CHAPTER I

INTRODUCTION

1.1. Research Background

Banking began with the first prototype banks of merchants of the ancient world, which made grain loans to farmers and traders who carried goods between cities. This began around 2000 BC in Assyria and Babylonia. Later, in ancient Greece and during the Roman Empire, lenders based in temples made loans and added two important innovations: they accepted deposits and changed money. Archaeology from this period in ancient China and India also shows evidence of money lending activity.

The origins of modern banking can be traced to medieval and early Renaissance Italy, to the rich cities in the centre and north like Florence, Lucca, Siena, Venice and Genoa. The Bardi and Peruzzi families dominated banking in 14th-century Florence, establishing branches in many other parts of Europe. One of the most famous Italian banks was the Medici Bank, set up by Giovanni di Bicci de' Medici in 1397. The earliest known state deposit bank, Banco di San Giorgio (Bank of St. George), was founded in 1407 at Genoa, Italy.

Modern banking practices, including fractional reserve banking and the issue of banknotes, emerged in the 17th and 18th centuries. Merchants started to store their gold with the goldsmiths of London, who possessed private vaults, and charged a fee for that service. In exchange for each deposit of precious metal, the goldsmiths issued receipts certifying the quantity and purity of the metal they held

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as a bailee; these receipts could not be assigned, only the original depositor could collect the stored goods.

The Bank of England was the first to begin the permanent issue of banknotes, in 1695. The Royal Bank of Scotland established the first overdraft facility in 1728. By the beginning of the 19th century a bankers' clearing house was established in London to allow multiple banks to clear transactions. The Rothschilds pioneered international finance on a large scale, financing the purchase of the Suez canal for the British government.

In the first half of the 19th century, many of the smaller commercial banks within New England were easily chartered under applicable laws (primarily due to open franchise laws). The rise of commercial banking saw an increase in opportunities for wealthy individuals to become involved in entrepreneurial projects. These early banks acted as intermediaries for entrepreneurs who did not have enough wealth to fund their own investment projects and for those who did have wealth but did not want to bear the risk of investing in ventures. Thus, this private banking sector witnessed an array of insider lending, due primarily to low bank leverage and an information quality correlation, but many of these banks actually spurred early investment and helped spur many later projects. Despite what some may consider discriminatory practices with insider lending, these banks actually were very sound and failures remained uncommon, further encouraging the financial evolution in the United States.

In 1781, the Congress of the Confederation established the Bank of North America in Philadelphia, where it superseded the state-chartered Bank of

Pennsylvania, founded in 1780, to help fund the American Revolutionary War. The Bank of North America was granted a monopoly on the issue of bills of credit as currency at the national level. Prior to ratification of the Articles of Confederation and Perpetual Union, only the States possessed sovereign power to charter a bank authorized to issue their own bills of credit. Afterwards, Congress also had that power.

Meanwhile in China, Chinese financial institutions were conducting all major banking functions, including the acceptance of deposits, the making of loans, issuing notes, money exchange, and long-distance remittance of money by the Song Dynasty (960-1279). In 1024, the first paper currency was issued by the state in Sichuan. The two major types of indigenous Chinese financial institutions, piaohao (票號) and qianzhuang (錢莊), more often cooperated than competed in China's financial market.

Due to structural weaknesses of traditional Chinese law, Chinese financial institutions focused primarily on commercial banking based on close familial and personal relationships, and their working capital was primarily based on the float from short-term money transfers rather than long-term demand deposits. The modern concepts of consumer banking and fractional reserve banking never developed among traditional Chinese banks and were introduced to China by European bankers in the 19th century.

In 1905, China's first central bank was established as the Bank of the Board of Revenue(大清户部銀行). Three years later, its name was changed to the Great Qing Government Bank (大清銀行). Intended as a replacement for all

existing banknotes, the Da Qing Bank's note was granted exclusive privilege to be used in all public and private fund transfers, including tax payments and debt settlements. Da Qing Bank was also given exclusive privilege to run the state treasury. The Board of Revenue that controlled most of the central government's revenue transferred most of its tax remittance through the bank and its branches. The government entrusted the bank with the transfer of the Salt Surplus Tax, diplomatic expenditures, the management of foreign loans, the payment of foreign indemnities, and the deposit and transfer of the customs tax in many treaty ports. Following the Xinhai Revolution of 1911, Daqing Bank was renamed the Bank of China. This bank continues to exist today.

