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Research.

Impact of Corporate Governance, Capital Structure, and Liquidity on Regional Bank Profitability in Indonesia

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Abstract. *Profitability indicates a bank's capacity to produce revenue from its assets and activities. Robust corporate governance facilitates prudent decision-making and risk management, whereas larger entities may leverage economies of scale to improve profits. Conversely, excessive leverage amplifies financial risk and can diminish profits, while too conservative liquidity management, although stabilizing, may restrict income possibilities. This study analyzes the impact of corporate governance, leverage, and liquidity on the profitability of regional development banks in Indonesia. The study employs secondary data from the annual reports of 26 regional development banks and utilizes multiple regression analysis. The results indicate that corporate governance does not significantly influence profitability, while leverage and liquidity negatively affect bank profitability. The findings indicate that corporate governance processes are typically effectively executed and monitored; yet, substantial debt commitments and significant cash reserves are likely to diminish profitability due to heightened interest expenses and reduced income production.*

Keywords: profitability; corporate governance; capital structure; liquidity; regional development bank.

INTRODUCTION

Background

Profitability is an indicator that measures the financial performance of an entity, including the regional development banks sector in Indonesia, reflecting the operational efficiency of the bank. This efficiency can drive business sustainability, enhance competitiveness, and maximize the bank's role as an intermediary institution. By achieving optimal profitability, Regional Development Banks can expand their business operations, increase credit disbursement capacity, improve service quality for customers, and strengthen their capital structure. Furthermore, profitability provides an overview of the bank's health and a positive contribution to economic development, thereby boosting regional development (Ruxho & Beha, 2024).

When examining the financial performance of one of Indonesia's regional development banks - Bank Jateng - it shows a decline in profits for two consecutive years, specifically in 2023 and 2024, with earnings of 1.27 trillion in 2024 and 1.59 trillion in 2023, respectively. In 2022, Bank Jateng recorded higher profits compared to 2023 and 2024, amounting to 1.83 trillion. The decline was caused by a larger increase in interest expense, which put pressure on net interest income (Galih, 2025). Based on this phenomenon, there are several factors that affect bank profitability, including corporate governance, leverage, and liquidity.

Governance relates to the rules, practices, and management processes that guide and control the bank, which are adhered to by all levels, from the board of commissioners to the lowest level (Patel & Gupta, 2024). Research explaining the influence of corporate governance on profitability has not yielded consistent findings, with some research results from Almashhadani (2023) indicating that corporate governance, represented by independent commissioners, audit committees, and the number of board meetings, has a positive impact on profitability. However, another study conducted by Millenianto (2024) showed that corporate governance did not affect profitability.

Next, leverage relates to capital structure, particularly the loans held by banks, where banks must consider the interest expense they will incur on the loans received (Li, 2025). Besides researching corporate governance factors, leverage is also one of the variables analyzed as a factor influencing profitability. Research findings exploring the influence of leverage on profitability also still yield heterogeneous conclusions. Eckbo & Kisser (2021) found that leverage negatively affects profitability, indicating that higher levels of debt can place downward pressure on a company’s profits.This is due to the increasing burden of interest paid to creditors borne by larger companies. On the other hand, research results Al-Zuhairi & Halouani (2025) confirm that leverage does not affect profitability.

The final factor examined in this study is liquidity, which is related to the availability of cash within the bank that must be able to cover all operational expenses. However, liquidity must also be maintained according to the bank's needs, as excessive liquidity will put pressure on profitability. Research on the influence of liquidity on profitability still yields different conclusions. Nguyen et al. (2024) suggest that liquidity negatively impacts profitability. This is because high liquidity will depress profitability due to unused cash in the bank. Excess cash (idle cash) should be utilized in instruments that can contribute to the bank's income. Another study revealed that liquidity has a positive impact on profitability. This result confirms that strong liquidity will enhance the bank's ability to handle large-scale fund withdrawals, which implies high customer confidence and the bank's potential profitability.

Based on the above description, this study aims to examine the influence of governance, leverage, and liquidity on profitability at regional development banks in Indonesia. This research was conducted to fill the research gap that shows heterogeneous results regarding the influence of these three variables on profitability. Theoretically, this research aims to support previous studies on governance in local government-owned financial institutions. Furthermore, from a practical perspective, the results of this study can be used as a basis for evaluating management policies in developing more effective liquidity policies and capital structures. This study is expected to serve as a reference for developing governance policies to improve financial performance. Therefore, this research plays an important role in the development of theory and practice in the regional banking sector.

