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# THE EFFECT OF CORE CAPITAL, QUALITY OF GOVERNANCE IMPLEMENTATION ON THE PROFITABILITY OF RURAL BANKS IN KALIMANTAN WITH CREDIT RISK AS A MEDIATION VARIABLE

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**Abstract**

Rural banks (BPR) have an important role in supporting financial inclusion, especially in remote areas. This study examines the effect of core capital and governance quality on profitability with credit risk as a mediating variable at BPRs in Kalimantan during the period 2016–2023. Using quantitative methods with secondary data, the research sample consisted of 51 BPRs with 326 observations after outlier adjustment. The analysis was conducted with SPSS 26.0 using path analysis two-fold regression. The results of the study show that the first regression shows that core capital has a significant negative effect on credit risk (sig. 0.002; coefficient -0.172), the quality of governance implementation as measured by the decrease in the value of the governance composite has a significant positive effect on increasing credit risk (sig. 0.086; coefficient 0.094). The second regression shows that core capital has a significant positive effect on profitability (ROA) (sig. 0.023; coefficient 0.112), while the quality of governance implementation as indicated by the decrease in the value of the governance composite is not significant (sig. 0.338; coefficient 0.115). Credit risk was found to have a significant negative effect on profitability (sig. 0.000; coefficient -0.368). The Sobel test shows that credit risk is able to mediate the relationship between core capital and profitability (sig. 0.00380 < 0.10; Coef 0.063), and credit risk can also mediate the relationship between the quality of governance implementation and profitability (sig. 0.0933 < 0.10; Coef -0.034).

**Keywords:** ***Core Capital, Governance Quality, Credit Risk, Profitability, Rural Banks (BPR).***

## INTRODUCTION

In an effort to support the development of a healthy, resilient, inclusive and productive BPR industry, the Financial Services Authority (OJK) issued Financial Services Authority Regulation (POJK) Number 5/POJK.03/2015 concerning the Obligation to Provide Minimum Capital and Fulfillment of Minimum Core Capital for BPR. This is done to encourage BPR in providing the amount of capital that has strong characteristics to strengthen the institution and the ability to absorb risk for BPR in the form of minimum core capital. For BPRs that have a minimum core capital of IDR 3 billion but have not reached IDR 6 billion, they are required to achieve a core capital of at least IDR 6 billion no later than December 31, 2019. Meanwhile, BPRs with core capital below IDR 3 billion are required to achieve minimum core capital no later than December 31, 2024.

Fulfillment of the minimum core capital by existing BPRs (already operational) is closely related to the financial performance and financial capabilities of shareholders. BPRs with good financial performance and strong financial capabilities of shareholders will soon be able to meet the minimum capital. However, for BPRs with less than optimal financial performance and relatively small business scales, it will be difficult to meet the minimum core capital, especially due to the low ability of BPRs to generate profits that will be capitalized as core capital. This condition is exacerbated by the fact that BPRs with small business scales are owned by shareholders with limited financial capabilities. These two factors are closely related and are the main causes of the difficulty of BPRs in meeting the minimum core capital, which ultimately also affects the financial performance and sustainability of BPR businesses. The profitability ratio is assessed through the measurement of Return on Assets (ROA). The Return on Assets (ROA) ratio quantifies how profitable an organization is relative to its total assets. Throughout 2016 to 2023, the profitability of BPR in Kalimantan fluctuated as seen from the average ROA, as reflected in the following graph.

