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## CAPITAL STRATEGY ARCHITECTURE TO OPTIMIZE RDB'S ROLE: CASE STUDY OF BANK SUMSEL BABEL

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**ABSTRACT:** *The Adequate capital capacity of Regional Development Bank (RDB) is needed in achieving the foresight vision of banking industry. RDB is expected to become a leader in its region -the largest, best, and strongest bank group- especially in the national banking industry. This study aimed to identify the financial performance of Bank Sumsel Babel (BSB) as one of RDB in Indonesia in optimizing its capital using descriptive analysis, to analyze factors affecting capital adequacy of BSB used environmental scanning and to formulate BSB capital strategies used foresight analysis that is designed on BSB's capital architecture strategy in optimizing its role as agent of regional development. As the result, there were six main strategies namely strengthening the organization, getting additional share deposits from local government, generating higher revenues, increasing the third party funds (TPF), issuing subordinate obligation, and selling the share to the public (Initial Public Offering).*

**KEYWORDS:** architecture strategy, BSB, capital, foresight industry, RDB's role

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### INTRODUCTION

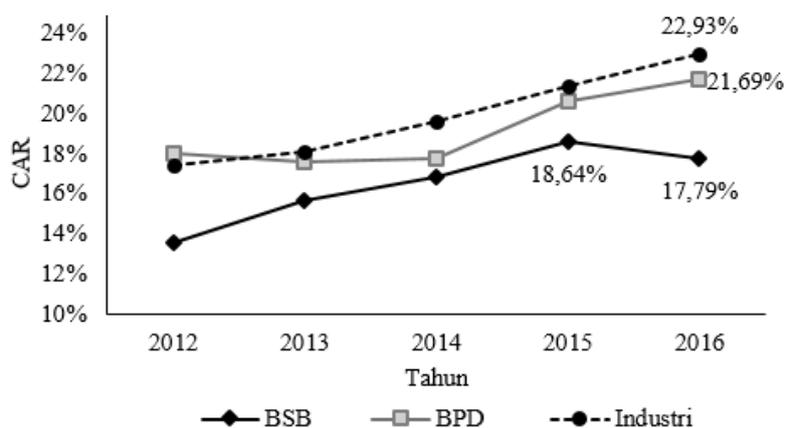
National banking has a very important role in facilitating the economic growth of a country because of its function as an intermediary institution (Buchory, 2014). The intermediary function of the Regional Development Bank (RDB) is still not running optimally although it tends to increase (Endri, 2009). RDB assets and credit share are just 8% of the total national banking industry (OJK, 2016b). RDB currently faces three fundamental problems in carrying out its core tasks as a regional development agency including (1) low contribution to the local economy, (2) inadequate governance, human resources, management and infrastructure and (3) low power competitiveness (OJK, 2015). One of the factors contributing to the low contribution of RDB to the regional economy is reflected in the relatively small composition of productive credits is the lack of capital. Ichsan et al. (2014) concludes the limitations of non-regional government capital, low brand image, and the focus of lending in the non-productive consumer sector can reduce the role and function of RDB and on the other side also can be a potential loss for RDB in the future due to the financing of the productive sector and the real sector can be taken over by others.

Therefore, one focus of OJK's attention is the strengthening of the role of RDB in supporting the regional economy through increasing the capital of RDB and the share of productive credit in cooperation with the Association of Regional Development Banks (Asbanda) and the Ministry of Home Affairs. In 2010 Asbanda has launched the RDB Regional Champion program which has the vision to transform RDB across Indonesia into a leading bank in its respective region through the enrichment of competitive products and services with professionally managed networks to foster regional economic growth. In 2015, the RDB Transformation Program was launched as a follow-up to RDB Regional Champion program to

fix the structural weakness and strengthen the organizational foundation to grow and compete so that it will play a role in the regional economy. The RDB Transformation Program has a vision of becoming a highly competitive and strong regional bank and contributing significantly to the growth and equitable distribution of sustainable regional economies. In the foresight industry, RDB is expected to become a leader in the region and as the largest, best, and strongest bank group in the national banking industry (OJK, 2016a).