Research Question

Based on the description above, the research questions proposed in this study are as follows:

1. Does corporate governance have a positive effect on profitability?
2. Does leverage have a negative effect on profitability?
3. Does liquidity have a negative effect on profitability?

LITERATURE REVIEW

Agency Theory

Agency theory, proposed by Jensen & Meckling (1976), explains the contractual relationship between the principal—such as owners or shareholders—and the agent, who operates the company on their behalf. The theory originates from the division between ownership and administrative control, resulting in the possibility of divergent aims. Managers are ideally expected to prioritize the interests of the owners; yet, they may pursue personal objectives, such as enhancing their own remuneration or seeking prestige, which might conflict with shareholder value. This imbalance creates agency conflict, resulting in inefficiency, elevated operational expenses, or inferior strategic choices. To alleviate these issues, companies utilize corporate governance measures, such as monitoring systems, performance-based incentives, and open reporting, to align managerial actions with the interests of the owners and minimize the costs related to agency conflict.

In the banking industry, agency theory has a direct correlation with profitability. Banks with poor governance can end up with higher agency costs as a result of misaligned goals between management and shareholders, such as excessive risk-taking or inefficient capital allocation (Nizar & Kiswanto, 2022). On the other hand, good corporate governance, such as a highly efficient board of commissioners, independent oversight, and clear reporting, can be very helpful in resolving agency conflicts, increasing management accountability, and leading to healthier financial decisions. Improved governance is not only good for shareholders but also for sustainable profitability because it helps reduce the scale of losses, increase efficiency, and gain the trust of stakeholders.

Profitability

Profitability is a fundamental indicator of a firm's financial robustness, overall performance, and operational efficiency (Desai & Dharmapala, 2006). It is often evaluated using Return on Assets (ROA) and Return on Equity (ROE), which demonstrate the efficiency with which a bank utilizes its assets and equity to produce earnings. Allarusi & Alhaderi (2018) assert that profitability is influenced by internal factors such as management competence, operational efficiency, and risk management, alongside external influences including economic conditions, interest rates, regulatory frameworks, and the overall macroeconomic landscape. Banks generate revenue primarily from interest on loans and income from various other banking services. Credit risk assessment and loan portfolio management are crucial for maintaining asset quality, and banks consistently ensure that debtor repayments are obtained consistently according to the predetermined schedule (Shaheer Aris & Rahimi, 2023). Additionally, the cost-to-revenue ratio is often used to assess operational efficiency and its impact on profitability. Banks that maintain a balance between revenue generation and cost control will be able to achieve stable and sustainable profitability.

Several structural and governance-related factors also play a significant role in determining bank profitability. Strong corporate governance mechanisms can improve decision-making and reduce agency problems, leading to enhanced performance (Puni & Anlesinya, 2020). Meanwhile, leverage, although it can increase profits, must be managed carefully to avoid excessive risk exposure that could threaten financial stability. Liquidity is also important; while ensuring the bank's ability to meet its obligations, excessive liquidity can reduce profits due to lower investment in high-yielding assets. Therefore, a well-managed balance between leverage and liquidity is crucial. Compliance with regulations and capital adequacy further influence profitability by shaping a bank's ability to absorb losses and grow. Ultimately, profitability in the banking sector is not only a function of financial metrics but also a reflection of good governance, strategic management, and prudent risk-taking.

Corporate Governance

Corporate governance provides the system of regulations, methods, and procedures employed to direct and supervise a company's operations. It involves the interactions among the board of directors, management, shareholders, and other stakeholders to foster accountability, transparency, and ethical decision-making (Sari, 2023). Essential elements of corporate governance encompass board composition, participation of independent directors, the function of audit committees, and the establishment of internal control systems (Nour et al., 2024). In the banking sector, where risk and public trust are paramount concerns, effective corporate governance is crucial for protecting the interests of depositors and maintaining financial stability. A strong governance framework helps prevent mismanagement, reduce agency conflicts, and support compliance with regulatory requirements (Dote-Pardo et al., 2025). Furthermore, corporate governance contributes to strategic alignment by monitoring executive actions and ensuring that decisions align with the organization's long-term goals. Thus, good governance structures serve as the foundation for responsible and sustainable management in financial institutions.