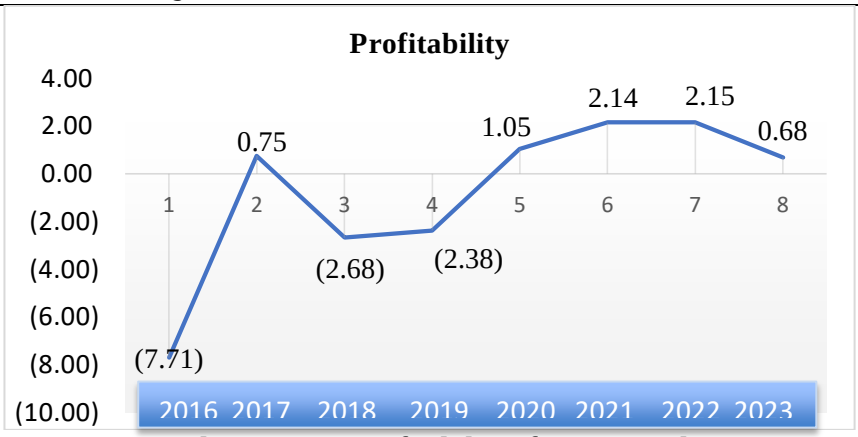


**Figure 1.Phenomenon Profitability of BPR in Kalimantan**

Source: OJK BPR Report 2023

On a consolidated basis, the average ROA of all BPRs in Kalimantan at the end of 2016 to 2023 showed fluctuating developments, with the lowest value in 2016 of -7.71% mainly contributed by the low profitability of BPRs in East Kalimantan and North Kalimantan (-25.83%), South Kalimantan (-3.97%) and Central Kalimantan (-2.56%). This low profitability was mainly caused by the poor performance of several BPRs with very low ROA values. This condition was mainly triggered by low capitalization capacity and poor BPR governance followed by high credit risk. The performance of BPR in Kalimantan had improved at the end of 2017, which was recorded at 0.75%, but worsened again in the following two years, which were recorded at -2.68% and -2.38% respectively. Along with the improvement in the performance of several BPRs that were previously very poor, in 2020, 2021 and 2022 the average consolidated ROA of BPR in Kalimantan was recorded to have improved, respectively to 1.05%, 2.14% and 2.15%. However, it decreased again at the end of 2023 to 0.68%. ThenThe core capital of BPR in Kalimantan is presented as follows.

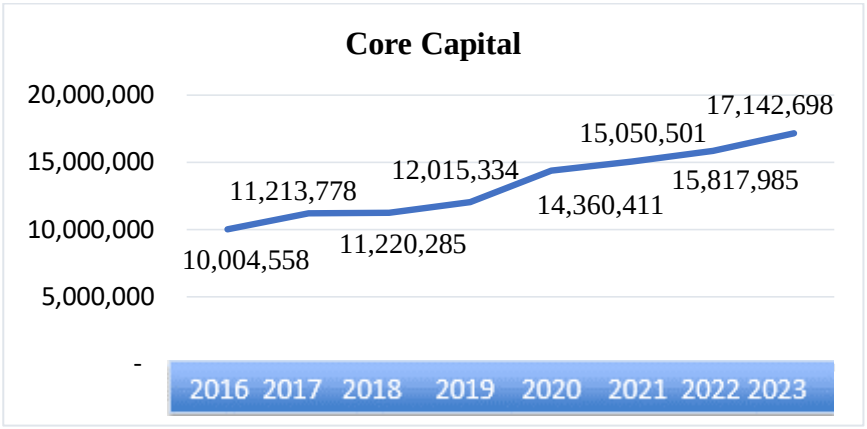


**Figure 2.Phenomenon Core Capital of BPR in Kalimantan**

Meanwhile, the average core capital of BPRs in Kalimantan from 2016 to 2023 continues to increase, from an average of IDR10,004,558 thousand at the end of 2016 to IDR17,142,698 thousand at the end of 2023. This capital strengthening is in line with the encouragement of regulators through provisions for fulfilling minimum core capital which are responded to by BPRs, including through shareholder capital deposits, dividend distribution adjustment policies, organic profit fertilization and mergers of several BPRs.

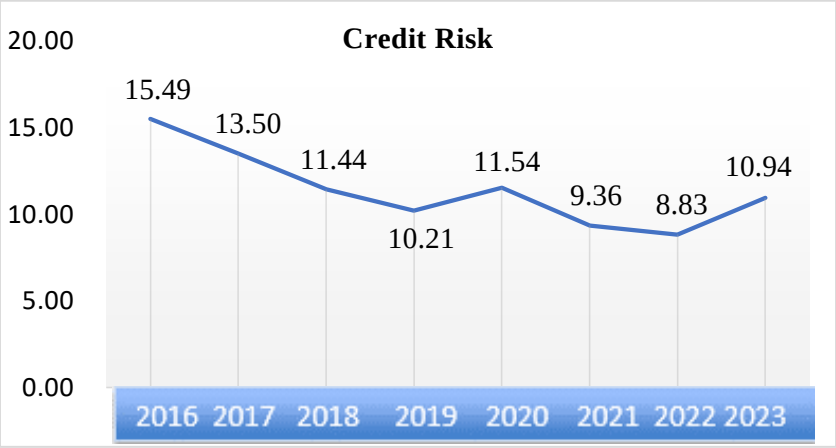


**Figure 3.Phenomenon Non Performing Loan BPR in Kalimantan**

As shown in the graph above, the credit risk of BPR in Kalimantan throughout 2016 to 2023 fluctuated and tended to decline, as seen from the decline in the average consolidated NPL at the end of 2016 which was recorded at 15.49% to 10.21% at the end of 2019. However, credit risk increased again in 2020, with the average consolidated NPL recorded at 11.54%, then decreased again in the following two years to 9.36% at the end of 2021 and 8.83% at the end of 2022. Credit risk increased again at the end of 2023 as indicated by the average NPL of 10.94%. Although there was a tendency for a decrease in NPL in the period from 2016 to 2023, the credit quality was still above the psychological NPL threshold of 5.00%.

