The Impact of Diversification to Risk and Return of a Finance Company

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Abstract: As the economy began to recover, some believed that only financing companies who focused in consumer financing have a better opportunity to generate profit compared to those who diversify their product on leasing. Thus, the objectives of this research were to identify the following: did risk variables have an impact to return? And did product diversification have any impact to the risk and return of financing companies. A non proportional stratified random sampling was used to get samples from the total population listed in APPI (Indonesian Financing Company Association). Multiple regression analysis was adopted and disclosed that only Inefficiency risk variable impacts to Profit Margin on Sales ratio, while the Inliquidity risk impact to both ROA and ROE. All risk variables will simultaneously impact to ROA and ROE significantly, while product diversification is proven not having any influences to the relation of risk and return of a financing company. The result also concluded that consumer financing was enjoying rapid growth compared to leasing, and managed to recover faster from economic crisis due to aggressive support of automotive industry and because of the traumatic experience of some financing companies in dealing with leasing business, finally ended in debt restructuring program under IBRA's observation.

Keywords: Leasing, factoring, equity to asset ratio, capital inadequacy risk, inefficiency risk, IBRA

INTRODUCTION

Multi Finance Company is a Non-Banking Financial Institution which specially established to conduct activities in financing sector. Finance companies begin their operations in Indonesia since 1974 based on Minister of Finance Decree No.125/1998. Type of business activities of a Finance company as arranged by Regulation Minister of Finance No. 448/KMK.017/2000 covered leasing, factoring, credit card and customer financing.

The existence of a finance company, as a part of financial system in modern economy to serve the needs of financial services by community, become more important in efforts to support national economics, especially in automotive industry. During the last four years, sales of vehicles such as car and motorbike incisively increase. In 1999 car sales only around 94.000 unit, but incisively increase up to 354.000 unit in 2003. Motorbike sales increase 5 times from 1998 up to 2003 with 2.3 million unit. Further, the Association of Indonesian Motorbike Industry (ISMI) has optimism that motorbike sales will reach 4 million units in this year (Tabel 1).

The biggest asset of a finance company is in loan to private sector and individual, that is 95% of total asset. The remaining 5% is in the form of reserve, foreign assets etc. This indicates that finance company business priority is giving loan. On the other hand, banking sector only own 40% from total asset in giving loan. This condition occurred because finance company has more simple business activities than a bank. Besides they have to be more aggressive in extending their business by directly deal with consumer, such as automotive dealer.

The Development of Financing Activities.
Up to 2000, the main activities of Finance company is leasing, but its condition experiencing of degradation up to 2003, before it went up at first quarter of 2004.

Consumer financing having an increase up to become Rp. 26,2 trillion in first quarter of 2004, or growth more than 5 times since 1999 (Rp. 4,3 trillion). While factoring in 2001 was 50% decreased to be Rp. 3,3 trillion compared to condition in the 2000 (Rp. 6,6 trillion) and the trend still take place until reach Rp. 3 trillion in first quarter of 2004.

Credit card business increased from 2001 to 2002, but then decreased since 2003. The portion of credit card business activities to entire finance company
portfolio is consequently decreasing from 3.4% in 2002 to only 1.9% in first quarter of 2004 (Table 2).

From 4 (four) type of business activities of Finance company, only 2 (two) type are the uppermost that is consumer finance equal to 61% and leasing 29% from total finance company portfolio at first quarter of year 2004 (1Q04). The remaining is combination of factoring and credit card.

**The Performance of Finance Companies.**

During monetary crisis in year 1998 where economics condition of Indonesia was falling down up to -13 percent, there were 114 finance companies under BPPN (National Banking Recovery Body) observation with total value of bad debt equal to Rp. 8.6 trillion, and 48 among them participated in restructuring and capital recapitulation program. Total loss of finance companies at that moment was booked up to Rp. 4,661 trillion.

Another 38 finance companies reported suffered from loss in year 2000, due to difficulties to access banking capital because of restructuring credit process of finance companies still under BPPN. As consequences, expansion opportunity of financial services having a resistance. But in the last three years, the performance of finance company in Indonesia tends to recover. In 2002 accumulative profit generated by finance companies reach Rp. 1,837 trillion, and in 2003 increased to Rp. 2,987 trillion. From 116 financial statements of success companies gathered in 2003, the recovery condition of this finance companies industry came from 96 companies that able to reach profit. This condition was better compared to year 2002 which only 84 companies as profit gainers from 112 financial statements collected.

Pursuant to result previous research by Info Bank, finance company that having credit portfolio in consumer financing sector, especially automotive, will be able to perform better. This supported by leaping of sales in automotive products. While company that finance heavy equipments (leasing) will not able to survive. Further, level of efficiency on operational cost played significant role to company ability in recovering its performance.