RDB Sumsel Babel (BSB) as one of 27 RDBs in Indonesia whose main operational area is in South Sumatera Province and Bangka Belitung Islands is expected to contribute significantly to economic growth in the region as both provinces have the potential to become industrial development areas, especially agriculture and mining based industry. This is supported by the presence of several big companies such as PTPN VII, PTP Mitra Ogan, PT Sampoerna Agro, PT Tanjung Enim Lestari (TEL), PT PP London Sumatera, PT Sriwijaya Palm Oil, PT Interbis Sejahtera Food Industry, PT Indofood Sukses Makmur, PT Pusri, PT Semen Baturaja, PT Pertamina, PT Bumi Permai Lestari, PT Timah and many other companies. In addition, the development of various supporting infrastructure which is the driving wheel of economic growth and regional development has also started.

The fulfillment of adequate capital requirement becomes a challenge for BSB in order to achieve the vision of transformation. The regulator requires the bank to manage its capital where the capital adequacy of the bank is measured from the Capital Adequacy Ratio (CAR) of the bank with a minimum requirement of 8% in accordance with Banking International Settlement (BIS) regulation. Loan to Deposit Ratio (LDR) of South Sumatera Province and Bangka Belitung Islands reaches 165.38% and 93.03% (BPS, 2016) whereas according to LDR maximum of 92% (BI, 2016). In 2016, LDR BSB amounted to 88.92% (BSB, 2016) while the market share of TPF and credit is still relatively low, 17% and the remaining 15% is controlled by other banks. This condition shows that BSB needs additional capital other than TPF considering the still big chance BSB to do a business expansion.



source: IBS Report and Annual Report BSB 2016

**Figure 1. Comparison BSB's CAR and banking industry**

Business expansion requires strong capital, otherwise, BSB may lose its expansion opportunities due to the contradiction of banking regulations and may even be exposed to various risks because business expansion can affect the adequacy of bank capital. In figure 1

the ability of BSB to meet its capital adequacy in 2016 is quite high at 17.79%, but the value is lower than the capital adequacy in 2015, 18.64% (BSB, 2016). BSB CAR value in the last five years is always below the average of BPD's CAR in Indonesia and even the national banking industry. The problem of capital lacking faced by BPD becomes the main problem of market expansion (Darwanto, 2012).

Previous research on the adequacy of bank capital was done by Martynova (2015) who saw its impact on economic growth where high capital adequacy requirement of the bank can reduce credit supply so that will slow economic growth. Other studies conducted by Varroto (2011) and, Moussa (2015) saw the relationship between capital and risk and performance of banks were having sufficient capital can improve financial stability, absorb risk and improve performance. Research on the factors affecting the capital adequacy of banks such as TPF, total assets, cost efficiency (OER), profitability (ROA), ROE, LDR, asset quality (NPL) had been done by Al-Tamimi and Obeidat (2013) and Mandiefe (2016).

The explanation above shows that the adequacy of BSB's capital is quite good right now. But, BSB needs additional capital in order to achieve the capital requirement and keep the CAR value in accordance with bank capital requirement. BSB must formulate the appropriate capital strategy to meet the needs of bank capital by considering the condition of factors that influence it in the future to achieve that transformation vision. Yuneline and Anggono (2012), and Setiawan (2017) reviewed the financial strategy of BPD Jabar Banten (BJB) in fulfilling their capital requirement as National Bank by evaluating BJB internal capability through its current performance. Thus, the following research questions are 1) how BSB financial performance condition in strengthening its capital, (2) what factors affect the capital adequacy of BSB, and (3) how BSB capital formulation strategy in optimizing his role as an agent of regional development.