The increase in the average core capital of BPRs in Kalimantan for the period 2016 to 2023 followed by a decrease in NPL is expected to encourage improvements in BPR performance as reflected in the improvement in ROA. However, in 2017 to 2018, there was an increase in the average core capital from IDR11,213,778 thousand to IDR11,220,285 thousand, followed by a decrease in the average NPL from 13.50% to 11.44%, but BPR profitability actually decreased from an average ROA of 0.75% to -2.68%.

*Gap phenomenon*in this study is an increase in core capital followed by a decrease in credit risk but not followed by growth in BPR profitability in Kalimantan, as occurred in the 2018 data compared to 2017, presented as follows.

**Table 1. Average ROA, Core Capital and NPL**

| Information | Dec 16 | Dec 17 | Dec 18 | Dec 19 | Dec 20 | Dec 21 | Dec 22 | Dec 23 |
|---|---|---|---|---|---|---|---|---|
| Average ROA (%) | -7.71 | 0.75 | -2.68 | -2.38 | 1.05 | 2.14 | 2.15 | 0.68 |
| Average Core Capital (Millions of Rp) | 10,005 | 11,214 | 11,220 | 12,015 | 14,360 | 15,051 | 15,818 | 17.143 |
| Average NPL (%) | 15.49 | 13.50 | 11.44 | 10.21 | 11.54 | 9.36 | 8.83 | 10.94 |

Based on The table above shows that there is still a data ***gap phenomenon*** in the form of an increase in core capital followed bywith a decrease in credit risk but BPR profitability actually decreased, as happened in 2017 and 2018. Although core capital increased and credit risk was successfully suppressed, BPR profitability actually showed a downward trend. This phenomenon indicates other factors that may affect BPR profitability, such as operational efficiency, uncontrolled operational costs, or changes in market conditions. This research is also to fill **research gap** in literaturethat the influence of capital that is mostly formed from core capital - and the quality of governance implementation on BPR profitability is still inconsistent and has not reached a conclusive conclusion. There are still several studies with conflicting results and different research approaches to the influence between variables. The summary of the reset gap is as follows.

**Table 2. Summary of Previous Research Gap**

| ***Research Gap*** | **Findings** | **Researcher** |
|---|---|---|
| There is inconsistency in the influence of Core Capital on profitability | Bank capital has a positive effect on profitability | Kanga et al (2020) |
| | Bank capital has a negative effect on profitability | Bitar et al (2018) |
| | Bank capital does not affect profitability | Evi Dwi Jayanti and Farahiyah Sartika (2021) |
| There is an inconsistency in the influence of the Quality of Governance Implementation on Profitability | TGood governance has a positive effect on profitability | Zagorcheva and Gao (2015) |
| | Tgovernance does not affect profitability | Adi Surahmat, Mukhzarudfa and Yudi (2020) |

Source: Previous research journal (processed, 2024)

Previous research related to how capital affects banking performance, still focuses on the approach of measuring the total amount of capital, capital adequacy through the CAR ratio and capital structure. However ***novelty*** from this research by referring to existing literatureThere has been no research that measures the extent to which core capital influences banking performance. In the banking industry, the main component of capital formation is core capital, mainly sourced from paid-in capital, reserves, previous years' profits and current year's profits. The study was conducted by analyzing the influence of Core Capital, Implementation of Governance on Return on Assets (ROA) mediated by Non Performing Loans (NPL) at the Rural banks (BPR) headquartered in the Kalimantan Island region between 2016 and 2023.

