

Banking Regulation Role as Moderation the Effect of Risk Management on Capital Structure Decisions (Study at People Credit Bank in North Sulawesi and Gorontalo Provinces)

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ABSTRACT : *This study purposes are : (i) examining and explaining effect of risk management on capital structure decisions, (ii) examining and explaining effect of banking regulations on capital structure decisions, and (iii) examining and explaining banking regulation role in moderating effect of risk management on capital structure decisions. This study was conducted at People Credit Bank (PCB) in North Sulawesi and Gorontalo Provinces at 2011. Population are 20 banks that determined by population criteria. Analysis method used is Generalized Structural Component Analysis (GSCA). This study result found that risk management practice is a key determinant of capital structure decisions. Adherence to banking regulations determines capital structure decisions. Research findings show that compliance with banking regulations did not moderate risk management role in determining capital structure decisions.*

KEYWORDS : *Banking Regulation, Risk Management, Capital Structure Decisions*

I. INTRODUCTION

Banks capital not only contributes to fund business but also has other important roles. Allen and Santomero (1999) stated that bank capital is protective security. It provides protection to shareholders and depositors against temporary loss or unexpected loss. Capital can serve as a tool used by bank to provide a signal to public about their financial profitability, and could also become a good consideration for competitors, customers, and agency as a proxy of strength or health. It is an indication of shareholder value (Jorion, 2000). Bank's capital existence has strategic aspects related to operational sustainability, profitability and bank safety net toward risk taking. Relationship between capital and risk adjustments depend on bank retained capital exceeds minimum capital reserves (Cai and Wheale, 2009). Strategic role of bank capital in banking business especially relates to specific characteristics of banking business. Hasan (1997) stated that banks borrow money to make money. Banks and other financial institutions is a specialized business where capital structure is influenced by a number unique conditions to banking business, such as government regulation and access to government safety net which includes insured deposits and loans (Kwan, 2009). At same time, bank is a company, financial intermediaries, and regulated entity. Incentive regulation that imposed by rule determines a unique interaction between banks capital and their behavior (Marques and Santos, 2004). In addition, bank's operations are based on precautionary principle. Banks as financial intermediaries operationally borrow funds from one agency and then lend again to other agents. Consequently, banking institutions tend to have higher debt levels due to security and its intermediary function (Boyd and Prescott, 1986). Banking institutions also must operate under strict regulations environmental that differ even among different banks. Minimum capital adequacy ratio is one important tool for regulators to maintain stability of financial system.

Capital structure relates to company value and profitability. Therefore, it is important for banks to determine about optimal capital structure. Bank management should determine capital structure policy in supporting bank operations, particularly in lending. Funds allocation to bank loans also require large financing in order not interfere bank 's liquidity. Each credit expansion plan should be supported by additional capital so that credit expansion has no effect on bank's capital adequacy ratio. This case shows that determination of bank's capital structure policy is very important for bank management. Capital structure policy is a policy concerning the optimal combination to use various sources of funds that will be used to finance an investment and also to support company's operations in effort to boost corporate profits in order to achieve a high company value (Gitman, 2009).

Main source of theoretical and empirical research on capital structure are many phenomena testing in United States (Marques and Santos, 2004). It implies that studies findings on capital structure difficult to be generalized in other countries, where generally have different economic, financial, and institutional. Information and operating efficiency, and liquidity is a feature of financial markets play important role to determine combination of corporate finance (Demirguc - Kunt and Maksimovic, 1996). Therefore, more research is needed to test capital structure strength for predictive ability. Further studies about capital structure hypothesis are needed to improve the prediction robustness (Rajan and Zingales, 1995; Harris and Raviv, 1990) that still being debated about empirical testing the capital structure in different environments, such as country, time and industry. The investigation may help to better understand implications of environmental and behavioral factors on capital structure decisions. It could have contribution to expand explanatory power and predictions of existing theories. Motivated from statements and study findings above, this study aims to examine and explain effect of risk management and banking regulations on bank capital structure decisions, especially People Credit Bank in North Sulawesi and Gorontalo provinces. People Credit Bank is chosen because the uniqueness. People Credit Bank is a commercial bank as usual, but People Credit Bank have specificities to serve communities needs in rural areas and small micro enterprises in form of deposits (savings and deposits) and credit. There are some differences between People Credit Bank with commercial banks, namely: People Credit Banks have capital just under Rp. 100 billion, the product only savings and deposits, People Credit Bank can not issue checks and giro as commercial banks, People Credit Bank can not commit the transaction clearing, People Credit Bank operational area is limited only within scope of province, and most of People Credit Bank business is a family business.

There are a number of problems that must be faced by People Credit Bank in their business, especially in face increasingly fierce competition today, namely: limited capital held that determination of capital structure decisions is critical to get attention, high risk, as well as adherence to banking regulations that limit the movement of bank leadership in carrying out its operations.

Table 1. Development of People Credit Bank in North Sulawesi Province and Gorontalo

YEAR	PCB NUMBER		TOTAL PCB	TOTAL ASSET (Rp. Billion)	Third Party Fund (Rp. Billion)	Credit (Rp. Billion)	LDR (%)	NPL (%)	CAPITAL STRUCTURE (%)
	North Sulawesi	Gorontalo							
2006	18	7	25	137	97	106	90,92	4,45	70,80
2007	16	4	20	170,6	125,9	130,8	103,9	3,4	73,80
2008	17	4	21	205,2	144,0	156,9	109,0	3,3	70,17
2009	13	4	17	241,1	170,9	202,7	118,6	2,9	70,88
2010	16	4	20	402,0	281,8	288,3	102,3	4,24	70,10
2011	17	4	21	651,7	439,5	455,8	103,7	3,92	67,44

Sources : Bank Indonesia Manado (2011)