Based on this background we will analyze in more detail “The Influence of Business Activity Diversification to the relation between Level of Risk and Return of Finance Company”.

Levels of risk as subject in this research are Capital Inadequacy Risk (comparison of debt to equity and equity to assets), Inliquidity Risk (comparison of current assets and current liabilities), and Inefficiency Risk (comparison of total non interest cost divided with total income). While rate of return as subject was measured from Profit Margin on Sales Ratio, Return On Asset ratio (ROA) and Return On Equity ratio (ROE).

### Table 1. Asset of Multi Finance Company, its Amount and Growth

| Assets                        | 2000  | 2001  | 2002  | 2003  | 1Q04 | Change (IDR tn) 2000-1Q04 | CAGR (%) |
|-------------------------------|-------|-------|-------|-------|------|--------------------------|--------|
| Reserves                      | 1.2   | 1.2   | 1.5   | 1.3   | 1.5  | 0.3                      | 8.1    |
| Foreign assets                | 1.2   | 1.1   | 1.1   | 0.2   | 1.0  | -0.2                     | -6.8   |
| Claims on Central Gov.        | 0.1   | 0.1   | 0.1   | 0.1   | 0.1  | 0.0                      | -1.6   |
| Claims on Private Ent.        | 35.1  | 35.5  | 37.7  | 46.8  | 54.3 | 19.2                     | 14.4   |
| Other Assets                  | -1.8  | -0.5  | -0.4  | -1.1  | -0.3 | 1.5                      | -44.1  |
| Total Assets                  | 35.8  | 37.3  | 39.9  | 47.2  | 56.6 | 20.8                     | 15.2   |

### Table 2. Development of Business Activities of Finance companies, 2000-1Q04

| Financing Assets | 2000  | 2001  | 2002  | 2003  | 1Q04 | Change (Trillion Rp) |
|------------------|-------|-------|-------|-------|------|---------------------|
| Leasing          | 13.7  | 14.1  | 12.6  | 13.3  | 1.3  | -1.4                |
| Factoring        | 6.6   | 3.3   | 3.2   | 0.2   | 1.0  | -3.5                |
| Credit Card      | 0.4   | 0.8   | 1.1   | 0.8   | 0.8  | 0.4                 |
| Consumer Finance | 8.5   | 13.4  | 16.6  | 22.7  | 26.2 | 17.7                |
| Others           | 0.2   | 0.3   | 0.4   | 0.1   | 0.5  | 0.3                 |
| Total            | 29.4  | 31.8  | 33.9  | 38.3  | 42.9 | 13.5                |

Source: Indonesia Update, published by Bank Mandiri in November 2004
METHODS

Characteristic of Finance company. Finance company in principle represent a business entity that conduct financing activities in term of providing capital or capital goods without draw direct capital from business society or also known as non-depository financial institutions. From such definition, finance company having business characteristic as follows: (1) Not allowed to draw direct fund from business society in term of: giro account, deposit, saving and issuing promissory note (2) Issuing promissory note only allowed as a guarantee of bank loan (3) giving financing either for working capital or investment needs (4) Not allowed to give direct loan.

Based on business characteristic mentioned above, a finance company is Financial Institution that not allowed to conduct capital gathering activities and to give direct loan. This is the factor that made it is difference with bank. But with the existence of finance company, hence alternative in financing sources mobilization will be more vary and more wide to fulfill the financing needs of business world, which getting bigger amount in accordance with economic growth.

In accordance with above characteristic of finance company, hence the objective of finance company development among others: (1) To increase the activities of financing development sources mobilization, both domestic and foreign. It is possible due to investment in finance company is potential enough for investors or parties with financial surplus, (2). To be able using financing sources productively and efficient. It is only happened when finance company activities conducted in professional way (3). To increase the activities of finance sector more efficient so will be able to increase the investment activities in business through cooperation patent between finance sectors based on clear task/activities distribution among Financial Institution, (4). To increase independency of each finance sector based on modern and professional management system. In this case, a natural selection process will play important role and became a key success factor of related finance sector.

Business Activities of Finance company. Regulations concerning Finance company arranged in Presidential decree No. 61 year 1998 and Decree of Ministry of Finance Republic of Indonesia No. 448/KMK.017/2000 and its amendments arranged in Decree of Ministry of Finance No. 172/KMK.06/2002. In Decree of Ministry of Finance arranged many kind of regulations concerning Finance company business activities, which covered: (1) Leasing, (2) Factoring, (3) Credit Card, (4) Consumer financing.