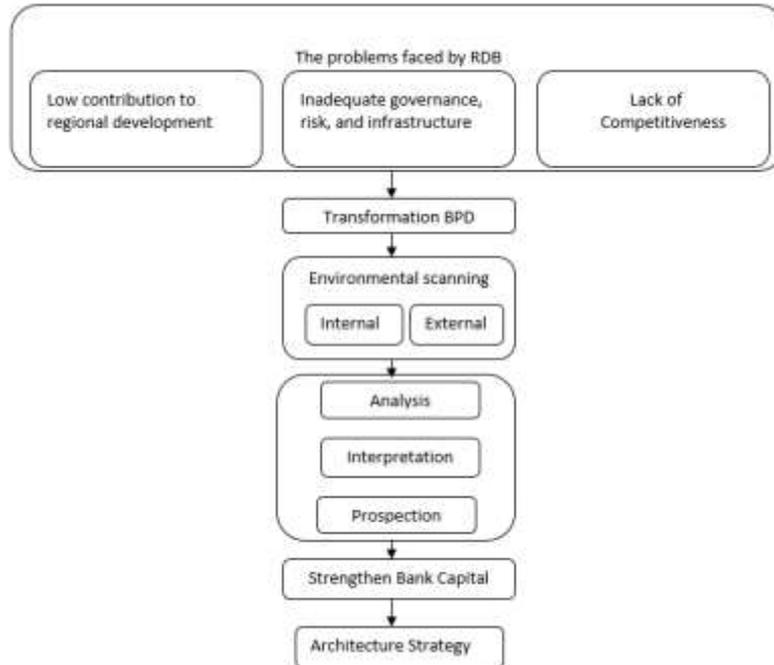
This study aims to 1) identify the financial performance of BSB in strengthening its capital, 2) to analyze factors affecting the capital adequacy of BSB, and 3) to formulate BSB capital strategy in optimizing its role as an agent of regional development. The scope of this research is limited to BSB's capital strategy architecture in enhancing its role as an agent of regional development. This study does not discuss the implementation and evaluation of the strategies.

## **METHODOLOGY**

This research was conducted at PT Bank Pembangunan Daerah Sumatera Selatan and Bangka Belitung better known as Bank Sumsel Babel (BSB). The research method using descriptive analysis with a case study approach. Data and information were collected through documentation, questionnaires, and interviews. Respondents in this study were not only from internal BSB but also external parties were considered in optimizing the role of BSB.

The research consisted of five stages: 1) input stage to collect various internal and external information of BSB as information base to formulate strategy; 2) strategic foresight stage consisting of analysis, interpretation and prospecting phase; 3) designing BSB capital strategy architecture based on the output of strategic foresight, 4) gap analysis phase, which aims to analyze gaps between what is needed and what BSB has to support the implementation of the strategy, and 5) the stage of preparing an action plan based on the strategy architecture that has been developed.

Based on the description of the research background and the method of analysis, the framework in this study can be seen in Figure 2.



**Figure 2. Conceptual framework**

## RESULTS AND DISCUSSION

### **BSB Financial Performance in Strengthening its Capital**

BSB managed to record the maximum achievement of operational performance and financial performance when the world and national economic conditions were in the recovery phase. The financial performance of BSB seen in the analysis of financial position in 2016 has increased compared to 2015. Total assets of BSB in 2016 reached Rp18,911 trillion, increased 14.51% compared to 2015, Rp16,515 trillion. The total loan portfolio also increased to Rp12,645 trillion, increase about 15.06% compared to the year of 2015 of 10,990 trillion, driven by an increase in loans disbursed to third parties. The accumulation of third-party funds reached Rp.14,221 trillion in 2016, increase about 17.44% from Rp.12.110 trillion. Net profit also increased 214.91% to Rp883 billion compared to Rp280 billion in 2015 due to the revaluation of fixed assets. Total equity in 2016 amounting to Rp2,829 trillion increased by 36.41% compared to Rp2,074 trillion in 2015, driven by additional share deposits from several shareholders.