People Credit Bank Performance in North Sulawesi and Gorontalo Provinces during years 2006 - 2011 generally increased from year to year. It reflected by increase of total assets, third party funding (TPF), and amount of credit in banking system, higher Loan to Deposit Ratio (LDR), and a decrease in ratio of non-performing loans (NPLs). Table 1 shows good intermediation PCB from year to year. It reflected by LDR is above 100 % from years 2007 to 2011. This condition is a positive, because it shows the tremendous potential in North Sulawesi province and Gorontalo. It is proven by the amount of investment at North Sulawesi province and Gorontalo with LDR ratio tend quite high. However, LDR tendency value that exceeding 100 % indicates a high risk of PCB to meet short-term liabilities (liquidity). LDR above 100 % indicates high risk banks in liquidity problems (Sunarsip and Salamun, 2003). As a result, bank makes policies to use assets source to cover outstanding loans to third parties. Assets usage to meet ongoing lending can lead PCB difficult to meet the minimum capital adequacy ratio. However, an increase in assets, deposits and loans in PCB was not followed by an increase in capital structure. This is due to PCB must comply with regulations from Bank Indonesia, obligation to provide a minimum capital. In addition, People Credit Bank lacks capital so that some PCB are required to merge with others. Merger is used by shareholders in attempt to strengthen PCB capital position. As a result, number of People Credit Bank not increased.

Previous studies have attempted to examine the theory of capital structure in banking industry, but so far most of these studies take an object of large banks that have been registered in capital markets, especially banks that listed in United States and Europe. Still rare to find research conducted at banks outside the United States and Europe, particularly Asia banks. Study the relationship between risk and capital structure in manufacturing companies has been done. Studies of Cathoth (2002), Cathoth and Olsen (2007), Zhao et. al., (2008), Crinigoj and Mramor (2009), and Akhtar and Oliver (2009) found negative effect of capital structure (leverage) and risk. Parlak (2010) found no relationship between risk and capital structure. However, studies the relationship between risk management and capital structure still rare. Miller and Modigliani (1958) said the establishment of effective risk management can reduce risk of bankruptcy and increased financial leverage. Active risk management can reduce the level of business risk, increasing financial risks associated with high external debt (Ward, 1993 in Andersen, 2005). Empirical studies of Andersen (2005) shows a positive effect of capital structure on risk management at large companies in U.S. But Andersen (2005) found capital structure does not have effect on risk management at financial institutions U.S. even showed coefficients in opposite direction but not significant between risk management and capital structure. Furthermore, study of Deelchand and Padgett (2009) show that credit risk, market risk and liquidity risk become indicator of risk management that proved have a significant negative effect on ratio of capital at cooperative banks in Japan.

A number of studies indicate that banking regulation determine capital structure decisions. Empirical studies of Ghosh et al. (2003) and Mishkin (2000) show banking regulations affect banks' capital structure decisions. Adversely, Groop and Heider (2009), Flannery (1994), Myers and Rajan (1998), and Diamond and Rajan (2000) find that banking regulations, in terms of capital adequacy requirement, does not affect bank's capital structure decision. Inconsistent results of previous studies showed research gap. This opens up opportunities for researchers to conduct further research and testing the relationship between banking regulation and capital structure decisions. This study was conducted to explain inconsistent results. In addition, this study aims to examine and explain banking regulation role as a moderating variable to strengthens the effect of risk management on bank's capital structure decision because there has not yet found any research to study that. This study aims are: (1) examining and explaining effect of risk management on capital structure decisions, (2) examining and explaining effect of banking regulations on capital structure decisions, and (3) examining and explaining banking regulation role in moderating effect of management risk on capital structure decisions.

II. LITERATURE REVIEW

2.1. Risk Management

Banks as well as other financial institutions and companies generally run business in order to obtain return of operations that always exposed to risk. Risks that occur can result in losses for bank if not detected and not managed properly. Therefore, banks have to understand and know risks may arise in carrying out its business activities. The top leadership in management of bank as well as all relevant parties should know risks that may arise in business activities of bank, as well as knowing how and when these risks appear in order able to take appropriate action. Common understanding of each risk category is important in order managers, executor and supervisor can discuss common issues that naturally occur from a variety of emerging risks (Idroes and Sugiarto, 2006). Risk management practice aims to avoid a loss that is caused by occurrence of risk or event. Risk management is identification, assessment, and risks priority that accompanied by implementation of economical and coordinated resources to minimize, monitor, and control the possible effect of unfavorable events (Njogo, 2012). Essentially risk management is a comprehensive process that is equipped with tools, techniques, and science that needed to identify, measure, and manage risk more transparently. Motivated by the sense to take a risk in carrying out the functions to offer financial services, bank must take or accept risk and manage various types of financial risks effectively to avoid negative impacts. Before awareness for risk management need emerges, almost all banks argue that risk should be avoided or eliminated. According Idroes and Sugiarto (2006), risk itself should not always be avoided in all circumstances, but should be managed properly without reducing the achieved. Risks that managed properly can provide benefits for banks to generate attractive profits. In order these benefits to be realized then decision-makers must understand about risk and its management. Bank Indonesia Regulation No. 5/8/PBI/2003 dated May 19th 2003 about Risk Management for Commercial Banks is a manifestation of problem seriousness in bank risk management. This is reinforced by the issuance of Circular Letter of Bank Indonesia No. 5/21/DPNP dated September 29th 2003 concerning with Risk Management Application for Commercial Banks. Bank Indonesia's seriousness is more emphasized with the issuance of Bank Indonesia Regulation No.7/25/PBI/2005 in August 2005 on Risk Management Certification for management and officers of commercial banks, which requires all banks from low-level officials to highest to have a risk management certification that appropriate with his rank (Idroes and Sugiarto, 2006). Essence of risk management application is a set of procedures and methodology that used to identify, measure, monitor, and control risks that arising from business activities of bank (Bank Indonesia, 2009).