Leasing. Decree of Ministry of Finance No.1169/ KMK.01/1991 dated 27 November 1991 regarding Leasing activities: Leasing is a financing activity in term of providing capital goods, either with finance lease (with option) or operating lease (without option) to be used by Lessee during a certain period of time based on installment. Providing capital goods could be conducted by purchasing the goods then leased it back. Finance lease is leasing activity where lessee at the end of contract has an option to buy the leasing object leasing based on agreed residual value, while Operating lease has no option to buy the leasing object.

From above mentioned definition, in every leasing transaction there will always involve 3 main parties, which are: Lessor is the leasing company or in this case representing owner which has property rights of the goods, Lessee is company or user of the goods with option at the end of contract and Supplier is seller of the leased goods.

Factoring. Definition of factoring company or according to Decree of Ministry of Finance No. 1251/KMK.013/1988 dated 20 December 1988 is a business entity that conducting financing activities in term of buying and/or transfer and taking care of receivables or short term claim of a Company from domestic or foreign trading transaction.

From above definition it could be concluded that factoring activities covered among others: (1) Buying and/or transferring short-time receivables from business transaction (2) To manage credit sales (3) Collecting receivables of client’s company.

Other definition of factoring is a business conducted by company, either in term of receivables or promissory note based on discount from client with or without recourse conditions, so the collection rights changed to the factoring company.

Recourse (with recourse). Factoring mechanism with recourse related to risk that a customer or client cannot afford to pay or fulfill his obligations. This is a credit risk. In recourse or with recourse contract, a client will bear the credit risk of receivables that he transfers to factoring company. Hence the factoring company will return the responsibility of receivables collection to its client or supplier when a client, with any reason, cannot pay including financial disability to pay his debt.

Non recourse (without recourse). In non-recourse or without recourse contract, factoring company minimize the risk of uncollectible receivables in agreeable amount, just because of financial disability.
of related clients. In this case, the credit risk will be bear by factoring company.

**Credit Card.** Credit card is a card that could be used as payment tools in trading transaction of goods or services, where the settlement or payment back could be done by installment with a minimum amount. The amount of installment counted from debt balance added by monthly interest. Last month bills including retail interest will become next month principal.

Credit card also can be used for direct cash withdrawal or via teller office bank or through ATM (automated teller machine) where ever there is a stamp logo of card owned, either domestic or abroad. Credit card generally used in the transaction is Visa and Master Card.

**Consumer Financing.** Consumer financing is financing activities of goods procurement based on consumer needs with installment payment system or in periodic by consumer. Consumer product needs could be vehicles, electronic goods or household equipment, camera, furniture, computer, fitness equipment etc.

Consumers have not to pay cash on a product, because the payment can be installed in a certain period (during a few months) and added an interest cost per month. In this case finance company has a cooperation with certain dealers and/or merchants that will accept payment facility through installment. Consumer can take the product home from dealer or merchant without have to pay a cash price of the goods, after filling credit application form credit to Finance company and get approval on such application. Finance company will later pay the customer debt to the dealer or merchant, all in advance. Then every month consumer will pay installment on credit purchasing of the product to Finance company, plus interest.

**Source of Capital.** Source of capital of a finance company as arranged in Decree of Ministry of Finance No. 606/KMK.017/1995 dated 19 December 1995 regarding accepted loan regulations, Participation and Reports of Finance company. In such Decree of Ministry of Finance mentioned that Finance company can received loan either from domestic and abroad, with maximal amount 15 (fifteen) times of total net worth after equity participation deduction.

Equity net worth of Finance company consist of paid-in capital plus retain earnings, current profit, unused general reserve, agio of shares, and sub-ordinate loan counted based on latest month financial statement.

Sub-ordinate loan is an accepted Finance company loan with conditions: (1) minimum of 5 (five) years period (2) in case of liquidation occurred, collection rights will be the latest valid from all kind of loan (3) sub-ordinate loan that could be counted as equity components maximum 50% of paid-in capital.

**Factors that influencing Business Risk of Finance company.** Based on research conducted by Pefindo (a company that handle credit rating in Indonesia), there are few factors that influencing assessment of business risk in Finance companies:

**Market Position.** This assessment covered comprehensive analysis on competitive advantage of Company compared to other Companies in similar industry, measured from level of market share, brand image strength and kind of products owned. A few finance companies have a strong brand image because well supported by a distinguished financial institution or a well-known Group of Companies in automotive, while some others still count on their operational efficiency operational and ability to do a market penetration. Company capabilities in developing business at various areas, profits gained by the support of Mother Company or in position of market leader are also considered factors.

**Distribution Channel & Capability.** This assessment covered comprehensive analysis on network coverage of Companies (number of branch offices, sales points, payment flexibility spread out in few locations to cover wider consumer area), Company ability to maintain a good and long-term relationship with branch offices and dealers (because most of loan given by finance company are coming from dealer references), Company ability to conduct an integrated Information Telecommunication (IT) system and coordinating database collection from all branches, and company ability to accelerates loan approval process and fund disbursement.