**Table 1. BSB's financial ratio 2012-2016**

Ratio	Year				
	2012	2013	2014	2015	2016
CAR	13.55	15.67	16.82	18.64	17.79
NPL	4.75	2.92	2.45	2.01	3.46
LDR	75.98	94.00	85.97	95.43	88.92
ROA	1.90	1.76	2.13	2.18	2.23
ROE	16.71	11.74	15.63	18.07	19.32
NIM	6.50	7.97	7.91	7.67	11.82
OER	82.28	86.23	81.54	81.44	80.17

source: Annual Report BSB 2016

Most of BSB's financial ratios that illustrated in Table 1 has fluctuated. In 2016 BSB can improve its performance and efficiency, but the Capital Adequacy Ratio (CAR), Loan to Deposit Ratio (LDR) and Non-Performing Loan (NPL) performance were decreasing. However, when compared the average performance of BSB to the banking industry and the average performance of RDB in Indonesia, in general, the performance of BSB is still below the industry average. BSB NPL rose from 2.01% to 3.46% causing its capital ratio (CAR) to decline from 18.64 to 17.79%. Moussa (2015) states that there is a negative relationship between capital and bank risk because capital has an important role as a risk absorber to accommodate the increase of unexpected losses, especially from credit risk. The growth of deposits of BSB is higher than the credit growth causing the LDR to decrease. Rivai et al. (2013) argue that the LDR is one of the credit policies indicators to know the ratio of loans provided with third-party funds plus own capital. The LDR of BSB 2016 is 88.92% lower than 2015, 95.43% while the LDR of South Sumatra and Bangka Belitung Islands reaches 165.38% and 93.03% in 2016. This indicates the weak role of BSB in the regional economy. BSB must expand its business through credit channeling, especially the increase of productive credit portion. BSB must prepare adequate capital capacity to support business expansion plan in optimizing its role.

### **Factors Affecting Capital Adequacy BSB**

Bank capital is not only an important source to meet the bank's funding needs, but it also affects management decisions in terms of achieving profit levels and the possibility of risks on the other. Based on the results of the trend analysis on the factors that affect the adequacy of capital BSB showed a fluctuating trend and the interrelationship between factors. Several studies analyzing the interrelationship between factors affecting the adequacy of bank capital include research conducted by Al-Tamimi and Obeidat (2013) to identify important factors that determine the adequacy of bank capital where there is a positive relationship between the level of capital adequacy (CAR) with liquidity risk and ROA and a reciprocal relationship between CAR and ROE, interest rate risk, capital risk, and credit risk.

Environmental scanning is conducted with the aim to find out what important issues affect the adequacy of the capital capacity of BSB both from the internal environment and external environment. Inayatullah (2008) categorizes environmental scanning in the past, present and the future mapping method. The result of trend analysis conducted on internal factors such as the quality of management represented by ROE (Return on Equity) shows that the ability of

BSB in generating net profit is increasing from year to year. This shows the better the management of BSB in managing equity. BSB LDR is quite high but still in accordance with applicable regulations. The high value of LDR BSB can inhibit BSB in doing the business expansion in the future while to grow and develop sustainably BSB must continuously expand business through credit channeling. BSB NPL as an indicator of asset quality (credit) experienced a very fluctuating where in 2016 there was an increase which means the decrease of asset quality, especially credit disbursed. This, of course, affects the amount of credit that can be channeled back to the community due to increased reserve losses. It also affects the ability of productive assets to increase profits and ultimately lead to the decline in retained earnings that also affect the growth of BSB capital sourced from own funds. A low credit risk indicates a good quality of bank management that is more trustworthy to investors (Mas'ud et al., 2013).