2.2. Banking Regulation

Banking sector is a system that linked one to another. The failure of one bank not only cause problems at individual banks. Furthermore, a bank failure can cause a domino effect in banking industry. Because bank provides a means of payment, then the failure of banking sector will lead to failure in corporate sector where there is a bottleneck in payment settlement. As a result of failure in this sector can have a negative effect on entire system. Failure of one bank can cause problems in banking system as a whole and can cause massive withdrawal of health bank (Sunarsip and Salamun, 2003). Bank is a financial institution that is most tied to regulation (Mukuddem - Petersen and Petersen, 2008). Banks regulation is associated with banking institutions as well as products and services offered. Purpose of regulation in banking industry is to protect customers and increasing their confidence to products of banking industry. Regulation for a bank is different from regulation of other industries. The effect of any bank management will have an effect on overall economy. If on other industries regulation generally concerning with standardized products and business competition, regulation on banking industry comprehensively covers the entire bank (Idroes, 2008).

2.3. Capital Structure Theory of Financial Institutions

Company financial strategy is very interesting to study, especially its application to banking industry. One important thing is decision-making. According to Salim (2011) there are three (3) major financial decisions, namely: (1) investment decision, determination amount of input and output using capital budgeting analysis, (2) determination of capital structure, namely the determination of funding mix, whether full capital, long-term debt, or a mix between capital and long-term debt, (3) determination of profit distribution or dividend policy. Corporate spending is grouped into two types In financial management strategy, namely : debt and equity (own capital). Debt advantages are: 1) reducing the interest tax to lower cost of debt, 2) creditor acquire limited returns so shareholder do not have to share the profits when business conditions were developed, 3) creditor does not have voting rights so shareholders can control company with small investments funds (Brigham and Ehrhardt. 2008). But debt also has drawbacks, namely : (1) debt usually must be paid in a certain period of time, (2) a high debt ratio will increase risk that will further increase the cost of capital, (3) if company in difficult conditions and profits can not be meet interest charges then it may create liquidation. Modigliani and Miller (1958) suggested that capital structure does not affect the company value with the various assumptions that in reality these assumptions are difficult to be fulfilled. According to Brigham and Ehrhardt (2008), Modigliani and Miller 's theory is based on following assumptions : (1) there are no transaction costs in capital markets, (2) does not takes into account taxes, (3) does not takes into account the presence of bankruptcy costs, (4) same treatment to customer, (5) absence of agency costs, and (6) EBIT is not affected by debt usage.

Literature about capital structure discussion in financial institutions is rather rare. Existence of banking companies depend on imperfections in capital markets, including transaction costs and information. According to Modigliani and Miller (1958), and Miller (1977) personal tax and company value does not depend on capital structure. In such an environment, it is not necessary financial intermediaries or banks (Fama and French, 1998). Boyd and Prescott (1986) showed that in banking environment the investment opportunities is agency personal information. Kaufman (1992) suggests that banks are always accepted by less risky market than non-financial businesses, and able to operate with a ratio of capital lower to assets. However, capital structure in corporate banking can not be fully explained by theories for non-financial companies. Sealey (1983) argue that corporate finance theory can not directly applicable to banks. Although the theory of corporate finance in perfect capital market is well developed, but only applies to non-financial companies. Banks as financial intermediaries generally excluded because these banks only exist in imperfect markets that have imperfect information. Although theory of corporate finance has been extended to handle multiple market imperfections, for example, bankruptcy, agency problems, asymmetric information, etc., however Sealey argues that most theories still can not be applied to financial institutions for two reasons : first, the existing models ignore the liquidity services that provided by these institutions, and secondly, these institutions face unique production conditions where deposit funding level is stochastic. Buser et al. (1981) suggested that without regulation and deposit insurance, capital structure decisions on banking companies is similar to non-financial companies. Arshadi (1989) showed that optimal capital structure for banking companies is within agency theory framework. Bigger banks typically have a greater effect than smaller banks, as well as presence of agency costs variations.

III. FRAMEWORK FOR RESEARCH AND DEVELOPMENT HYPOTHESIS

Strict regulation in banking industry is needed because risk inherent in banking system. Banks products that used by all clients are money. If a bank does not have sufficient funds to pay the deposits of depositors who want to withdraw their funds, will further raise concerns about bank stability. This can lead more other depositors withdraw their deposits despite issue is not necessarily true,

only perception. In addition, risk management application in banking is a necessity because bank is one of financial institutions that vulnerable to risk (Susatyo, 2010). Risk management application in banking is regulated in Bank Indonesia Regulation No. 5/8/PBI/2003 dated May 19th, 2003 on Risk Management for Commercial Banks. In accordance with banking needs to grow dynamically, then the regulation is updated with Bank Indonesia Regulation No. 11/25/PBI/2009 concerning Amendment to Bank Indonesia Regulation No. 5/8/PBI/2003 on Risk Management Application for Commercial Banks. Bank Indonesia Regulation is a translation of Basel II. It is basis principles of risk management adopted by most banks in world. Cebenoyan and Strahan (2004) suggested a relationship between risk and capital. The greater risks, bank need greater capital bank. Based on this regulatory, authorities require banks to have sufficient capital to absorb risks. In this case a bank's capital level should be based on level of capital risk (risk based capital). This regulation is known as capital Adequacy Ratio (CAR) or the minimum capital adequacy or Minimum Capital Adequacy Compliance (CAR). It is interesting to study further relationship between risk management, banking regulation and bank capital structure decisions as proposed at study conceptual framework in Figure 1.

