The Local Government Equity Participation in the Regional Development Banks in Indonesia

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Abstract: *Local government equity participation in the regional development banks, called Bank Pembangunan Daerah (BPD), is a local government program in order to encourage local businesses in Indonesia for community welfare, which is based on the Law Number 23 of 2014. The objective of this study was to analyze the local equity participation of 26 provinces in 26 BPDs. The research method used two stage least square (2SLS) regression. The results of the study illustrated the estimations of six structural equations and one identity equation by using the data in the provincial government financial statements and the data in the financial statement/annual report of each BPD from 2010-2015. The conclusion is that the model built was able to perform the estimations and simulations because the validity of the model met the U-Theil requirements of near zero and R^2 approaching one. The simulation results showed that the policy of increasing equity participation will raise local revenues as well as banks' dividends and profits,but lower per capita income and local incomes. Thus, the provincial governments in allocating the budgets have to focus on the improvement of community welfare, and BPDs have to be able to manage themselves by changing the paradigm of consumer credit distribution into productive credit distribution.*

Keywords: *equity participation, Two Stage Least Square (2SLS), equity participation simulation, investment*

I. Introduction

The regional development banks, Bank Pembangunan Daerah (BPD), in Indonesia are the banks which are individually formed by each provincial government together with the district/city governments that aim to hold the local treasury and help improve the local economy by providing credit or financing for the execution of regional development efforts in order to implement national development. Local equity participation in the nomenclature of the local balance sheet belongs to the local long-term investment category that according to the mandate of Law Number 1 of 2004 and Law Number 23 of 2014 can be done on enterprises, both the regional-owned enterprises, called Badan Usaha Milik Daerah (BUMD), and the state-owned enterprises, called Badan Usaha Milik Negara (BUMN). BUMDs can take the form of banks or other companies which are established to provide benefits to the local economy, the supply of goods and/or services for the livelihood fulfillment of the local community in accordance to the local condition, as well as to obtain profit. Local equity participation is one of the regional fiscal targets for the benefits of the local economy. The most prominent fiscal target is for regional economic growth and to reduce unemployment and control inflation (Ahmad and Wajid, 2013 and Romer, 2006).

Until the end of 2013, the allocations of local equity participation, either by the provincial government or district/city government, with various risks undertaken by the 28 provinces of 34 provinces along with the districts/cities within each province have aggregately reached Rp38.4 trillion, distributed to regional-owned banking of Rp21.8 trillion, district/city-owned water company (PDAM) of Rp443.03 billion, and other regional-owned enterprises of Rp16.45 trillion. By contrast, from 2010 to 2015, the unused (idle) local government funds in the form of budget financing surplus (SILPA) in national banking have ranged from Rp 60 trillion to Rp113 trillion, namely about Rp 60 trillion in 2011, Rp80 trillion in 2011, Rp100 trillion in 2012, decreasing to over 80 trillion in 2013, increasing again to Rp113 trillion in 2014 and per December 2015 amounting to Rp99.68 trillion.

Following the regulation, the unused funds can be utilized for financing expenditure in the form of direct and indirect investments, where direct investments are given to regional-owned enterprises or other enterprises that are permitted by the legislation. The most prominent regional-owned enterprises in Indonesia are regional-owned banks, regional-owned water companies, and other enterprises in accordance to the character of each region. Each investment, either directly or indirectly, has financial risks that must be managed, such as

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return risks for the investments requiring a return and gaining a decisive influence, legal risks caused by the liability of a policy, and business risks due to the fluctuations in the economy that cannot be controlled such as credit risk, dividend repatriation risk, and non-informative financial statements (Aurelio Pappalardo, 1987; Deo and Sundar, 2015; Al-Suburi, 2013; Kun and Duo, 2014.)

The regional development banks (BPDs) are the banks with the least risks when compared with other commercial banks in terms of capital structure because BPDs have no debts to other parties. Without debts, BPDs should be more flexible in positioning themselves as a credible institution to collect funds and give credits, as an investment fund institution, as a payment institution, and as a money transfer institution as stated by Handayani in 2005. Such flexibility has resulted in BPDs becoming the main target of local equity participation compared with other banks or companies. Ni Nengah in 2010 has stated that BPDs are determined as the equity participation target to get the dividends before taxes and levies. As for other public banks, the biggest bank financing comes from the third parties in addition to bonds (Widiarti, Siregar and Andati, 2015).

This study aimed to simulate the implication of bank capital additional investment policy, in influencing the model of local equity participation in BPDs for community welfare.