**Diversification.** This is to assess the level of company advantages in business diversification, from all kind of consumer point of view, geographical area, and source of fund, loan portfolio, or financed product portfolio in order to guarantee income stability, profit, asset, quality and liquidity of the company.

**Quality of Business.** This assessment covered comprehensive analysis on operational efficiency and company ability to maintain its asset quality that in this particular case determined by Company management quality and implementation of strong and integrated internal control. Company operational efficiency was often measured by cost to income ratio. Besides operational efficiency, business quality of a company also defined by underwriting policy, process and procedure of loan disbursement, receivables collection management, marketing strategy,
surveyor quality in customer data verification and executor quality in collaterals repossesion.

**Risk and Return Factor of Finance company.**

Based on research conducted by Perindo (a company that handle credit rating in Indonesia), there are few assessments of financial risk factors of finance companies:

**Capital Sufficient / Capitalization:** This research covered analysis on total equity of a company and its composition (paid-in capital, retain earnings, current profit, un-used general reserve, agio of shares, and sub-ordinate loan). Company obligation to fulfill the regulation Ministry of Finance (maximal loan amount for every Finance company is 15 (fifteen) times of total net worth after equity participation deducted), equity growth rate, capability to get capital from internal / external sources, equity to asset ratio, management philosophy, and strategy to retain minimum level of equity that to enable maximizing the used of financial leverage. (Leverage is utilizing any capital sources (debt) to gain a return for Company owner).

**Asset Quality:** This assessment covered extensive analysis on receivables with problems, divided into categories (1-30 days, 31-60 days, etc), portfolio of loan products (leasing, consumer financing, etc), portfolio of financed products (car, motorbike, heavy equipment etc), concentration on credit risk (focus on particular company or individual), settlement on receivables with problem (claims overdue, write-off uncollectible receivables policy, and repossess of a guarantee goods policy), and reserve policy of uncollectible receivables write-off.

**Profitability:** This assessment covered Company ability analysis on level of return, based on net profit generated of total asset, total equity, and total income of Company.

**Asset Liability Management:** This assessment covered Company liquidity strategy on current liabilities composition on current assets of a financing company, profile of type of liabilities and financing (in rupiah or forex), and management philosophy in minimized financial risk.

**Strategy and Financial Policy:** This assessment covered Company strategy analysis and financial policy (direct or indirect, joint financing etc), expansion (type of products, brand, area etc), market penetration, and distribution network through branches and cooperation with dealer or merchant to increase Company performances.

**Financial Flexibility:** This assessment covered company ability in obtaining fund from various sources such as shareholders, business society or other sources to finance its business activities in ordinary condition or hard times, ability to obtain joint financing from banking sector, reviewed by strength of brand or support from company owner and capital owner. Past record on company in payback its debt/liabilities also include in this assessment.

**Efficiency.** Performance evaluation of efficiency was based on Company ability in gaining income, reviewed from total operational cost (non-interest) that paid by Company in efforts to get income.

**Capital / Fund Adequacy Ratios: Debt to Equity Ratio (DER) is used to measure the comparison between fund sources of debt and equity or net worth. Maximum loan amount for every Finance company is 15 (fifteen) times of total net worth after equity participation deducted in order to limitation finance company strategy to minimized the level of own equity in generating return for the company owner:**

\[
\text{DER} = \frac{\text{Total Debt}}{\text{Total Equity}}
\]

**Equity / Capital to Asset Ratio** is used to measure how much own equity become sources (of total resources) to fund the company activities. Closer to 1 (one) means more good/healthy the company is:

\[
\text{Capital to Asset Ratio} = \frac{\text{Total Capital}}{\text{Total Asset}}
\]

**Liquidity Ratio** is to measure Company ability in generating cash to fulfill its short-time obligation past due. Bigger the ratio, better the company finance condition is.

\[
\text{Liquidity Ratio} = \frac{\text{Current Asset}}{\text{Current Liabilities}}
\]

**Efficiency Ratio** is used to measure the efficiency level on operational cost (non interest) incurred in order to generate income / sales. Smaller the ratio means more efficient company activities.

\[
\text{Efficiency Ratio} = \frac{\text{Cost (Non Interest)}}{\text{Income}}
\]

**Profit Margin on Sales (PMS) Ratio** is used to know the amount of net profit compared to sales income generated. Bigger this ratio means better profitability of company.

\[
\text{Profit Margin on Sales (PMS) Ratio} = \frac{\text{Net Profit}}{\text{Sales}}
\]

**Return on Asset (ROA) Ratio** is used to measure Company affectivity in utilizing all resources in generating profit. Higher this means better level of company profitability.
Return on Equity (ROE) Ratio is used to measure level of return of investment from shareholders. Higher this ratio means better level of company profitability.

\[ \text{ROE} = \frac{\text{Net Profit}}{\text{Total Asset}} \]

All financial ratios used in this research followed up the research conducted by Pefindo (a company that handle credit rating in Indonesia), concerning some financial risk evaluation factors in Finance company, as mentioned before in Chapter II.5.