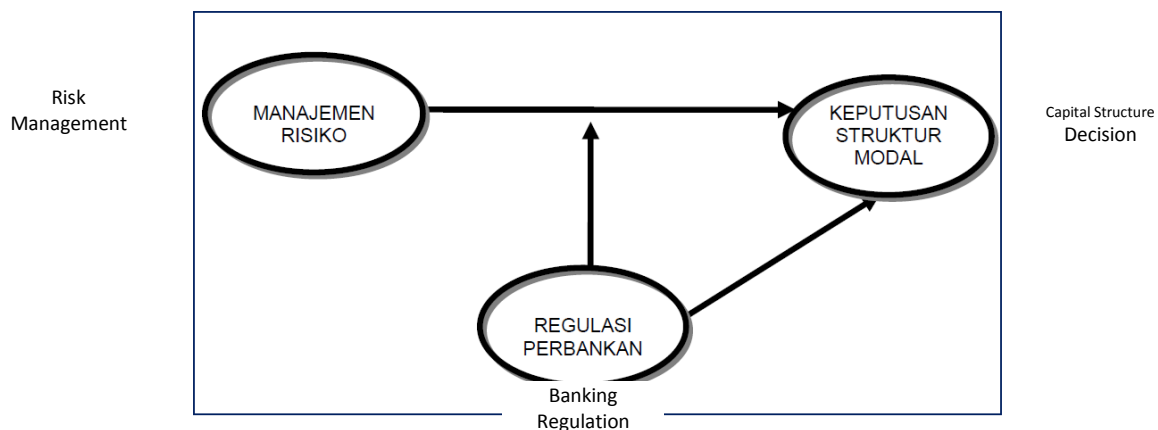


Figure 1. Research Concept Framework

3.1. Effect of Risk Management on Capital Structure Decisions

Research of Low and Chen (2004) suggests that business risk negatively correlated with debt ratio. This shows that company with business risk tend to have low debt ratios. Although findings of Cassar and Holmes (2003) showed business risk does not effect significantly on leverage, but studies show coefficient direction of business risk to leverage is negative. This finding was supported by Welch (2002) that risk was significantly and negatively affect on capital structure. Cebenoyan and Strahan (2004) research results found that banks improve their ability to manage credit risk (risk management), in this case credit risk management can be done with large debt (leverage), and can lend more assets risky borrowers. Good risk management practice will make banks more effective to choose their capital structure decisions. This means that risk management has a positive effect on capital structure. Therefore, hypotheses formulation of this study is follows:

Hypothesis 1 : Good risk management practice will determine better capital structure decision.

3.2. Effect of Banking Regulation on Capital Structure Decisions

Buser et al. (1981) showed that without regulation and saving assurance, capital structure decisions in banking companies is similar to company's industry. Kwan (2009) suggested banks and other depository institutions are specific businesses where capital structure is affected by a number of unique conditions in banking industry, such as banking regulation and deposit assurance. Capital structure is needed to encourage banks maintain larger capital. Groop and Heider (2009) argued that banking regulation does not affect bank's capital structure decision. These results support research findings of Flannery (1994), Myers and Rajan (1998), Diamond and Rajan (2000), and Allen, Carletti and Marquez (2009) that banking regulation, in this case capital adequacy requirements, do not affect banks' capital structure decisions. Adversely, Ghosh et al. (2003) in a study of public sector banks in India found that banking regulations affect on banks' capital structure decisions. This supports expressed by Mishkin (2000) which states that banking regulation, in this case capital requirements regulatory, affect on bank's capital structure. Therefore, hypotheses formulation of this study is follows:

Hypothesis 2 : Higher adherence to banking regulations will determine better capital structure decisions.

3.3. Relationship between Risk Management, Capital Structure Decisions and Banking Regulation

Relationship between capital and risk adjustments depend on amount of capital retained bank that exceed the minimum capital reserves (capital buffer). In Germany, banks with low capital reserves try to rebuild capital reserves in order sufficient to raise capital while simultaneously lowering risk (Heid et al., 2004). Adversely, banks with large reserves try to maintain their capital reserve ratios by increasing risk when capital improved. These findings support the theory of capital reserves. Research of Barrios and Blanco (2003) suggests that banks are affected by regulations to regulate capital above minimum. Although regulatory limits is one factors associated with additional capital at commercial banks in Spain, but it is not the most important. Instead, pressure of market forces is a major determinant of bank capital requirements. Santomero and Watson (1977) show that too strict capital regulation will lower bank credit offers. It will increase bank's failure to increase productive investment. Flannery and Rangan (2008) concluded that banking regulation does not affect relationship between risk and capital structure. Adversely, Calomiris and Wilson (2004) found that risk have negative relationship with capital structure when there is no banking regulations.

According to Syer (2003), regulation pressure is an important driver of risk management for market order, credit and operational risk. Negative effect of regulation can be seen as a barrier to innovation. Therefore, hypotheses formulation of this study is follows:

Hypothesis 3 : Adherence to banking regulations will strengthens the effect of risk management on better capital structure decision-making.

Based on conceptual framework and research hypotheses that have been described above, then hypothesis model can be presented in Figure 2.