II. Research Methodology

The study was conducted in Indonesia in the provincial governments and regional development banks which partly or entirely have received equity participation from the local governments from 2010 to 2015; the data are available in the Audit Board of the Republic of Indonesia, named Badan Pemeriksa Keuangan (BPK-RI). Those data are related to the secondary data of twenty-six provincial government financial statements and the annual reports/financial statements of twenty-six regional development banks (BPDs).

The study design is described in Figure 1 in the form of a conceptual framework. Data modelling and collecting were originated from the financial statements of 26 provincial governments from 34 provinces and 26 BPDs' financial statements for 6 years respectively. The analytical tool used was 2SLS (two stage least square) simultaneous equation system.

Simultaneous equations were performed because single regression model could not be conducted due to the presence of causal relationship between endogenous and exogenous variables (Gujarati, Damodar, 2004 and Daryanto, Hafizrianda, 2012), with operational and indicator variables as follows:

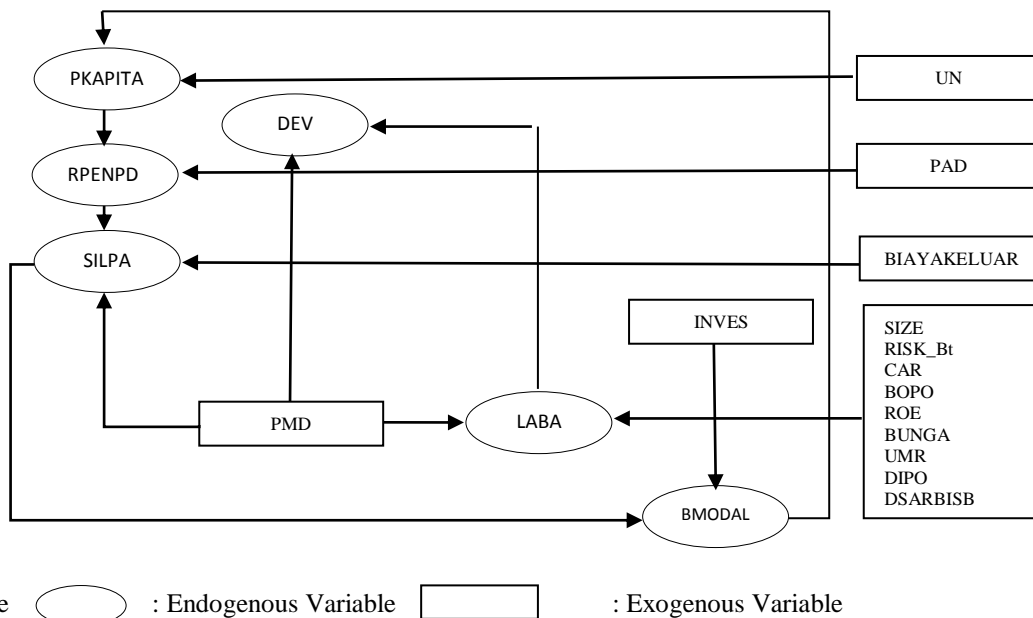Where ⬭ : Endogenous Variable ▭ : Exogenous Variable

Figure 1. Research methodology

The results of data processing are presented including six econometric structural equations and one identity equation, namely:

$$\text{PKAPITA}_{p,t} = \alpha_0 + \alpha_1 \text{UN}_{p,t} + \alpha_2 \text{BMODAL}_{p,t} + \varepsilon_{p,t} \qquad (1)$$

where

PKAPITA = Per capita income
UN   = Unemployment
BMODAL = Capital expenditure of the provincial government
α = Coefficient
p=1,2……n and t = 1,2…..n with the following hypothesis:
α_0 ; $\alpha_1 < 0$; $\alpha_2 > 0$

$$RPENPD_{p,t} = \beta_0 + \beta_1 PKAPITA_{p,t} + \beta_2 PAD_{p,t} + \nu_{p,t} \tag{2}$$

RPENPD = Revenue realization of the provincial government
PAD = Local revenue
β = Coefficient
with the following hypothesis:
$\beta_0; \beta_1; \beta_2 > 0$

$$SILPA_{p,t} = \gamma_0 + \gamma_1 RPENPD_{p,t} + \gamma_2 BIAYAKELUAR_{p,t} + \gamma_3 PMD_{p,t} + \mu_{p,t} \tag{3}$$