The impact of diversification in business activities leasing and consumer financing on relation between risk and return level of a finance company was taken from financial statements component of Finance Companies, then calculated by using financial ratios.

Level of risk measured by Capital Adequacy Ratio (DER and Equity to Asset Ratio), liquidity ratio and efficiency ratio will be tested on correlation coefficient with level of return that measured by Profit Margin on Sales (PMS) Ratio, ROA and ROE.

While differences between diversification activities of leasing and consumer financing and its impact on relation between risk and return level will be measured by t-test on coefficient regression. From difference test result, we could proved that business diversification will give lower risk and higher return level compared to finance company that only has 1 (one) kind of business activities.

HYPOTHESIS FORMULATION

In this research, we will test the following hypothesis:

- \( \text{H}_1: \) There is an impact of Debt to Equity Ratio on PMS Ratio.
- \( \text{H}_2: \) There is an impact of Equity to Asset Ratio on PMS Ratio.
- \( \text{H}_3: \) There is an impact of liquidity ratio on PMS Ratio.
- \( \text{H}_4: \) There is an impact of efficiency ratio on PMS Ratio.
- \( \text{H}_5: \) There is an impact of Debt to Equity Ratio on ROA.
- \( \text{H}_6: \) There is an impact of Equity to Asset Ratio on ROA.
- \( \text{H}_7: \) There is an impact of liquidity ratio on ROA.
- \( \text{H}_8: \) There is an impact of efficiency ratio on ROA.
- \( \text{H}_9: \) There is an impact of Debt to Equity Ratio on ROE.
- \( \text{H}_{10}: \) There is an impact of Equity to Asset Ratio on ROE.
- \( \text{H}_{11}: \) There is an impact of liquidity ratio on ROE.
- \( \text{H}_{12}: \) There is an impact of efficiency ratio on ROE.
- \( \text{H}_{13}: \) There is a simultaneously impact of Debt to Equity Ratio, Equity to Asset Ratio, liquidity ratio and efficiency on PMS Ratio.
- \( \text{H}_{14}: \) There is a simultaneously impact of Debt to Equity Ratio, Equity to Asset Ratio, liquidity ratio and efficiency on ROA.
- \( \text{H}_{15}: \) There is a simultaneously impact of Debt to Equity Ratio, Equity to Asset Ratio, liquidity ratio and efficiency on ROE.

In this research we tested the hypothesis of correlation and differences. It will be evaluate how strong the relation between business return of finance companies as dependent variable in one side with level of Capital Inadequacy Risk, liquidity and inefficiency as independent variables on the other side. In this research we used multiple regression statistic method.

Further we will evaluate the difference as impact of business diversification activities in leasing and consumer financing on relation between risk and return level. We herewith used bivariat analysis through inferential method, which is t-test on regression coefficient.

Sample withdrawing method used in this research is stratified random sampling, which in this case a simple random sub samples draws from each level that more or less similar in some characteristic. Type of samples level selected in this research is non proportional level samples, where selected sample is finance company that has a business diversification, leasing and consumer financing.

Total population of finance company listed in APPI (Indonesian Financing Company Association) year 2005 were 134 finance companies (N = 134). But due to the limitation of available data on total population of finance companies that have characteristic business activities as mentioned above, from 134 total of population it was planned to draw samples for each characteristic 5% of total population. Thus, 7 (seven) samples will be selected to represent a characteristic companies that active in consumer financing activities, and the next 7 (seven) samples for characteristic companies that still active in conducting both leasing and consumer financing activities.

Description of Research Object and Respondents Characteristic. First characteristic se-
lected from samples research are finance companies that active in consumer financing activities, and second selected characteristic are finance companies with business diversification activities in consumer financing and leasing. Data used is Financial Statement of year 2003 and 2004.