In the context of the banking industry, banks that implement good governance mechanisms (such as independent commissioners, board of commissioner's meetings, and transparent disclosure practices) tend to make more informed and prudent financial decisions (El-Chaarani et al., 2022). This will help companies reduce operational inefficiencies, mitigate agency problems, and prevent misconduct that could lead to financial losses or reputational damage. Additionally, by aligning management's interests with those of shareholders and regulators, corporate governance fosters trust and confidence among investors and customers (Dak-Adzaklo & Wong, 2024). This improved credibility can enhance the bank's ability to attract capital and expand its business operations. Empirical studies have shown that well-managed banks often achieve higher returns on assets and equity compared to banks with weaker governance structures (Abiad et al., 2025; El-Chaarani et al., 2023). Therefore, strong corporate governance not only supports compliance and stability but also directly contributes to improved financial performance. Based on this, the hypothesis proposed in this study is:

H_1: Corporate governance has a positive effect on profitability.

Leverage

Leverage refers to the utilization of borrowed capital to fund a company's assets or operations, with the objective of increasing returns for equity stakeholders (Ima et al., 2024). The assessment is typically conducted via the ratio of total debt to equity or assets, reflecting the extent of dependence on debt funding. While leverage can enhance returns in growth phases, it simultaneously increases financial risk during losses or asset devaluations (Ahmed et al., 2024; Ima et al., 2024). Excessive leverage diminishes financial flexibility and undermines a company's ability to withstand economic shocks, especially in turbulent markets. Regulators in the banking sector meticulously monitor leverage ratios to ensure systemic stability and mitigate excessive risk-taking (Gao et al., 2022; He et al., 2023). Effective leverage management is crucial for maintaining sensible risk levels and achieving a balance between profitability and long-term solvency.

Excessive leverage tends to negatively impact profitability due to the increased financial and regulatory risks it creates (Arhinful & Radmehr, 2023). Highly leveraged banks face greater interest obligations, which can erode net profits, especially when interest rates rise or revenues decline (Arhinful & Radmehr, 2023; Rathnayake et al., 2022). Furthermore, high leverage can signal financial fragility to investors and depositors, potentially reducing market confidence and increasing the bank's cost of capital. This can also trigger stricter regulatory requirements, including higher capital buffers, which limit the bank's ability to allocate resources to profitable investments. Under pressure, banks with excessive leverage are more vulnerable to default, asset devaluation, or liquidity shortages, all of which can further reduce profitability (Rathnayake et al., 2022). Therefore, maintaining a conservative and well-managed leverage ratio is crucial for sustainable financial performance in the banking sector. Based on the description above, the hypothesis proposed in this study is:

H_2: Leverage has a negative effect on profitability.

Liquidity

Liquidity represents a bank's ability to fulfill short-term financial obligations by converting assets into cash with minimal loss of value (Guerra et al., 2022). Adequate liquidity enables banks to meet withdrawal requests, issue loans, and manage unforeseen financial pressures. The loan-to-deposit ratio (LDR) is commonly utilized to evaluate the efficiency of deposit utilization in financing lending activities. Ensuring adequate liquidity is crucial for operational stability, adherence to regulations, and the preservation of depositor trust (Chen et al., 2024). Excessive liquid assets can result in opportunity costs, as these assets typically generate lower returns compared to loans or alternative investments (Ma et al., 2022). Banks must balance liquidity and profitability to attain optimal financial performance. Effective liquidity management necessitates the maintenance of sufficient reserves alongside the efficient deployment of assets to generate income.

Excess liquidity can negatively impact profitability by limiting the bank's capacity to allocate funds to investments with higher returns. Banks that maintain an overly conservative liquidity position may miss out on revenue opportunities from loans or market instruments, thereby reducing their net interest margin (Kalimashi et al., 2022). While high liquidity provides security and flexibility, the trade-off is often lower returns, especially in a low-interest-rate environment where liquid assets yield minimal profits (Ruqaya Hamz, 2025). Additionally, excessive liquidity can indicate inefficiencies in asset allocation or risk aversion, which can harm a company's competitive position in financial markets. Empirical evidence shows that there is a point where increased liquidity no longer contributes to profitability and may even have the opposite effect (Mohammad & Khan, 2024). Therefore, bank activities not only maintain liquidity stability but also increase profitability, which can boost the bank's financial performance. Based on this, the hypothesis proposed in this study is:

H_3: Liquidity has a negative effect on profitability.