SILPA = Provincial budget financing surplus
BIAYAKELUAR = Provincial budget financing expenditure
PMD = Local equity participation
γ = Coefficient
with the following hypothesis:
$\gamma_0; \gamma_1; \gamma_2 > 0$ and ; $\gamma_3 < 0$

$$LABA_{BANKi,t} = \delta_0 + \delta_1 SIZE_{i,t} + \delta_2 RISK\_Bt_{i,t} + \delta_3 CAR_{i,t} + \delta_4 BOPO_{i,t} + \delta_5 ROE_{i,t} + \delta_6 BUNGA_{i,t} \\ + \delta_7 PMD_{i,t} + \delta_8 UMR_{p,t} + \delta_9 DIPO_{i,t} + \delta_{10} DSARBISB_{p,t} + \xi_{i,t} \tag{4}$$

LABA   = BPD's profit
SIZE   = Bank's size
RISK_Bt   = Bank's business risk
CAR   = Bank's capital adequacy ratio
BOPO   = Operational cost compared with operating income
ROE   = Return of equity
BUNGA   = bank's applicable interest rate;
UMR   = regional minimum wage
DIPO   = dummy of bank after IPO
DSARBISB = dummy of bank's business target
δ = coefficient
with the following hypothesis: $\delta_0; \delta_1; \delta_2; \delta_3 > 0; \delta_4 < 0 ; \delta_5 ; \delta_6; \delta_7 > 0; \delta_8 < 0; \delta_9 ; \delta_{10} > 0$

$$DEV_{i,t} = \phi_0 + \phi_1 PMD_{BANKi,t} + \Phi_2 LABA_{BANKi,t} + \vartheta_i \tag{5}$$

DEV = Dividend received by the provincial government
Φ = coefficient, with the following hypothesis: $\Phi_0: \phi_1; \phi_2 > 0$

$$BMODAL_{p,t} = \psi 0 + \psi_1 SILPA_{i,t} + \psi_2 INVES_{p,t} + \varkappa_p \tag{6}$$

INVES   = Private investment
Ψ = coefficient
with the following hypothesis: $\psi 0; \psi_1; \psi_2 > 0$

Identification equation
$$PAD = PAJAKD + RETRID + DEV + HDEV + LAINPAD; \tag{7}$$

PAJAKD   = Provincial tax
RETRID   = Provincial levy
HDEV   = Result of separated local assets minus dividend
LAINPAD = other legitimate local revenues

III. Situational analysis

This study managed to collect 24 variable data as the model built from all the data collected for six years from 2010 to 2015. The 24 variables are the data representing the 11 variables in the provincial government financial statements and the 7 variables derived from BPDs' financial statements, sourced from the Statistics Indonesia as many as 4 variables and two dummy variables. The significant number of BPDs in Indonesia until 201 7 is 27 banks, but in this study only 26 banks were researched because one bank was only acquired in 2016 by the Provincial Government of Banten from PT. Bank Pundi.Tbk and the 26 provinces have been the most dominant provinces in implementing equity participation and are the original provinces prior to provincial segregations. The compositions of the capital structure during the 2010-2015 study are averagely 45.34% for provincial ownerships, 54.05% for district/city ownerships and the rest is other ownerships.

The average growths of equity participation are - 1.12% for provinces and 4.10% for districts/cities. During the study, all regional development banks did not have debts to other parties, whether companies or banks. The main capital source for regional development banks is the equity participation of provinces and districts/cities in the form of shares, and there are employee cooperative stocks and private equity participation in a few banks with very small portions. In addition, in this study, there are two banks owned by the public in the form of shares in the capital market, namely Bank Jabar-Banten and Bank Jatim with 20% to 25% shares. The business orientation of the regional development banks in general is credit distribution to the consumer sector such as employee loan disbursement; only 11 financial statements/annual reports of BPDs that have distributed the productive credits into business forms of the 156 financial statements/annual reports that became the object of the study.

Based on these data, the model of econometric equations was then formulated into six endogenous variables focusing on the analyses of per capita income (PKAPITA), provincial government's realization (RPENPD), budget financing surplus (SILPA), BPD's profit ($LABA_{BANK}$), dividend received by the provincial government (DEV), the capital expenditure of provincial government (BMODAL) and one identity equation, namely local revenue (PAD). The exogenous variables of the endogenous equations are the unemployment rate in the province (UN); provincial budget financing expenditure (BIAYAKELUAR); local equity participation (PMD); bank's size (SIZE); bank's business risk (RISK_Bt); capital adequacy ratio (CAR), operational cost compared with operating income (BOPO), return of equity (ROE); BPD's interest rate (BUNGA); dummy of BPD after IPO (DIPO); dummy of BPD distributing credits to the productive sector exceeding 51% (DSARBISB) and private investment (INVES). The identity equation that could be made in this 2SLS simultaneous equation system is the local revenue (PAD) as the sum of local tax (PAJAKD); regional levy (RETRID); dividend (DEV); the number of other separated local assets (HDEV) as well as other legitimate local revenues (LAINPAD).