### Table 3. Characteristic Samples Finance company

| No | Samples                          | Total Asset (in Million Rupiah) |
|----|----------------------------------|---------------------------------|
|    |                                  | 2003                            | 2004                            |
| 1  | Swadharma Indotama Finance       | 794,861                         | 804,552                         |
| 2  | UFJ BRI Finance                 | 900,615                         | 662,610                         |
| 3  | Bussan Auto Finance             | 1,862,308                       | 1,202,779                       |
| 4  | BFI Finance Indonesia           | 1,068,273                       | 1,126,413                       |
| 5  | PT Bhakti Finance               | 236,920                         | 59,269                          |
| 6  | PT U Finance Indonesia          | 467,883                         | 348,999                         |
| 7  | PT Astra Sedaya Finance         | 5,736,136                       | 3,299,413                       |
| 8  | Artha Asia Finance              | 62,992                          | 45,330                          |
| 9  | PT ITC Adira Multi Finance      | 537,444                         | 322,853                         |
| 10 | PT Bina Multi Finance           | 78,753                          | 76,312                          |
| 11 | PT Armada Finance               | 391,014                         | 288,934                         |
| 12 | PT Indomobil Finance Indonesia  | 778,253                         | 342,291                         |
| 13 | PT Andalan Finance Indonesia    | 75,514                          | 30,646                          |
| 14 | PT Bringin Indotama Sejahtera Finance | 196,527 | 131,325 |

**Data Analysis Method.** Considering descriptive model established, the analysis technique being used is multiple regressions:

\[
Y_1 = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4
\]

\[
Y_2 = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4
\]

\[
Y_3 = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4
\]

where:

- \(Y_1\): Profit Margin on Sales (PMS) Ratio
- \(Y_2\): ROA
- \(Y_3\): ROE
- \(X_1\): Debt to Equity Ratio (DER)
- \(X_2\): Equity to Asset Ratio
- \(X_3\): Liquidity Ratio
- \(X_4\): Efficiency Ratio

Testing of hypothesis / t-test: to prove is there any relation between each independent variable, which is: Capital Inadequacy Risk, Inliquidity Risk and Inefficiency Risk on financial company level of Return, comprises of PMS Ratio, ROA and ROE. There are 5 (five) steps of hypothesis testing, that are: stating initial hypothesis (Ho) & hypothesis alternative (Ha), selecting level of significance, identifying statistic test, deciding a rule of decision making. Testing hypothesis / F-test: to prove is there any simultaneously impact of independent variables (Capital Inadequacy Risk, Inliquidity Risk and Inefficiency Risk) on dependent variables (PMS Ratio, ROA and ROE).

### RESULTS AND DISCUSSION

**Mean and Standard deviation on Level of Return and Risk.** From 14 Financial Statements samples of Finance Companies evaluated during year 2003 and 2004, a result of descriptive statistic was obtained as shown on table 4. Mean (average value) and standard deviation on 7 variables as follows (Table 4). Profit Margin on Sales Ratio \((Y_1)\) has average value equal to 0,1869018 with standard deviation equal to 0,13440712. This indicates that based on samples available, 18.6% from total sales will generate net profit for finance company. ROA \((Y_2)\) has average value equal to 0,0552424 with standard deviation equal to 0,0571412. This indicates that based on samples available, only 5.5% of all resources in finance companies succeeded to generate net profit. ROE \((Y_3)\) has average value equal to 0,19634 with standard deviation equal to 0,130921. This indicates that level
of return on investment by shareholders on such finance companies is 19.6%. Debt to Equity Ratio ($X_1$) has average value equal to 3.412287 with standard deviation equal to 2.018549. In other words, in conducting its activities those finance companies have a structure of debt to equity 3:1. Equity to Asset Ratio ($X_2$) has average value equal to 0.340722 with standard deviation equal to 0.2054524. This indicates further that equity only has 34% contribution from total source of fund to finance companies business activities, and the remaining was from debt. Liquidity Ratio ($X_3$) has average value equal to 0.167662 with standard deviation equal to 0.3071888. From 14 samples of finance companies with finance performance during 2 years, it showed that those Companies not have adequate level of liquidity to cover their current liabilities. Efficiency Ratio ($X_4$) has average value equal to 0.43996 with standard deviation equal to 0.1361236. It means that those finance companies have not sufficient efficiency level, because 44% of their income used for operational cost (non-interest).

### Table 4. Descriptive Statistics

| Variable                        | Mean    | Std. Deviation | N  |
|---------------------------------|---------|----------------|----|
| Profit margin on Sales (PMS) Ratio | 0.18600918 | 0.13440712    | 28 |
| ROA                             | 0.055242 | 0.0571412     | 28 |
| ROE                             | 0.19634  | 0.130921      | 28 |
| Debt to Equity Ratio            | 3.412287 | 2.018549      | 28 |
| Equity to Asset Ratio           | 0.340722 | 0.2054524     | 28 |
| Liquidity Ratio                 | 0.167662 | 0.3071888     | 28 |
| Efficiency Ratio                | 0.43996  | 0.1361236     | 28 |