## FORMULATION OF THE PROBLEM

As shown in table 1. it can be seen that the increase in core capital and the improvement in the quality of governance implementation followed by a decrease in credit risk are not consistent in increasing the profitability of BPRs in Kalimantan during the period 2016 to 2023. In addition, previous research findings have not been consistent in proving the effect of core capital and the quality of governance implementation on BPR profitability. Based on the gap and research gap phenomena, several research questions can be formulated, namely:

1. Is there an influence of Core Capital on Credit Risk at the Rural banks (BPR) headquartered in the Kalimantan Island region in the financial reporting period 2016 to 2023?
2. Is there an influence of the Quality of Governance Implementation on Credit Risk at the Rural banks (BPR) headquartered in the Kalimantan Island region in the financial reporting period 2016 to 2023?
3. Is there an influence of Core Capital on Profitability at the Rural banks (BPR) headquartered in the Kalimantan Island region in the financial reporting period 2016 to 2023?
4. Is there an influence of the Quality of Governance Implementation on Profitability at the Rural banks (BPR) headquartered in the Kalimantan Island region in the financial reporting period 2016 to 2023?
5. Is there an influence of Credit Risk on Profitability at the Rural banks (BPR) headquartered in the Kalimantan Island region in the financial reporting period 2016 to 2023?
6. Can Credit Risk mediate the effect of Core Capital on Profitability at Rural banks (BPR) headquartered in the Kalimantan Island region in the financial reporting period 2016 to 2023?
7. Can Credit Risk mediate the effect of the Quality of Governance Implementation on Profitability at Rural banks (BPR) headquartered in the Kalimantan Island region in the financial reporting period 2016 to 2023?

## LITERATURE REVIEW

### Influence Between Research Variables

### The Influence of Core Capital on Credit Risk

Higher core capital will make banks financially stronger and more capable of facing risks. Thus, high core capital can affect bank credit risk by increasing the bank's ability to cope with losses that may occur from bad credit (default). Mohammad Bitar et al (2018) examined how capital ratios affect bank risk, efficiency, and

profitability in OECD countries. The researchers concluded that good quality capital will be more effective in reducing bank risk and increasing efficiency and profitability compared to other types of capital, which is in line with the Basel III recommendation to limit supplementary capital in banks.Research was conducted by Afriyanto (2021) on the effect of the capital adequacy ratio (CAR) - where core capital is the largest component of capital formation in measuring CAR - on credit risk in conventional commercial banks in Indonesia during the period 2016 to 2020. The results of the study showed that CAR affects the amount of non-current credit in conventional commercial banks in Indonesia. Based on the discussion above, the following hypothesis can be formulated:
H1: Core capital has a negative influence on the credit risk of Rural banks

**The Impact of Governance on Credit Risk**

According to OJK Circular Letter (SE) Number 5/SEOJK.03/2016 Concerning Implementation of Governance for BPR, it states that the higher the composite value of governance indicates the worse the quality of BPR governance implementation. The better the quality of BPR governance implementation will be seen from the lower composite value of governance. With good quality of BPR governance implementation, banks are financially stronger and more capable of facing risks. Thus, good quality of governance implementation can reduce BPR credit risk. According to Puspitasari (2014), good governance in the banking industry is an important part of the factors that help stimulate the growth of a strong banking sector. Corporate governance is absolutely needed in solving problems that doubt the viability of the entire monetary and financial system. Andrey Zagorcheva and Lei Gao (2015) found that improved governance is not only negatively related to excessive risk taking but also positively to the performance of US financial institutions. For example, general and specific governance procedures are associated with a decrease in the overall amount of assets considered non-performing.

Based on the research results of Mohamad Bastomi (2017) entitled "The Effect of Corporate Governance, Credit Risk, and Operational Risk on Financial Performance (Study on Banking Listed on the Indonesia Stock Exchange)", it was concluded that improving the quality of corporate governance has an effect on reducing credit risk and operational risk, thus encouraging improvements in business performance. In addition, the study proves that credit risk and operational risk positively mediate governance in influencing the company's business performance. Based on the description above, the following hypothesis can be formulated:
H2: Increasing the Quality of Governance Implementation as measured by the decreasing value of the governance composite will reduce the credit risk of Rural banks.

**The Influence of Core Capital on Profitability**

According to Kuncoro and Suhardjono (2002), the bank's ability to handle credit risk and productive assets increases in proportion tocapital size. Banks with strong capital are optimally able to support their business operations and contribute greatly to profitability. The adequacy of bank capital is directly correlated with the profitability of the institution. According to Dendawijaya (2009), a bank's ability to take risks is directly proportional to the amount of capital available to do so. Banks with strong capital are able to support their operational activities well and contribute to their profitability. Adjustments to the capital structure need to be made in order to increase the capacity of BPRs to finance the real sector, especially micro and small businesses, in line with the spirit of creating a healthy, resilient, and productive BPR industry. In this regard, it is necessary to regulate the amount of capital that has strong characteristics in strengthening institutions and the ability to reduce risk in the form of minimum core capital for BPRs.