Based on the above description, the research framework model for this study is presented in Figure 1 below:

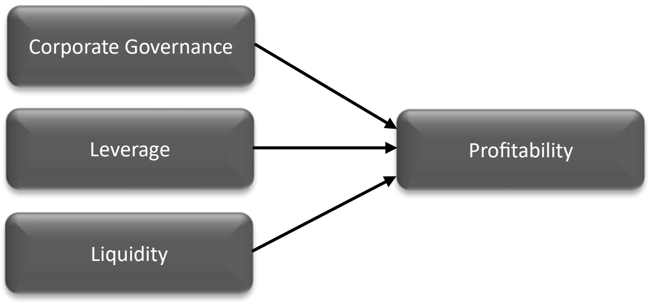

Figure 1. Research Framework

RESEARCH METHODS

Research Design

This study utilizes a quantitative methodology to examine the impact of corporate governance, leverage, and liquidity on the profitability of regional development banks in Indonesia. The population encompasses all 26 regional development banks, offering an exhaustive perspective on this sector. Secondary data were obtained from the financial statements and annual reports of each bank, accessible on their official websites, spanning the years 2020 to 2024. Corporate governance is indicated by the quantity of board members, leverage is quantified by the debt-to-asset ratio, and liquidity is evaluated through the loan-to-deposit ratio (LDR). Profitability, the dependent variable, is assessed by return on assets (ROA), a conventional metric in banking research. The selection of these variables was informed by previous empirical research and the presence of reliable, comparable data.

Data analysis was conducted using a multiple linear regression model to assess the influence of independent variables on the dependent variable. Before regression analysis, classical assumption tests were conducted, including normality, multicollinearity, heteroskedasticity, and autocorrelation tests, to ensure the validity of the regression model. Regression models allow for the identification of the direction and significance of each variable's influence on profitability. Statistical analysis was performed using SPSS software, which facilitated accurate calculations and interpretation of the results. A significance level of 5% (α = 0.05) was used to determine the statistical relevance of the findings. Descriptive statistics are also presented to provide an overview of the characteristics of each variable across the entire sample. Based on this, the multiple linear regression equation in this study is presented as follows:

$$Y = \alpha + \beta 1.X1 + \beta 2.X2 + \beta 3.X3 + \varepsilon \quad \text{...... 1)}$$

Description:
- Y : Profitability
- α : Constanta
- β : Coefisien
- X1 : Corporate Governance
- X2 : Leverage
- X3 : Liquidity
- ε : Error

RESULTS AND DISCUSSION

Result
Descriptive Statistics

The results of the descriptive statistical analysis, as presented in table 1, indicate that Regional Development Banks in Indonesia demonstrate consistency in corporate governance practices, as reflected by the narrow range and low standard deviation. Profitability, measured by return on assets (ROA), also appears relatively similar, indicating nearly identical revenue-generating efficiency across banks. Conversely, leverage shows considerable variation, implying different capital structures and risk exposures. Similarly, liquidity shows a fairly high dispersion, indicating that some banks maintain very high liquidity ratios, which suggests a very cautious financial strategy. The low average ROA highlights the overall relatively low profitability, which could be influenced by conservative lending practices or limited market reach. Significant variations in leverage and liquidity indicate that not all banks manage their financial resources optimally. This finding implies the need for more standardized financial management practices to improve efficiency and profitability in the regional banking sector.

Table 1. Descriptive Statistics

Variables	Data	Min.	Max.	Avg	Std. Dev.
Corporate Governance	112	1,00	6,00	3,1429	0,93825
Leverage	112	0,51	29,09	13,9198	6,04725
Liquidity	112	0,49	41,85	2,3708	5,63313
Profitability	112	0,02	0,04	0,0275	0,00642

Data Testing

These tests were conducted to determine data normality, correlation between independent variables, equality of residual variance from one observation period to another, and the correlation between disturbance errors in period t and errors in period t-1. Data testing was performed before hypothesis testing was conducted. The results of the normality test using the Kolmogorov-Smirnov test show a significance level of 0.200 (asymp. sig – two tail). This value is above the predetermined significance level of 0.05 (5%). This indicates that the data is normally distributed. Meanwhile, the results of the autocorrelation test using the Durbin-Watson (DW) test showed that the DW value was 1.830. This value is greater than the DU value of 1.7764 and less than 4 – DU, which is 2.2336. Based on this, autocorrelation does not occur in the regression model. Furthermore, the multicollinearity test showed the results as shown in the following table 2:

Table 2. Multicollinearity Test

Variables	VIF Value
Corporate Governance	1,455
Leverage	3,169
Liquidity	2,914

Based on table 2 above, the VIF value is greater than 0.1 and less than 10. Therefore, there is no relationship between these independent variables. The heteroskedasticity test using a scatterplot showed that the points were randomly scattered. Thus, it can be concluded that heteroskedasticity did not occur, as shown in figure 2 below.