### Hypothesis testing. Partial Test (T-test).

Partial or individual test (t-test) conducted to test the hypothesis $H_{a1}$ up to $H_{a12}$ as provided on table 5. Based on table 4 above, it is disclosed that: Variable Debt to Equity Ratio ($X_1$) has no impact on Profit Margin on Sales Ratio ($Y_1$) due to $p$-value higher than 0.05 (0.118 > 0.05) so $H_{o1}$ accepted. Variable Modal on Asset ($X_2$) has no impact on Profit Margin on Sales Ratio ($Y_1$) due to $p$-value higher than 0.05 (0.173 > 0.05) so $H_{o1}$ accepted. Variable Ratio Liquidity ($X_3$) has no impact on Profit Margin on Sales Ratio ($Y_1$) due to $p$-value higher than 0.05 (0.135 > 0.05) so $H_{o3}$ accepted. Variable Efficiency ($X_4$) has an impact on Profit Margin on Sales Ratio ($Y_1$) due to $p$-value lower than 0.05 (0.038 < 0.05) so $H_{o4}$ rejected. Variable Debt to Equity Ratio ($X_1$) has no impact on ROA ($Y_2$) due to $p$-value higher than 0.05 (0.548 > 0.05) so $H_{o1}$ accepted. Variable Modal on Asset ($X_2$) has no impact on ROA ($Y_2$) due to $p$-value higher than 0.05 (0.586 > 0.05) so $H_{o2}$ accepted. Variable Ratio Liquidity ($X_3$) has an impact on ROA ($Y_2$) due to $p$-value higher than 0.05 (0.092 > 0.05) so $H_{o3}$ accepted. Variable Efficiency ($X_4$) has no impact on ROA ($Y_2$) due to $p$-value higher than 0.05 (0.183 > 0.05) so $H_{o4}$ accepted. Variable Debt to Equity Ratio ($X_1$) has no impact on ROE ($Y_3$) due to $p$-value higher than 0.05 (0.736 > 0.05) so $H_{o1}$ accepted. Variable Modal on Asset ($X_2$) has no impact on ROE ($Y_3$) due to $p$-value higher than 0.05 (0.424 > 0.05) so $H_{o2}$ accepted. Variable Ratio Liquidity ($X_3$) has an impact on ROE ($Y_3$) due to $p$-value lower than 0.05 (0.034 < 0.05) so $H_{o3}$ rejected. Variable Efficiency ($X_4$) has no impact on ROE ($Y_3$) due to $p$-value higher than 0.05 (0.183 > 0.05) so $H_{o4}$ accepted.

### Table 5. Hypothesis testing $H_{a1} - H_{a12}$

| Variables             | $X_{1}$   | $X_{2}$   | $X_{3}$ | $X_{4}$ |
|-----------------------|-----------|-----------|---------|---------|
| Coefficient           | -0.049    | -0.408    | 0.160   | -0.510  |
| $p$-value             | 0.1       | 0.1       | 0.1     | 0.0     |
| Decree of             | 19        | 0         | $H_{o1}$ accepted | $H_{o4}$ rejected |
| $X_{1}$               | -0.548    | -0.586    | 0.000   | 0.092   |
| $p$-value             | $H_{o1}$ accepted | $H_{o2}$ accepted | $H_{o4}$ rejected | $H_{o4}$ accepted |
| Decree of             | 18        | 73        | 35      | 38      |
| $Y_{1}$               | 0.010     | -0.218    | 0.214   | -0.293  |
| $p$-value             | 0.736     | 0.424     | 0.034   | 0.183   |
| Decree of             | $H_{o1}$ accepted | $H_{o2}$ accepted | $H_{o4}$ rejected | $H_{o4}$ accepted |
Simultaneous test (F-test). F-test used to test that all independent variables simultaneously have a significant impact on dependent variables ($H_{13} - H_{12}$).

| Model | $F$ hitung | p-value | Decree of |
|-------|------------|---------|-----------|
| $Y_1$ | 2.049      | 0.121   | $H_{13}$ Accepted |
| $Y_2$ | 6.986      | 0.001   | $H_{14}$ Rejected |
| $Y_3$ | 2.938      | 0.042   | $H_{15}$ Rejected |

Source: Data processed by SPSS 11.0

From regression analysis with table Anova, found that:

- If tested simultaneously Debt to Equity Ratio ($X_1$), Equity to Asset Ratio ($X_2$), Liquidity Ratio ($X_3$) and Efficiency Ratio ($X_4$) has no impact on Profit Margin on Sales Ratio ($Y_1$) due to $F_{hitung}$ 2.049 with p-value equal to 0.121 > alpha 0.05, so $H_{13}$ accepted.

- If tested simultaneously Debt to Equity Ratio ($X_1$), Equity to Asset Ratio ($X_2$), Liquidity Ratio ($X_3$) and Efficiency Ratio ($X_4$) has an impact on ROA ($Y_2$) due to $F_{hitung}$ 6.986 with p-value equal to 0.001 < alpha 0.05, so $H_{14}$ rejected.