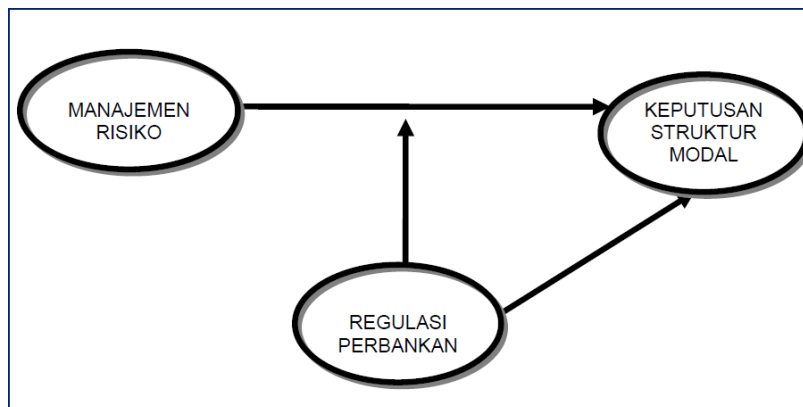


Figure 2. Research Hypothesis Model

IV. RESEARCH METHODS

This study uses a quantitative approach that supported by in-depth interviews. This study used a survey method, which collects information from a number of individuals in a population by using a series of formal questions (Veal, 2005). Data analysis technique is multivariate statistical methods (Structural Equation Modeling) using GSCA software. This research was conducted at People Credit Bank (PCB) that listed in Office of Bank Indonesia in Manado and Gorontalo in 2010. Study population was all PCB in North Sulawesi province (17 banks) and Gorontalo (4 banks). Population criteria in this study were all PCB are categorized health by Bank Indonesia. Number of banks that suitable to criteria are 20 banks. Analysis unit of this study were People Credit Bank (PCB) in North Sulawesi province and Gorontalo province. Respondents are CEO or top management, namely Commissioner, Commissioner, Director and Director. It is based on consideration that Commissioner and Director know condition and policy of People Credit Bank they lead. Bank samples are People Credit Bank with full operation and have not problem or have status being supervised by Bank Indonesia. Data was collected through questionnaires to 20 People Credit Bank, from September to December 2011. Total 87 questionnaires are distributed. Until deadline, 51 research questionnaires filled and worthy to be analyzed (57.95 percent respond rate). It represent 20 banks, including 17 banks in North Sulawesi (85 percent) and 3 banks in Gorontalo area (15 percent). Because analysis unit in this study were PCB, number of data samples analyzed were 20 banks. There are a number of banks that are represented by more than one CEO respondent (the commissioner / director). In data analysis, data is averaged for bank that represented by more than one CEO respondents.

Data analysis in this study is based on research questionnaire instruments distributed throughout 87 respondents according to CEO position occupied in PCB of North Sulawesi and Gorontalo province. The number of directors is 40 people and as many as 47 commissioners. Questionnaire collection takes approximately three (3) months from September 19th 2011 until December 19th 2011. Inferential statistical analysis is used to test management conception that stated in research hypothesis (Ferdinand, 2006). To answer this hypothesis the analysis method used is Generalized Structural Component Analysis (GSCA), with aims to replace factor with a linear combination of indicators (manifest variables) in SEM analysis. This analysis approach use least square method in parameter estimation process. GSCA method is a new method of component-based SEM that very important and can be used for score calculation (not scale) and can also be applied to very small samples (Solimun, 2012).

V. RESULTS AND DISCUSSION

5.1. Result

This study aims to test model and to explain effect of risk management and banking regulation on capital structure decisions. Hypothesis testing is done by path analysis model. Summary of hypothesis testing results are presented in Table 3.

Table 3. Hypothesis Testing Results

Hypotheses	Path Coefficient				Description
		Estimate	SE	CR	
H1	Risk Management → Capital Structure Decision	0.839	0.138	6.06*	Significant
H2	Banking Regulation → Capital Structure Decision	0.571	0.179	3.18*	Significant
H3	Interaction of Banking Regulation with Risk management → Capital Structure Decision	-0,334	0.612	0.54	Insignificant

Testing Hypothesis 1

Effect of risk management variables measured through 8 dimensions. They are credit risk management, market risk management, liquidity risk management, operational risk management, legal risk management, reputation risk management, strategic risk management, and compliance risk management. Parameter estimation the effect of risk management on capital structure decisions is 0.839 with significant value at CR = 6.06. According to Ferdinand (2006), value of CR (Critical Ratio) ≥ 2.00 means that a hypothesis is accepted. Therefore, value of CR = 6.06 is above requirements of CR ≥ 2.00 with a significance level of 0.05 (5 %), null hypothesis (H0) is rejected and alternative hypothesis is accepted. This means that risk management has significant and positive effect on capital structure decisions where hypothesis 1 is accepted.

Testing Hypothesis 2

Effect of banking regulation variable is measured through follows indicators: banks always comply with the minimum capital requirement, bank always comply with legal lending limit, bank always comply with statutory reserve and bank always comply with provisions of Loan to Deposit Ratio (LDR). Parameter estimation the effect of banking regulations on capital structure decisions is 0.571 with a significant level at CR = 3.18 is above the requirements of CR ≥ 2.00 with a significance level of 0.05 (5 %) so that null hypothesis is rejected and alternative hypothesis is accepted. This means that banking regulations has significant and positive effect on capital structure decisions, so that hypothesis 2 is accepted.

Testing Hypothesis 3

High or low levels of adherence to banking regulations will moderate or strengthens risk management practices in determining better capital structure decisions is not proven. Analysis showed that interaction the parameter estimation of banking regulations and risks management on capital structure decisions is -0.334 and significant at level of CR = 0.54. These results indicate that value of CR is lower than requirements of CR ≥ 2.00 with a significance level of 0.05 (5 %) so that null hypothesis is accepted and alternative hypothesis is rejected. This suggests that interaction of adherence to banking regulations on risk management has significant and negative effect on capital structure decisions, so hypothesis 3 is rejected. This means that strict adherence to banking regulation had no significant effect to strengthen or moderate the effect of risk management on capital structure decisions.

5.2. Discussion

5.2.1. Effect of Risk Management on Capital Structure Decisions

Risk and risk management practices should always be considered in running a good business (Kendrick, 2004). Risks are things that can lead to unexpected losses. Risk measurement focuses on unexpected loss of banks income volatility, which started from a low income, loss of balance, up to a potential bankruptcy. Generally, bank risk is classified into category of market risk, credit risk, operational risk, liquidity risk, strategic risk, and business risk (Jorion, 2000) The most important aspect of risk management is capital controls (Cai and Wheale, 2009). There are two main critical concepts in managing a portfolio of bank capital (Rowe, Jovic, and Reeves, 2004), namely: (1) Risk assessment and management. Banks need to effectively and accurately determine the amount of capital required to absorb unexpected losses derived from market risk exposure, credit risk and operational risk. (2) Profit from business activities need to be evaluated with regard to need to address risk capital.

