Results of this study are expected to provide additional insight to risk theory in banking business that basically they receive and managing risk. However, if bank has an effective risk management capabilities, risky bank would provide higher benefits [47]. Lower credit risk is an indication of management success in credit risk,

so banks achieve efficiencies and asset quality has increased [22]. Based on analysis of qualitative information, research can prove that credit risk that managed effectively has a positive effect to increase efficiency, asset quality and earnings growth. Investor will makes positive response to share of go public bank, and this supports findings of [27] that credit risk and cost efficiency can increase company value (shareholders). This factor makes stock prices increase and bank asset growth become higher.

This article also contributes to conceptual perspective development on idea to combines strategic management theory and financial functions [10], to establish funding in capital structure decisions related to higher bank's financial performance. Banks as financial intermediaries supports its growth strategy with pecking order theory approach [50]. They first time use internal funds source (retained earnings) despite having surplus funds (idle funds) from third parties (deposits) which has a cost of funds. Because the existing idle funds can be used by banks to invest in securities with a higher level yield than cost of funds. This study also provides insight to theory development that income diversification, in addition serves to reduce risk and stabilize profits [14], also becomes market power catch public funds through fee-based service activities. This supports findings of [14.51] that income diversification through fee-based service activities to customers can increase debt (deposits). This latest research provides a perspective the relationship between credit risk and capital structure of banking industry. Because the lender (investor) gives funds to banks with high management quality, in this case bank has risk management capabilities. These findings support the signaling theory [58] that managers who use more debt become that bank has high quality management (credible).

Practical contribution expected from this research is this research can provide managerial implications for bank to help leaders improve risk management capabilities, especially credit risk. It will contribute to bank to set corporate strategy to increase asset growth and financial performance. Effective risk management capabilities will improve efficiency of higher quality assets. Banks that have efficiency and high asset quality become signal to investors (creditors) that bank management quality is credible so they like to give a loan or save their money to banks as debtor. This study findings are expected to further encourage bank leaders to improve quality in fee-based service activities, it is important for banks not only to achieve income diversification, but more important is to have market power in attracting third party funding (deposits) or loan. Goal of income diversification is to avoid risk of greater losses if bank only focuses on core businesses that rely on interest income.

This study finding will have implications for corporate management to set funding decisions to finance the implementation of growth strategies that improve financial performance. This will help banks management effort to improve risk management capabilities, efficiency and asset quality, making them easy to achieve profit growth, because income growth is a source of internal financing that more efficient to finance higher debt usage.

VII. CONCLUSIONS AND LIMITATIONS OF RESEARCH

Credit risk that managed effectively makes positive and profitable implication for banks, because it increase efficiency and quality of assets owned. It is a strength and encourages banks to take leadership in strategic decisions making of core competencies. This strategy is important for banks to achieve growth, as indicated by higher assets quality, loans and income earned. This condition responded positively by investors, so the stock price and market value of bank assets increased.

Market power is motivation for bank leader to increase income diversification. This strategy is done by improving quality of fee-based services to customers, so it is more able to attract bank deposits (deposits) or other loans. Income diversification is important to avoid risk of greater losses, especially credit risk, if banks rely on interest income. The success of growth strategy, indicated by earnings growth and growth in market value of assets, is responded positively by investors and third parties (creditors), because bank has a quality and credible management. However, to finance corporate strategy implementation to increase asset growth, go public bank prefers internal financing sources (retained earnings) than debt or using third-party funds that have risk fund costs

There are several limitations to this study, especially the usage of credit risk measurement and asset growth variables. Credit risk variable are measured at year-end position, which indicates the amount of non-performing loans during the month of December. Credit risk changes that occurred in the year are not detected in this research. Therefore, future studies need to consider other measures of credit risk such as loan loss provision, loan growth, non-performing assets (NPA) using monthly or quarterly data. Asset growth variable is measured by market value of assets that are affected by stock markets price, which tend not reflect the intrinsic value (fundamentals). This condition limits generalizability of these findings only for go-public banks during 2006-2010. The changes occurred primarily investor's response to shares of go public bank before and after study were not detected. Future studies need to consider variables to measure growth strategy with growth of book value of assets or income growth.

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