The main role of the bank is to carry out the financial intermediary function in collecting funds from outside parties and channeling them back to certain parties in need. The intermediary function of a bank can work well by relying on the trust principle of the community. Therefore, the bank is also called as agent of trust, the financial institution that runs its operational activities depends on the source of funds from the community. The sustainability of a bank's business depends on public trust. The decline in public trust in a bank will have a widespread impact on the banking system that could lead to a banking crisis.

Aside from being an agent of trust the bank also acts as an agent of development which means to act as a financial institution that contributes greatly to the economic development of a country. At the macroeconomic level, banks serve as a tool for establishing monetary policy while on the micro scale banks are the main source of financing for the community and support the smoothness of the

payment system so that the movement of the economy of a country depends on the dynamics and the real contribution of the banking sector.

Banks can be classified into several types based on function, ownership, transaction operation and price determination. Based on the function of the bank consists of Central Banks, Commercial Banks and Rural Banks. In terms of bank ownership consisting of Government-Owned Bank and Mixed Bank, bank classification based on transaction operation consists of Foreign Exchange Bank and Non-Foreign Exchange Bank, while in terms of determining the price consists of banks based on Conventional Principles and Sharia Principles. Bank Indonesia as the central bank divides the bank into several types, all of which are a combination of several bank classifications described above. The types of banks are Bank Persero, Foreign Exchange Bank, Non-Foreign Exchange Bank, Joint Bank, Foreign Bank and Regional Development Bank.

Each type of bank certainly has a different role in running every operational activity. But still, even in any category, banks have a primary function as an intermediary institution and play a very important role for the stability of the economy in a country. Therefore every type of bank must be able to maintain its performance in order to remain in healthy condition.

In 1985 - 1996, Indonesia's economic growth grew rapidly so dubbed as Miracle Asia by the World Bank. A number of conditions and policies issued during that period, one of which is the issuance of banking deregulation through facto 88 in 1988 which essentially facilitate the establishment of the bank. The existence of these policies resulted in the number of banks in Indonesia has

increased quite drastically. This is supported also by the issuance of Law No. 7 of 1992, which caused banks in Indonesia to flourish, dozens of newly established banks such as Rural Banks.

The 1988 banking deregulation indirectly plays a major role in the onset of the economic crisis that struck Indonesia since the middle of 1997. The problem arising as a result of deregulation is not the increase in the number of banks, but rather the lack of resources that meet the requirements to manage banks and the application of prudential principles. Given its very important role for the economy, the government issued a number of policies in order to nourish the national banking system. According to data from Bank Indonesia and IBRA, the policies issued include 71 banks closed and 20 banks merged so that the number of banks decreased from 238 banks in October 1997 to 159 banks at the end of 2001. The economic crisis indicates that the national banking industry does not yet have a strong banking institution with the support of poor banking infrastructure so that fundamentally still must be strengthened to overcome internal and external turbulence. The lack of solid fundamentals of national banking is a big challenge not only for the banking industry in general, but also for Bank Indonesia as its supervisory authority.

In fulfilling its supervisory function, Bank Indonesia has three instruments to monitor the soundness of a bank in accordance with the following regulations. First, CAMEL analysis (Capital, Assets, Management, Earning, and Liquidity). Second, Maximum Permitian Credit Limit, with the objective of avoiding business failure as a result of credit concentration either to protect interests, public