BSB's Return on Assets (ROA) performance in the last five years is getting better but still below the minimum requirement of 2.5%. Mandiefe (2016) examines the impact of capital management on profitability where capital management positively affects third-party funds (TPF), bank size (asset growth), bank expenditure (OER) and bank profitability (ROA). Improving the effectiveness of the management in managing its assets will increase the bank's capital by increasing the number of retained earnings. In 2016, BSB's NIM is very high indicating interest income on productive assets is increasing. However, this will hamper credit expansion where the high NIM also shows the high difference between the interest rate of saving and loan interest. In terms of cost imposition (OER), BSB shows a good performance in which BSB is able to increase the effectiveness of its operational activities seen from the OER ratio is decreasing.

The accumulation of Third Party Funds (TPF) of BSB in supporting the fulfillment of capital capacity is quite fluctuating but BSB is able to increase the TPF significantly in 2016. The view of the structure of the third party fund, the largest increase is obtained from deposits, while savings and demand deposits tend to decrease. In the long term, this could threaten BSB's operations due to the high cost of funds. The quality of operating procedures can be seen in the growth and composition of the assets of BSB, which are mostly allocated to credit disbursements. Judging from the composition, the credit distribution of BSB is dominated by consumer credit. The low level of productive credit composition causes BSB's role in increasing economic growth and driving regional development is not optimal. To increase the portion of the productive credit, additional capital is required because credit expansion without additional capital can cause the decrease of CAR value as an indicator of capital adequacy owned by banks to support risk-bearing assets. Varroto (2011) concluded that the minimum capital requirement of banks may prevent banks from losses.

External environment analysis is done using PESTEL analysis (politic, economy, social, technology, environment, and law). The results of external factor identification indicate a very high chance to expand business in optimizing its role, especially from economic factors where economic growth is getting better.

### **BSB Capital Strategy in Optimizing its Role**

The foresight analysis involves three stages: (1) the analytical stage to see what seems to be happening, or (2) the stage of interpretation to see what's really happening or what is actually happening and (3) prospecting to estimate "what might happen?" or what might happen in the future. Foresight and strategic thinking then relate to the question "what might we need to do?"

Or what we need to do, then do strategic development that question "what will we do?" Or what we will do and strategic planning about "how will we do it? "or how we will do it (Voros, 2003). Thus, before strategic decisions are taken it is necessary to consider what might happen or what might happen, in order for the organization to be better prepared to deal with the inevitable impact of changes in its operational environment.

To see what appears to be happening in the analysis phase, the futures method is obtained that improved economic growth will impact future aspects of increased public income, increased spending, raising public funds, increasing credit demand, increasing credit distribution and banks faced with the challenge of meeting the needs of capital with the consequences of seeking additional capital alternatives, violation of minimum capital requirements or loss of expansion opportunities. In the interpretation stage that is seeing what actually happens is done by the four quadrant analysis method that analyzes BSB as individual and as collective seen from inside (interior) and from outside (exterior). BSB has a relatively low market share so that its role as agent of regional development is not optimal yet, BSB has a good contribution as one of Regional Owned Enterprises but its role is not optimal yet, BSB has a good performance compared to other RDB but still below average RDB, and BSB Performance is below the average RDB in Indonesia and the banking industry as a whole.

At the interpretation stage to estimate what might happen in the future, strategic thinking is used to develop future-oriented vision and strategy. BSB is expected to become a strong and highly competitive market leader and contribute significantly to regional economic growth and equity.

### **BSB Capital Strategy Architecture**

Based on the result of internal and external environment analysis, RDB foresight industry and gap analysis, BSB capital strategy architecture in the form of strategy map created to face the challenge of fulfilling the capital requirement in optimizing its role as an agent of regional development. In the foresight industry, BSB is expected to be a leader in the region as a highly competitive and strong regional bank, and contribute significantly to the growth and equitable distribution of sustainable regional economies. Strategic architecture does not question the achievement of maximum profits but rather identifies what must be done now to capture future business opportunities (Hamel and Prahalad 1994).