- If tested simultaneously Debt to Equity Ratio ($X_1$), Equity to Asset Ratio ($X_2$), Liquidity Ratio ($X_3$) and Efficiency Ratio ($X_4$) has an impact on ROE ($Y_3$) due to $F_{hitung}$ 2.938 with p-value equal to 0.042 < alpha 0.05, so $H_{15}$ rejected.

Table 7. Coefficient Determination (Model Fit test)

| Model | $R^2$ |
|-------|-------|
| $Y_1$ | 0.135 |
| $Y_2$ | 0.470 |
| $Y_3$ | 0.223 |

Source: Data processed by SPSS 11.0

From data processing result using multiple regression method it is disclosed that:

- All variables Debt to Equity Ratio ($X_1$), Equity to Asset Ratio ($X_2$), Liquidity Ratio ($X_3$) and Efficiency Ratio ($X_4$) could explain the variation from variable Profit margin on Sales Ratio ($Y_1$) equal to 13.5% which seen from coefficient determination with adjusted $R^2$ value of 0.135. While the remaining explained by other factors which not involve in the model.

- All variables Debt to Equity Ratio ($X_1$), Equity to Asset Ratio ($X_2$), Liquidity Ratio ($X_3$) and Efficiency Ratio ($X_4$) could explain the variation from variable ROA ($Y_2$) equal to 47% which seen from coefficient determination with adjusted $R^2$ value of 0.470. While the remaining explained by other factors which not involve in the model.

- All variables Debt to Equity Ratio ($X_1$), Equity to Asset Ratio ($X_2$), Liquidity Ratio ($X_3$) and Efficiency Ratio ($X_4$) could explain the variation from variable ROE ($Y_3$) equal to 22.3% which seen from coefficient determination with adjusted $R^2$ value of 0.223. While the remaining explained by other factors which not involve in the model.

CONCLUSION

Based on empirical data analysis and supported by statistical measurement after limitation of research problem, so the result of this research could be concluded as follows:

- Capital Inadequacy Risk measured by Debt to Equity Ratio and Equity to Asset Ratio, have no impact on Return level of Company which measured by Profit margin on Sales Ratio.
- Inliquidity Risk have no impact on Return level of Company which measured by Profit margin on Sales Ratio.
- Inefficiency Risk have a significant impact on Return level of Company which measured by ROA.

- Capital Inadequacy Risk measured by Debt to Equity Ratio and Equity to Asset Ratio, have no impact on Return level of Company which measured by ROA.
- Inliquidity Risk have a significant impact on Return level of Company which measured by ROA.
- Inefficiency Risk have no impact on Return level of Company which measured by ROA.
Capital Inadequacy Risk measured by Debt to Equity Ratio and Equity to Asset Ratio, have no impact on Return level of Company which measured by ROE.

In liquidity Risk have a significant impact on Return level of Company which measured by ROE.

Inefficiency Risk have no impact on Return level of Company which measured by ROE.

Capital Inadequacy Risk, Inliquidity Risk and Inefficiency Risk simultaneously have an impact contribution of 22.3% on Return level of Company which measured by ROA.

From those analysis results, above risk factors have an impact contribution of 47% on variation occurred to ROA. Capital Inadequacy Risk, Inliquidity Risk and Inefficiency Risk simultaneously have an impact contribution of 22.3% on Return level of Company which measured by ROE.

Thus, managerial impacts of this research are as follows:

The most influencing Risk on level of return of finance company from ROA and ROE points of view is Inliquidity Risk. Many finance companies experiencing debt restructuring and under BPPN observation in monetary crisis era in year 1998 due to less cash flow management (mis-estimation to match current assets with account payables due).

Company not readiness in hedging the interest rate and in forex that not due yet, also as main factor that caused iliquidity in a finance company. Management philosophy and a comprehensive strategy in financial planning to maintain company level of liquidity must be conducted continuously, to minimize financial risk.

Level of efficiency was determined by the ability to conduct a comprehensive analysis on operational and the ability to maintain its assets quality. Underwriting policy, loan disbursement policy, account receivable collection management, marketing strategy, surveyor quality in customer data verification (field / phone verification) and executor quality in repossessing collaterals have a very significant influence in maintaining overall company level of efficiency.

In accordance with result of this research that described conditions of finance companies, we suggest the followings:

For next researchers that want to conduct analysis on finance companies as research object should involve quality of asset evaluated from product portfolio that has been financed in business diversification and also percentage of reserve of doubtful/uncollectible receivables write-off resulted of credit policy in such finance company.

In the next research can be conducted different test with t-test analysis to find out is there any performance differences of finance company owned by foreign investor (100%), joint venture (foreign and local investor), and also local investor (100%). Different test is important to know the difference of job performance resulted by differences in management policies from three types of finance companies mentioned above.

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