Good risk management practice is able to determine better capital structure decisions. Risk management practices that lead to better condition of belief will have a positive effect on capital structure decision-making so it can improve CEO support for better capital structure decisions-making. In turn this is expected to encourage CEO of People Credit Bank to make better capital structure decisions. Good risk management practices will lead to better capital structure decisions. This study findings is consistent with opinion of Cebenoyan and Strahan (2004) which states that bank with better ability to manage risk (risk management) can operate with large debts and assets and can lend to riskier borrowers. Good risk management practice will make bank decisions more effective to choose their capital structure. It means that risk management has a positive effect on capital structure.

Risk management that created from credit risk management, market risk management, liquidity risk management, operational risk management, legal risk management, reputation risk management, risk management strategies, and compliance risk management become incentive for top management (CEO) in determining better capital structure decisions. Credit risk management has highest loading estimated risk management. Good credit risk management will minimize risks stemming from lending. Giving credit to community is main activity of banks that contain risks that may affect bank survival. Bad credit payment will affect bank's capital because credit risk management is one part risk management that will affect capital structure decisions. Study findings suggest that credit risk is the highest risk for banks, especially PCB. This is consistent with results of interviews with informant, a director at one PCB in Manado, North Sulawesi, which says that :

" Generally, average credit risk positions between commercial banks and PCB still higher PCB. Data show that commercial banks have zero point, People Credit Bank has above one credit risk. Credit risk still dominate..... PCB is more risky because of HR, as well competition among industry.... "

Interviews result means that PCB loan risk is higher than commercial banks because of limited resources that are owned by PCB and also due to competition among PCB in lending. The high credit risks faced by People Credit Bank is indicated by mean value of NPL that greater than 5 %. Study findings show that 45% of PCB in North Sulawesi and Gorontalo province have NPL value greater than 5 %. This means that risks of People Credit Bank in terms of credit risk is very large due to asset quality is not as good as indicated by NPL value that greater than 5 %. Bad asset quality interfere banks liquidity that can affect on lower CAR. Banks must consistently apply precautionary principle and prudent credit in order to anticipate such risks. Therefore, banks are required to have written credit policy guidelines and procedures.

Banks that having a manual that contains a standard credit loans will have highest indicator value of credit risk management. Manual credit held by banks play an important role to anticipate credit risk. This manual is a guide to lending policies and credit procedures, the reference credit to community. Nevertheless a manual credit alone is not enough, bank must also carry out periodic reviews independently of approved credit and bank must perform a careful examination toward completeness of credit administration. Those things in line with PCB leaders who act as respondents.

Risk management practices are also shaped by risk management strategy. This risk management strategy is described by bank indicator that always evaluate strategy implementation as a basis to establish a new strategy. This strategy implementation evaluation is very important especially by People Credit Bank to face increasingly fierce competition. Competition occurs not only among People Credit Bank to capture market share, but also extends to cooperative and usurer. Even now competition is happened between commercial banks

and mortgage in credit tapping. This is consistent with interviews results of informant's researcher who become chief executive at one of PCB in Minahasa district, North Sulawesi, which says that:

"The competition is increasingly intense as the industry is growing. Competition between PCB, as well as with commercial banks.... we have to face too common bank. What is certain in terms of position, PCB is still one step below the commercial banks, we must make a good position, should be able to take care or public trust, users of banking services, it is not easy... "

The interview results implies that PCB facing very tough competition, both among PCB themselves, as well as with commercial banks. It need plan and set strategies in face of such competition.

Interviews result with one of Directors of PCB in Manado, North Sulawesi is follows :

" Indeed, we must make strategic plans, work plans... The work plan was part of a strategy to achieve goal, all indicators that reference of regulations, particularly from BI regulators. We should strive to achieve what has become the benchmark of BI through indicators of banks healthy. We must be on track to reaches the indicators of health banks. Bank managers must make maximum efforts and strategic plans to achieve desired goals either from shareholders including supervisors or commissioners.... That's our job as the manager... "

It can be concluded from above these statements that strategic planning needs to be done to achieve all targets as well as to minimize the possible negative effect of inaccuracy strategic decision making and failure to anticipate changes in business environment. Good risk management practices will determine better capital structure decisions. Analysis revealed that risk management has a positive effect on bank capital structure. Risk management is aimed to control risk or lowering risks faced by banks. Results showed that average respondent agrees to practice risk management in their bank. Right risk management can reduce risk. This encourages banks to raise debt or raise more funds from public. The greater funds collected from community, the greater funds could be channeled through the credit, so the greater profit. Reduced risk as a result of good risk management practices encourage banks collect fund from public through savings and deposits (external funding) rather than capital funding from shareholders (internal funding) thereby increasing bank's capital structure. These study findings are consistent with study results of Cebenoyan and Strahan (2004) which states that higher or better risk management practices makes banks better in choosing their capital structure decisions.

5.2.2. Effect of Banking Regulation on Capital Structure Decisions

Strict regulation in banking industry is much needed because risks inherent in banking system. Banks product that used by all clients is money. The greater risks, the greater required capital of a bank. Based on this condition, regulatory authorities require banks to have sufficient capital to absorb risks, in this case a bank's capital level should be based on level of capital risk, in other words, risk-based capital. In order banks have enough capital to absorb risk then it created a regulatory capital requirements. This Regulation closely related to bank's capital structure.