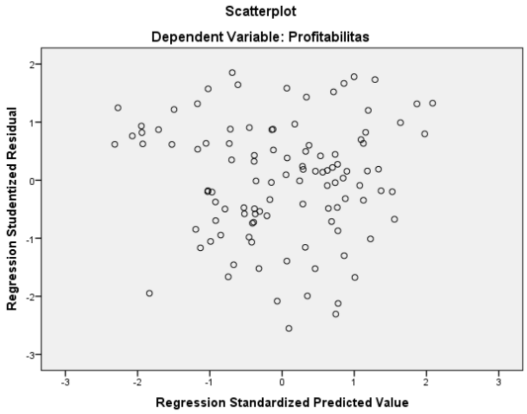

Figure 2. Heteroskedasticity Testing

Hypothesis Testing

The purpose of this research is to investigate the impact that factors such as leverage, liquidity, and corporate governance could have on the profitability of regional development banks in Indonesia. The findings of the testing of the hypothesis are given in table 3.

Table 3. Hypothesis Testing

Variables	Beta	t-value	Sig.	Hypothesis
Corporate Governance	0,071	0,665	0,508	Rejected
Leverage	-0,416	-2,624	0,010	Accepted
Liquidity	-0,440	-2,899	0,005	Accepted

The results of the hypothesis testing show that:

1. Corporate governance has no effect on profitability, with a significance value of 0.508. This value is greater than the predetermined significance value of 0.05. Based on these results, hypothesis 1 (H_1) is rejected.
2. Leverage has a negative effect on profitability, with a significance value of 0.010. This value is smaller than the predetermined significance value of 0.05. Based on these results, hypothesis 2 (H_2) is accepted.
3. Liquidity has a negative effect on profitability, with a significance value of 0.005. This value is smaller than the predetermined significance value of 0.05. Based on these results, hypothesis 3 (H_3) is accepted.

Discussion

Based on the hypothesis testing results presented above, the following discussion can be described as follows:

1. The effect of corporate governance on profitability.
   The results of the hypothesis testing indicate that corporate governance does not have a statistically significant impact on the profitability of regional development banks in Indonesia. This outcome indicates that differences in governance structures, particularly the number of board members, do not significantly influence the performance variations observed among these banks. This empirical finding directly contradicts the established assertions of agency theory, which argues that strong governance mechanisms are crucial for aligning management's interests with hose of shareholders, thus improving financial performance (Chen, 2024). The discrepancy can be understood within the specific context of the highly regulated banking sector. In this industry, corporate governance practices are primarily shaped by stringent directives from the Financial Services Authority, rather than independent board decisions (El-Chaarani et al., 2023). The regulatory framework establishes a standardized governance approach, significantly influencing the internal structure and oversight functions of banks. The significant level of external imposition results in the standardization of governance mechanisms among various Regional Development Banks.

   The regulatory uniformity has led to comparable internal governance structures among regional development banks, thereby reducing the likelihood that governance alone will generate a competitive advantage or directly influence profitability metrics. Consequently, efforts to enhance bank performance exclusively through modifications to formal governance structures, such as adjustments to board composition, are likely to result in diminishing returns. Leadership should implement strategic interventions that extend beyond standardized governance mechanisms to attain enhanced financial results. Possible areas for enhancement involve enhancing management capacity via targeted training programs, promoting an innovative culture in service delivery, and creating new, sustainable business models aligned with local economic requirements. This study's findings, which emphasize the neutrality of governance, are corroborated by previous research by Ni'mah & Syaiful (2021) and Pendong et al. (2022). These findings, however, diverge from the conclusions of Najamuddin et al. (2022) and Millenianto (2024), who identified a positive and significant relationship between governance and profitability. This divergence highlights the significance of contextual factors, including industry regulation and national economic conditions, in influencing the governance-performance relationship.