Per capita income is a measure of the level of community welfare; conceptually, Gross Regional Domestic Product (GRDP) is equivalent to the GDP, but GRDP of the number of output from the production units produced for a year generated by the population in a production region can be either provincial or district/city (Viet, 2010; BI, 2014). The amount of GRDP divided by the total population will then become per capita income (BPS, 2015). The endogenous growth theory is often used to discuss the relationship between growth and fiscal policy; balanced government budget leads to higher level of welfare with small debt to gross domestic product record (Greiner, 2015). Local incomes, local revenues, local taxes, local levies, other local revenues, capital expenditures, financing expenditures, and SILPA are fiscal policies that can have an impact on economic growth.

The measurements of banking performance commonly used are profitability ratios, rentability ratio and liquidity ratio (Sunaryo and Prasetyo, 2015). Investor is a person who avoid risks, especially legal risks, but investor is a person who manages risks; in connection with this, then it is necessary to measure the financial ratio performance of the invested company. Health is measured with CAMEL (Capital Quality, Management, Earnings and Liquidity) as described by Mirdani and Budiyanto, 2014. In this paper, Capital quality was measured by CAR, management was measured by the amount of profit obtained by the bank, earnings were measured by the return on equity ratio (ROE), and liquidity was measured by BOPO.

IV. Results and discussion

4.1 Data Analysis

The econometric estimation result of the equity participation model in 26 provincial governments in 26 regional development banks with the observation of 312 financial statements comprising 156 provincial government financial statements and 156 financial statements/annual reports of BPDs for respectively 6 years (2010-2015) shows the result's conformity with economic and statistical criteria (Budiman, et al 2016). The 312 financial statements did not include the financial statements of districts/cities and the statements of eight

provinces resulted from provincial segregations, namely the Provinces of Banten, Bangka Belitung, Riau Islands, West Sulawesi, Gorontalo, North Maluku, West Papua, and North Kalimantan.

There are 7 equations in the model of local government equity participation in regional development banks in Indonesia. The model equation consists of 6 structural equations and 1 identity equation. The estimation results of the model to determine the exogenous variables or the influencing factors in each equation of the endogenous variables were conducted using the *Two Stage Least Square* (2SLS) method. The coefficient interpretation for the equation estimation parameter individually resulted in 22 explanatory variables, giving the estimation parameter coefficients that are in accordance with the expectations based on theoretical concepts, phenomena, and empirical experiences. The estimation results of all equations are shown in table 1.

Table 1 The Model Estimation of Simultaneous Equations of Provincial Equity Participation in Regional Development Banks

Variable	Parameter Estimate	Standard Error	t Value	Pr > |t|	Other parameter
Per capita income equation (PKAPITA)					
UN	-15,5206	5,598891	-2,77	0.0063	R^2 = 0,448
BMODAL	16,61872	1,494464	11,12	<.0001	F stat = 61,84
					Pr > F = <,0001
Revenue realization of the provincial government (RPENPD)					
PKAPITA	0,066095	0,014381	4,60	<.0001	R^2 = 0,79006
PAD	1,156697	0,078881	14,66	<.0001	F stat = 286,01
					Pr > F = <,0001
Budget financing surplus (SILPA)					
RPENPD	0,200588	0,021268	9.43	<.0001	R^2 = 0,75016
BIAYAKELUAR	0,279282	0,145994	1.91	0,0576	F stat = 151,13
PMD	-0,46675	0,195910	-2.38	0,0184	Pr > F = <,0001
Regional development bank's profit equation (LABA)					
SIZE	243435,8	15805,83	15,40	<.0001	R^2 = 0,90508
RISK_Bt	2534,389	1297,556	1,95	0,0527	F stat = 137,31
CAR	4604,717	2117,237	2,17	0,0313	Pr > F = <,0001
BOPO	-6373.38	1710,525	-3,73	0,0003	
ROE	5667,271	1550,959	3,65	0,0004	
BUNGA	358728,8	197376,7	1,82	0,0712	
PMD	0,070360	0,019000	3,70	0,0003	
UMR	-0,16002	0,025338	-6,32	<,0001	
DIPO	445325,7	42223.10	10,55	<,0001	
DSARBISB	30296,97	18499,44	1,64	0,1037	
Dividend equation					
PMD	0.037165	0.005441	6.83	<.0001	R^2 = 0,83718
LABA	0.170192	0.013509	12.60	<.0001	F stat = 390,77
					Pr > F = <,0001
Capital expenditure equation					
SILPA	0.797268	0.089874	8.87	<.0001	R^2 = 0,78212
INVES	0.001957	0.001039	1.88	0.0615	F stat = 272,82
					Pr > F = <,0001