This study shows that adherence to high banking regulation can directly led to increase in better capital structure decisions. Adherence level to high banking regulations require a clear understanding toward basic principles of regulations issued by Bank Indonesia. When this is done then bank can obtain benefits of better capital structure decision-making, primarily through higher awareness toward importance of adherence to banking regulations. This can be explained by looking at indicators of banking regulations.

Banking regulation indicator, an indicator of operational practices that always comply with bank's capital adequacy ratio, has highest value of parameter estimation. This suggests that high adherence to banking regulation reflects adherence to provisions of minimum capital adequacy ratio. People Credit Bank which is object of this research generally has CAR above banking regulations provision. People Credit Banks in study have CAR with average of 41.44 percent, above the regulation that requires banks should have CAR above 8 percent. This finding is supported by research interviews results with a PCB director in Manado, North Sulawesi, as follows :

"CAR 8 % affects capital structure decisions, because.... CAR should be kept a minimum 8 %, or we will difficult to develop if we does not have strong capital, because it is not in accordance with minimum provisions of 8 %. Therefore, it must be at least 8 %, higher even better so bank had activity and expansion, as well as the provision of credit will not bothered"

Interview results imply that minimum capital adequacy ratio (CAR) requirement above 8 percent is believed by CEOs should be adhered because capital above minimum CAR will strengthens their capital. Therefore, bank could carry out its operations and more able to expand and to give greater lending without disturbed. This study result support the notion of Mishkin (2000) and Ghosh et al. (2003) that banking regulations affect banks capital structure decisions. Adversely, test results do not support the statement of Flannery (1994), Myers and Rajan (1998), Diamond and Rajan (2000), Allen et al. (2009), and Groop and Heider (2009) who found that banking regulation does not affect bank's capital structure decision.

5.2.3. Banking regulation role as a moderating effect of risk management on capital structure decisions

Flannery and Rangan (2008) suggests that banking regulation does not affect the relationship between risk and capital structure. Adversely, Calomiris and Wilson (2004) argue that there is a negative relationship between risk and capital structure when there is no banking regulations. But they did not explain how relationship between risk and capital structure without banking regulations. Barrios and Blanco (2003) suggests that banks are affected by the regulations that regulate capital in order more than minimum capital. Although banking regulation is one factor associated with banks capital additional, but banking regulation is not the most important factor in determining bank capital structure. They argue that main determinants of bank capital structure is pressure of market forces. Santomero and Watson (1977) show that too tight capital regulation will lower bank lending. It will increase bank failures in increasing productive investment. Regulation pressure is an important driver in risk management practices to control market risk, credit risk and operational risk. Regulation can stifle innovation (Syer, 2003).

Researcher has not found a previous study that together examined relationship of three variables, namely banking regulation, risk management, and capital structure. In addition, previous research did not examines the role of banking regulations in moderating effect of risk management on capital structure decisions, both in banking institution itself or in an industrial manufacturing company, so this will become a study originality. This research is a study of perceptions of internal financial management. The respondents were leader (CEO) of People Credit Bank (PCB) in North Sulawesi and Gorontalo Province. These study findings indicate that adherence to banking regulation does not significantly moderate risk management practices in determining capital structure decisions. Its effect is weak and not significant with negative relationship direction. It means that higher adherence level to banking regulations would lower the effect of risk management in determining capital structure decisions. These results differ from previous prediction that banking regulation would moderate the effect of risk management on capital structure decisions. This is research findings originality in field of financial management.

The test results showed that banking regulation act as predictor moderation variable, where only banking regulations become a predictor variable in determining capital structure decisions. This means that strict adherence to banking regulations can not able to become the deciding factor to determine capital structure decisions. Banking regulation can not act as a moderating relationship between risk management with capital structure. Adherence to banking regulation has no significant effect on risk management practices in determining capital structure decision. The effect of banking regulation has negative coefficient but not significant. Therefore, level of adherence to banking regulation will have no effect on risk management practices in determining the structure of decision capital. Results of these tests indicate that higher adherence to banking regulations will weaken risk management practices in determining capital structure decisions. Adversely, lower adherence level to banking regulations will further strengthens risk management practices in determining capital structure decisions.

This can be explained by looking at dimensions and indicators of risk management variable. Indicator that most describe risk management variables in this study is credit risk management. This refers to risk management practice of Bank Indonesia Regulation No. 11/25/PBI/2009 about Amendment to Bank Indonesia Regulation No. 5/8/PBI/2003 about Risk Management Application for Commercial Banks. Similarly, indicator variables that most describe banking regulation variable is operational management practices of banks that always comply with minimum capital requirement. This variable refers to banking regulation of Bank Indonesia Regulation No. 5/12/PBI/2003 dated July 17th, 2003 about Capital Adequacy of Commercial Banks. Both risk management and banking regulations variables refer to same source, namely bank Indonesia Regulation. When banking regulation is used as a moderating variable the effect of risk management on capital structure decisions, then higher adherence level to banking regulations will weaken risk management practices to improve capital structure decisions. This suggests that adherence to banking regulation and risk management practices thus provide a negative value. This opens opportunities for further research to use other variables outside of Bank Indonesia Regulation, such as leadership behavior variable in facing risk.

When compared with accumulation of Financial Statements of PCB, actually risk management practices have not been able to run properly, marked with a mean value of NPLs of 6.37% still above 5%. This study found that bank always comply with minimum capital indicators has highest load estimate, biggest to describe banking regulations variable. Banks always comply with minimum capital plays an important role to describe adherence to banking regulations. The better response of bank always comply with minimum capital means the better adherence to banking regulations. This study findings indicate bank always comply with minimum capital indicator attained the highest response from respondents. It indicates that minimum capital requirement is always followed by bank. But it is different from findings of PCB Financial Statements that still there are PCBs that do not comply this provision where the values is below 8%. There is a great desire of PCB leadership (CEO) to implement risk management practices, but in fact they have not been able to do so. This could be interpreted that risk management practices that implemented by PCB is quasi. It need guidelines regarding specific risk management practices of PCB. Until today, risk management practice of PCB refers to risk management guidelines for conventional banks, while PCB have different characteristics.