2. The influence of leverage on profitability.
   The empirical findings from the hypothesis testing clearly indicate that leverage has a statistically significant negative impact on the profitability of regional development banks. This finding confirms the potential benefits of debt while also highlighting its associated risks. Although debt offers a tax shield and enhances returns via financial leverage, these benefits are offset by the costs related to financial distress. Excessive leverage increases a company's financial risk profile, rendering it more susceptible to economic downturns and variations in earnings. This increased risk results in significantly higher interest expenses, which directly diminish net profits and operating margins. The inverse relationship within the operational context of Regional Development Banks is essential, as their stability is crucial for regional economic support. Consequently, these findings serve as a clear, evidence-based caution regarding excessive dependence on debt instruments in the capital structure.

   In the banking sector, these findings suggest that institutions reliant on debt financing are significantly more vulnerable to substantial profitability pressures. This pressure primarily arises from the challenge of managing high funding costs in relation to the returns produced by loan portfolios and other assets. A high leverage ratio creates a strict requirement to fulfill ongoing debt obligations, thereby limiting financial flexibility, particularly in times of reduced cash flow. This study's results are consistent with recent empirical research by Daruwala (2023), which identified a comparable negative correlation in a comparative analysis of financial institutions. Our conclusions, however, directly contradict the findings of Jayaprakash & Ramya (2025), who determined that leverage does not have a measurable impact on profitability metrics. The variation in research findings may result from differences in sample characteristics, diverse macroeconomic conditions, or distinct methodological approaches to assessing leverage and profitability. For managers of regional development banks, this highlights the essential need to prioritize effective capital management and optimize the debt-to-equity ratio to ensure long-term financial stability and sustainable profitability.

3. The effect of liquidity on profitability.
The findings from the hypothesis testing in this study demonstrate that liquidity has a statistically significant negative impact on the profitability of Regional Development Banks. This finding supports the established financial notion that holding excessive liquid assets, although safe, incurs a significant opportunity cost for financial institutions. Capital maintained in highly liquid forms, including cash reserves or low-yield government securities, possesses a limited capacity to produce significant income relative to other asset classes. This excess liquidity limits the bank's primary income-generating capacity, which typically derives from extending loans to borrowers or investing in more profitable financial instruments. Additionally, these empirical findings align with the core tenets of the trade-off theory in corporate finance. This theory posits that high liquidity is essential for maintaining operational security and financial stability; however, an excessively conservative approach to asset management may significantly impede potential earnings. This necessitates a careful balance in managerial strategy, which must reconcile the competing demands of risk mitigation and profit maximization.

   In the context of regional development banks, these findings have significant implications for both daily financial management and long-term strategic planning. The study's conclusions highlight the essential need for a balanced and disciplined approach to financial management to achieve sustainable performance. Bank executives and treasury managers must ensure liquidity levels are adequate to satisfy regulatory requirements and manage potential deposit withdrawals, while avoiding excess that could hinder income generation. This entails the ongoing optimization of the capital structure to guarantee that an appropriate share of assets is directed towards productive, higher-yielding investments instead of remaining unutilized. This study's results are strongly supported by recent empirical research by Gill (2022), which also identified a negative relationship between liquidity ratios and return on assets in a similar banking sample. These conclusions directly contradict the findings of Jayaprakash & Ramya (2025), whose analysis in a different market context indicated that liquidity does not have a measurable impact on profitability metrics. The divergence in academic findings highlights that the liquidity-profitability dynamic is not absolute; rather, it is influenced by contextual factors such as regulatory environments, market conditions, and specific business models, which necessitates tailored strategies for institutions like regional development banks.

CONCLUSIONS AND SUGGESTIONS

This study aims to examine the influence of corporate governance, leverage, and liquidity on profitability at regional development banks in Indonesia. The research object of this study is 26 regional development banks, with the observation period starting from 2020 to 2024. Multiple linear regression analysis was used to analyze the data with the help of the SPSS application. Based on the results of hypothesis testing, it can be concluded that corporate governance does not affect profitability, while leverage and liquidity have a negative impact on profitability. Based on the results of this study, there are 3 (three) suggestions that can be provided for future research, namely: (a) using other indicators in corporate governance, such as independent commissioners, commissioner activities, and audit committees; (b) adding mediation and moderation variables; and (c) expanding the scope of research beyond Regional Development Banks.

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