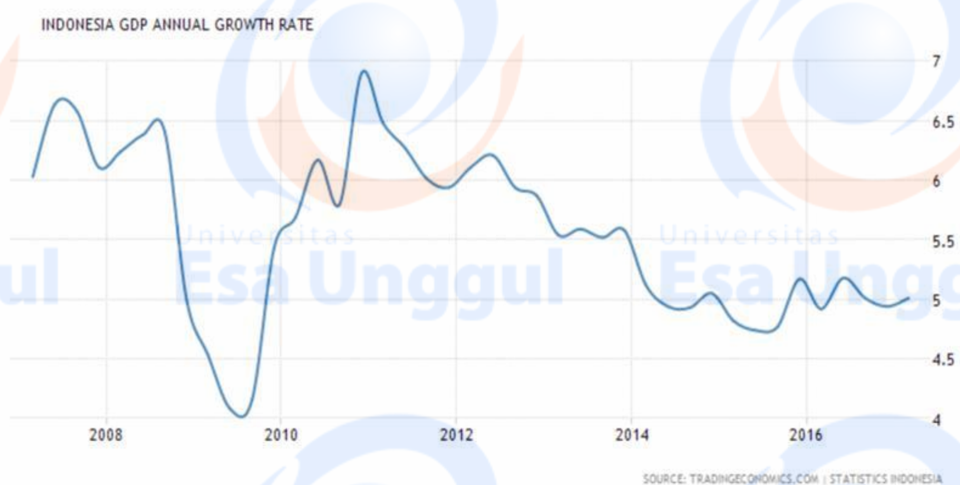
trust or to maintain bank health. Third, The fit and proper test, this provision is in line with the issuance of Bank Indonesia Regulation Number 5/25 / PBI dated November 24, 2003.

Analysis of banking financial statements can help business people, both government and other users of financial statements in assessing the financial condition of a company is no exception banking companies. To assess the financial performance of banks, generally used five aspects of the assessment of the analysis CAMEL (Capital, Assets, Management, Earning, Liquidity). Capital aspects include CAR, asset aspects include NPL, earning aspects include ROA and OEOP, while liquidity aspects include LDR. Four of the five aspects of each capital, assets, management, earnings, liquidity assessed by using financial ratios. This shows that financial ratios are useful in assessing the financial condition of banking companies.

CAMEL analysis first appeared in 1979. In 1979, the Uniform Financial Institutions Rating System (UFIRS) was implemented in U.S. banking institutions, and later globally, following a recommendation by the U.S. Federal Reserve. The system became internationally known with the abbreviation CAMEL, reflecting five assessment areas: capital, asset quality, management, earnings and liquidity. In 1995 the Federal Reserve and the OCC replaced CAMEL with CAMELS, adding the "S" which stands for (S)ensitivity to Market Risk. However, until now Indonesia is still using CAMEL in performing financial performance analysis of banking.

After successfully stabilizing economic conditions, Indonesia scored a successful achievement into the G20 (Group Twenty). As the only Southeast Asian country and the only developing country that made it into this list, the rapid development in Indonesia's economy shocked the world. Able to recover within 10 years after the economic downturn in 1998 gave a good sign for the future of the economy Indonesia. However, economic growth caused by a soaring GDP but not followed by a strong basic economic fundamentals may lead into black pit of economy crisis.

Indonesia GDP Annual Growth Rate



GDP figures dropped dramatically in 2009 which then increased dramatically to peak in 2011. During the year 2010 to 2011, economic analysts are optimistic about Indonesia's economic future. This is shown from the increasingly crowded stock market and bonds in Indonesia. Foreign investment is heavier with expectations that the Indonesian economy will continue to rise. However, until

2015, GDP growth has decreased periodically. The rebound occurred in 2016 but only on a small scale.

Given the importance of the company's financial performance assessment to determine the policies to maintain the continuity of the company's operations in the face of competition among business types and as a comparison of financial performance of banks in facing challenges coming from outside and within the country, the authors take a study entitled "**COMPARATIVE ANALYSIS OF FINANCIAL PERFORMANCE BETWEEN FOREIGN AND NON-FOREIGN EXCHANGE BANKS USING CAMEL METHOD FOR THE PERIOD 2014-2016"**.