4.2 Discussion and validation

The estimation parameter coefficient interpretations of the structural equations on the endogenous variables are shown in table 1. Individually, there are 21 explanatory variables and 1 (one) identity equation, namely local revenue (PAD) and 5 (five) explanatory variables, namely local tax (PAJAKD), levy (RETRID), dividend (DEV), the difference between separated local assets and the dividend (HDEV) and other local revenues (LAINPAD) that were made in the simultaneous equation model (2SLS). The validation test of the equation estimation shows U-Theil near zero and R^2 close to 1 in each endogenous variable. The validation results were capable of making model prediction in line with the actual condition (Sitepu and sinaga, 2006). See table 2.

Table 2 The Model Validation Results of Equity Participation of Local Governments in Regional Development Banks

No	Endogenous Variable Names	Variables	Validation	
			U-Theil's	R^2
1	Per capita income	KAPITA	0,3196	0,3264
2	Local Revenue Realization	R_PENPD	0,1415	0,8735
3	Budget Financing Surplus	SILPA	0,2454	0,7300
4	BPD's Profit	LABA	0,1012	0,9050
5	Dividend	DEV	0,1631	0,7982
6	Capital Expenditure of the Provincial Government	BMODAL	0,2190	0,7660
7	Local Revenue	PAD	0,1503	0,8737

Source: processed data

4.3 Simulation

The prediction was done by conducting a simulation on the exogenous variables of equity participation as the variables that can be controlled by the provincial government. In this study, a simulation was conducted on equity participation variables by increasing 3.15% of the actual condition. The number 3.15% was obtained from the average accumulation of participation growth, conducted by either the provinces or districts/cities with the resulted changes as shown in Table 3.

Table 3 The Simulation Results of Equity Participation Increase by 3.15 Percent

No	Variable Names	Variables	Increase/Decrease		Changes
			Base	Simulation	
1	Per capita income	KAPITA	37301911	37141528	-0,430
2	Local Revenue Realization	RPENPD	6639067	6629712	-0,141
3	Budget Financing Surplus	SILPA	893043	880938	-1,355
4	BPD's Profit	LABA	374276	375818	0,420
5	Dividend	DEV	83215,2	84292,1	1,294
6	Capital Expenditure of the Provincial Government	BMODAL	1039475	1029824	-0,928
7	Local Revenue	PAD	3192144	3,19E+06	0,034

Source: processed data

Simulation raises equity participation, causing the changes in per capita income decline, while budget realization, SILPA, and capital expenditure will raise banks' profits, dividends and local revenues. Thus, the provincial government policy needs to allocate the budget focusing on increasing per capita income, since the method of equity participation in banks can only raise local revenues and dividends as well as banks' profits during the study, whereas the other objective has not been touched, namely the economic benefits in general that are measured by the increased per capita income. As for the objectives of establishing regional government business entities, in this case business entities in the form of banks, they are to provide the benefits to the local economy, the supply of goods/services and the livelihood fulfillment of the community and to gain profits and/or benefits.

V. Conclusion

The implementation of the provincial equity participation negatively affects per capita income, local income's realization, budget financing surplus, as well as provincial capital expenditures. Conversely, it increases BPDs' profits, dividends and local revenues. The equity participation of the provincial governments in the study period has only benefitted the local revenues and BPDs' profits; it has not had any significant impact on the benefit of the local economy in order to increase community welfare or per capita income, and even decreasing when a policy is established for the interest of banking.

It is recommended that in the equity participation of the provincial governments in the regional development banks in order to improve community welfare the Governors along with the district/city governments should focus in allocating the budgets on indicators that can ensure community welfare. These indicators include increasing the role of human resources, improving income or community occupations, reducing social inequalities, balancing the number of workers with employment, increasing people's purchasing power by encouraging new businesses and controlling inflation. BPDs have to change their business orientation, which has been focusing on consumer credit distribution so far, into productive credit distribution. This is in line with the objectives of establishing local enterprises, which are for the benefits of the local economy, the supply of goods/services to the community and to get profits. In addition, the efficiency of the management of bank's BOPO needs to be revisited as a result of advances in science and technology, the determination of interest rates should be competitive with other commercial banks in general, the business risks are under control at reasonable limits, and the possibility of becoming a public company in order to increase the community's opportunity to add shares is open within tolerable limits.

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