In this research, six BSB capital strategies are defined as institutional strengthening, an increase of share deposit from local government, profit increase, an increase of Third Party Fund (TPF), issuance of subordinated bond and selling shares to the public. Yuneline and Anggono (2012) and Setiawan (2017) stated that each bank capital strategy has advantages and disadvantages as measured by performance achievement. Cohen & Scatigna (2014) analyzed the bank's strategy to increase the capital ratio by continuing to expand credit, lower dividend payout ratio, increase interest spreads, thus contributing to the bank's ability to use retained earnings to strengthen capital. The strategy is spelled out into several action plans that are expanded into five time periods by considering the current internal and external conditions of BSB. The action plan can be seen in Table 2.

**Table 2. Action plan of the capital strategy of BSB**

No	Action Plan	1	2	3	4	5
1.	<b>Institutional strengthening</b>					
	a. The development of human resource capacity	√				
	b. Strengthening of Good Corporate Governance (GCG), risk management and obedience	√				
	c. Optimizing the application of organizational culture (corporate culture)	√				
	d. Development and standardization of Standard Operation Procedure (SOP) and improvement of operational quality	√				
	e. Optimal use of information technology	√				
2.	<b>Increase share deposits from local government</b>					
	a. Periodic socialization of bank business plans to local government	√	√	√	√	√
	b. Forming partnership with other Regional Owned Enterprises		√			
3.	<b>Increase revenue</b>					
	a. An increase in market share through credit on an on-going basis	√	√	√	√	√
	b. Create a new source of fee-based income through product/service innovation	√	√	√	√	√
	c. Asset revaluation		√			
	d. An increase of business scale through the creation of new markets and acquisitions				√	
4.	<b>Increase Third Party Funds</b>					
	a. Quality improvement of customer service oriented	√	√	√	√	√
	b. Development of product and services marketing system	√	√	√	√	√
	c. Expansion of cooperation with various agencies in terms of fund management				√	
	d. Establishing alliances with other parties such as rural banks, multi finance, developer				√	
5.	<b>Subordinated bond issuance</b>			√		
6.	<b>Sale of shares to the public</b>					
	a. Socializing to the public about Initial Public Offering (IPO) plan				√	
	b. Conduct the Initial Public Offering (IPO)					√

### MANAGERIAL IMPLICATIONS

1. Strategy implementation is carried out with the stages in the strategic architecture due to the interrelationship between each strategy.
2. Implementation of the strategy should be comprehensive, balanced and integrated covering aspects of the institutional and business aspects.
3. Implementation of strategy requires the support of Asbanda and stakeholders of RDB, especially local government, Ministry of Home Affairs, and Regional House of Representative.
4. Capital strategic architecture design is not standard and required some adjustments to the capacity and condition of the internal and external environment of each RDB.

### CONCLUSION

Based on the results of analysis and discussion, the following conclusions are obtained:

1. The current financial condition of BSB in strengthening its capital adequately is fair, but need to prepare adequate capital capacity to support business expansion plan in optimizing its role as an agent of regional development.
2. Identification of internal factors that affect the capital adequacy of BSB showed a fluctuating trend and the interrelationship between factors. The internal factor which influential to capital adequacy was Non-Performing Loan (NPL). The results of external factor identification

indicated a very high opportunity to expand business in optimizing its role, especially from economic factors.

3. The results of foresight analysis indicate that BSB needs to formulate a capital strategy in optimizing its role, consisting of six main strategies: institutional strengthening, increased share payments from the local government, increasing revenues, increasing Third Party Funds (TPF), subordinated bond issuance and sale of shares to the public. The strategy is elaborated through programs mapped to BSB's capital structure architecture design divided into five periods.

## RECOMMENDATION

Recommendations that can be given in this research are as follows:

1. Further research should be conducted on RDB in Indonesia which has been grouped based on the core capital owned due to the linkage of strategy design with the bank capacity.
2. Further research can discuss other aspects of optimizing the role of RDB, not only limited to the capital aspect, considering the interrelationship between some banking aspects.

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