1.2. Identification and Limitation of Problem

1.2.1. Identification Problem

Based on the research background above, the identification problem of this research are follow:

a. The role of bank as the intermediary function, agent of trust, and agent of development has one purpose to stabilize economy in a country. It is why bank become one of the important financial institution regardless of what the bank category it is.

b. The historical background of the financial crisis of 1998 made the assessment of financial performance very important. The performance of the bank at that time which became one of the

causes resulted in huge losses that catapulted the exchange rate against U.S. Dollar up to double that time.

c. Indonesia's rapid economic growth has resulted in rush of economic activity and foreign investment. This opportunity can be a great opportunity for Indonesia if Indonesia is able to regulate it and use it for the development of fundamental economic fundamentals so as to strengthen the economic situation in order to face the challenges coming from outside and within the country.

1.2.2. Problem Scope Limitation

The problem limitation, it's necessary to make a clear the hedging of problem analyzing. The aim is to prevent the deviation problem. This research is conducted only to find the significant difference of financial performance between foreign exchange bank and non-foreign exchange bank registered in Bank Indonesia in period 2014-2016. The dependent variables studied are financial ratios in the CAMEL method to represent capital, asset, management quality, earnings, and liquidity which are influenced by independent variables, foreign exchange banks and non-foreign exchange banks. This research takes the source of data in the form of financial statements published on the official website of the bank company that became the sample.

1.3. Problem Formulation

The formulations of problem which will be discussed in this research are:

a. Does the capital of foreign exchange bank has a significant difference with non-foreign exchange bank?

b. Does the assets of foreign exchange bank has a significant difference with non-foreign exchange bank?

c. Does the management quality of foreign exchange bank has a significant difference with non-foreign exchange bank?

d. Does the earnings of foreign exchange bank has a significant difference with non-foreign exchange bank?

e. Does the liquidity of foreign exchange bank has a significant difference with non-foreign exchange bank?

1.4. Research Objective

The aims of this study are as follow:

a. To analyze the difference of capital between foreign and non-foreign exchange bank.

b. To analyze the difference of assets between foreign and non-foreign exchange bank.

c. To analyze the difference of management quality between foreign and non-foreign exchange bank.

d. To analyze the difference of earnings between foreign and non-foreign exchange bank.

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e. To analyze the difference of liquidity between foreign and non-foreign exchange bank.

1.5. Research Contribution

Generally, this study is to get information and then this information expected can be applying properly by the user. Different users are different benefit. This below specify of benefit:

1. For writer

   As a scientific study of the theories that have been obtained and applied empirically in the real world in the hope that it can be useful for other parties who want to know more in depth about analyzing financial performance using CAMEL method..

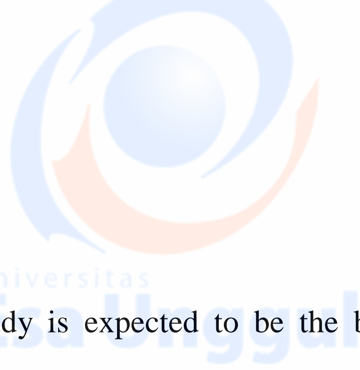
2. For manager or company

   The results of the study are expected to be considered in the assessment of bank financial performance so that it can take decisions to determine policies in improving performance and make company better.

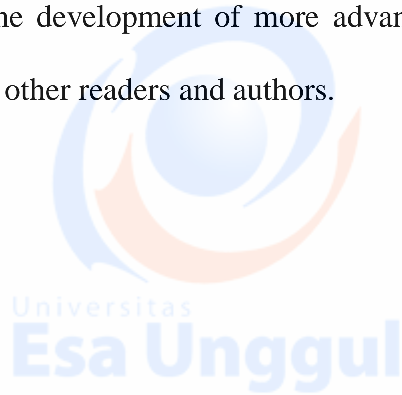
3. For investor

   Investors extremely need a lot of information before they decide whether they will invest on that firm or not. This information can help investor precisely when they choose some company and it can be some consideration.

4. For the next researcher



This study is expected to be the basis or reference for further research is better and the results of this study can be a reference for the development of more advanced research and add insight from other readers and authors.



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