Similarly, PCB also requires banking regulation that suitable with PCB characteristics where today PCB regulations still refers to regulation of conventional commercial banks that able to be adhered and implemented by PCB. Inability to deeply comply with banking regulations appears on PCB Financial Statements in 2011, where still not able to meet PCB capital adequacy ratio because still there are PCBs with CAR value under 8%. LDR provisions also can not be adhered to by PCB. The same thing is shown by NPL where many PCBs have NPL values above 5%. This indicates that adherence to banking regulations have not been able to improve PCB. Banking regulations establishment that suitable with PCB characteristics is expected to make PCB able to comply with banking regulations that could encourage investors to make People Credit Bank that consistent with third-party funds growth in North Sulawesi and Gorontalo province so that it can reach people in villages where during this research most PCB still located in cities. These study findings could explain why adherence to banking regulation had no significant effect to moderate effect of risk management practices on capital structure decisions. Adherence to banking regulation and risk management practices still become driving factor where higher adherence to banking regulation weakens risk management practices in determining capital structure. Adversely, lower adherence to banking regulation strengthens risk management practices in determining capital structure decisions. This finding is supported by interviews with a PCB director in Manado, North Sulawesi, as follows :

*" The role of banking regulation
ns... means synergy, means helping, regulation help to manage risk... yes, indeed the purpose of rule is
to become umbrella, meaning to secure and minimize risk... indeed closely related where rule is made
with concern to various aspects... it created comprehensively on how its relates with existing risks.
Regulation is made to help bank to minimize any risk. So it is good, rules or regulations concerning the
capital affect on risk management,... so it can help "*

5.3. Research Implications

Research model was built with looking at determinants of capital structure decision, where still very rare in banking, especially banks with small capital such as People Credit Bank (PCB) by inserting banking regulation variable as a moderating variable. Based on analysis and discussion, it can be seen that this study provides a theoretical implications of causal relationships between banking regulation, risk management and capital structure decisions variables. This study findings indicate that banking regulation become a predictor variable in determining capital structure decisions, but banking regulation can not become a moderating variable to strengthens risk management practices in determining capital structure decisions. The adherence level to banking regulation of People Credit Banks (PCBs) is within well enough category to create better capital structure decisions, although still there are some banking regulations that can not able to be adhered properly. This study result will hopefully contribute to develop theoretical knowledge of financial management and banking, particularly theory development of capital structure and risk management practices in banks. This study is a model that analyzes risk management practices in People Credit Bank to determine capital structure decisions that moderated by banking regulations to provide a better understanding. In addition, this study result are expected to provide more information for future researchers in field of financial management and banking with expanding and increase the writing vocabulary about risk management, capital structure and banking regulation. This study is testing media about risk management and banking regulations related to capital structure that provides a better understanding of factors that relevant in making capital structure decisions at banking institutions. It also will help to find more relevant capital structure theories at banking institutions. This result is also expected to lessen gap between empirical studies of capital structure in manufacturing companies (non-financial) and financial companies (banks). This study result are expected to become input for bank leaders

(CEOs) in order to improve profitability and stability of banks so that they can continue to exist and grow in today's competitive era.

This research also give benefits for regulator as Bank Indonesia. This study is very useful in helping to establish a good banking regulation and effective risk management practices related to bank's capital structure decision. In addition , this research gives benefits to community through information related to condition of bank's capital structure that can be used as a reference in investment decision at PCB. This study result study provide information about risk management practices that are beneficial for bank leadership in determining better capital structure decisions. This study will provide an overview of banking regulation that are beneficial to bank leadership in determining capital structure decisions. This study results also provides information about role of banking regulation adherence in moderating the effect of banking risk management practices to determine banks' capital structure decisions. This research has been implemented by following right scientific research steps, but still there are some limitations that need improvement in future. These study limitations are: (1) not all respondents willing to fill questionnaire because of his busy as a board of directors and commissioners in PCB, (2) rather difficult to obtain secondary data regarding financial statements of non go public companies as PCB, and (3) only few respondents who agreed to be interviewed to obtain qualitative information.

VI. CONCLUSIONS AND LIMITATIONS

Risk management practices are important determinants for bank capital structure decisions. Better risk management practices will improve leader's decision in determining bank's capital structure. Risk management practices at PCB in North Sulawesi and Gorontalo Provinces are implemented by increasing decision of bank leader in determining its capital structure as embodiment of better decisions making of top management (CEO). Risk management that carried out properly can reduce risk that encouraging banks to raise debt or raise more funds from public. More funds that collected from community will provide opportunities for banks to tap more funds through loans, thereby increasing their profit.

Banking regulations determine banks' capital structure decisions. Banking regulations is issued by monetary authority, in this case the Bank Indonesia. It must be adhered and implemented by PCB in North Sulawesi and Gorontalo Province. But still there is little Bank Indonesia regulation that has not been able to be implemented. High adherence to banking regulations make better capital structure decisions. Banking regulations do not act as a determining factor in risk management strengthens affect capital structure decisions. The high adherence level to banking regulations weaken risk management in raising capital structure decisions. Adversely, low level adherence to banking regulation actually strengthens risk management in raising capital structure decisions. This is because risk management practice and compliance with banking regulations in some PCB is still can not been able to implement properly. This research has limitations that need improvement for future research. Interviews results with some BPR leader in North Sulawesi Province show that organizational culture has a role to behavior management in making decisions regarding capital structure. Future studies are recommended to develop a sample outside PCB to increase the generalizability of research results, especially how banks create an effective risk management in determining capital structure decisions. It aims to further strengthen the research contribution for wider generalization.

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