A study written by Désiré Kanga, Victor Murinde, and Issouf Soumaré (2020) examines the simultaneous relationship between bank capital, risk, and profitability, as well as bank ownership and the emergence of Pan-African cross-border banks. The researchers found evidence supporting the hypothesis that increasing bank profitability (performance) is influenced by increasing capital ratios. Therefore, Basel III's suggestion to limit capital additions is supported by the fact that quality capital is more effective than other types of capital in reducing bank risk and increasing efficiency and profitability. Bitar et al. (2018) concluded that both risk-based and non-risk-based capital ratios contribute to increasing bank profitability and efficiency. Ajayi et al (2019) to measure the effect of Capital Adequacy Ratio (CAR) on the profitability of Deposit Money Banks (DMB's) in Nigeria with Return on Assets (ROA) as a measure of profitability. The findings lead to the conclusion that there is a positive influence between the capital adequacy ratio as measured by CAR and profitability as reflected in ROA. Considering the above description, the following hypothesis is formulated:
H3: Core capital has a positive influence on the profitability of Bank Perekonomian Rakyat.

**The Influence of Quality of Governance Implementation on Profitability**

The quality of corporate governance implementation can affect bank profitability. Governance is a set of principles, procedures, and mechanisms used by a company to regulate, control, and evaluate the company's operational activities. The quality of good governance implementation will make the bank financially stronger and more capable of facing risks. Thus, improving the quality of governance implementation will be able to increase bank profitability. Governance is a concept in an effort to encourage increased company performance by monitoring the quality of management work and ensuring management accountability to stakeholders in the specified work guidelines. The implementation of GCG results in increased productivity and organizational efficiency, which ultimately has a beneficial impact on bank profitability.

According to Zagorcheva and Gao (2015), good governance practices in general and specifically are associated with lower total non-performing assets and contribute to increased profitability and the ability to maintain business continuity. Financial institutions that perform well and are sustainable will implement better governance procedures. According to the findings of Heriyani et al. (2021), GCG indicators such as the board of commissioners, independent commissioners, audit committees, company size, and institutional ownership all have an impact on organizational performance.The following hypothesis can be made based on the description above, namely:

H4: Improving the quality of governance implementation as indicated by a decrease in the governance composite value will increase profitability.Rural banks.

**The Impact of Credit Risk on Profitability**

Studies have shown that higher credit risk tends to reduce bank profitability, particularly through the mechanism of increasing provisioning costs for non-performing loans (NPLs) and reducing net interest income. A study by Madugu et al. (2020) showed that credit risk has a significant negative impact on the profitability of domestic banks in Ghana. Similar results were found by Kidane (2020) in Ethiopia, who concluded that credit risk can be a major obstacle to achieving optimal profitability, especially if an effective level of credit risk management is not implemented. In addition, another recent study in Southeast Asia by Banna and Alam (2021) stated that bank financial stability can be threatened if credit risk is not managed properly, directly affecting bank profit margins.

Research by Madugu et al. (2020), Kidane (2020), Banna & Alam (2021) that banks must adopt better credit risk management strategies, such as tightening credit granting policies, conducting more in-depth monitoring of credit portfolios, and improving training for risk management staff to mitigate negative impacts on profitability.

H5: Credit Risk has a negative impact on the Profitability of Rural banks

**The Effect of Core Capital on Profitability Mediated by Credit Risk**

Higher core capital will make banks financially stronger and more capable of facing risks. Thus, high core capital can affect bank profitability by increasing the bank's ability to handle risks and minimize losses. Credit risk is one of the most significant risks for banks, which comes from the possibility of losses due to bad credit (default). Credit risk can affect bank profitability by reducing bank income or increasing costs. The carrying capacity of credit risk/productive assets is comparable to bank capital, and credit risk has a significant impact on profitability, as stated by Kuncoro and Suhardjono (2002). Credit risk is one aspect that contributes to the overall profitability of a bank. The higher the ratio of non-performing loans of a bank, the lower the credit quality and causes an increase in loans that fail to be paid off, which ultimately results in losses. On the other hand, when the bank's non-performing loan (NPL) ratio is lower, the bank is more profitable, which is reflected in the increase in ROA(Olweny, 2015).

According to Barus and Erick (2016), a larger CAR (with the majority of capital formed from core capital) indicates that the bank is better able to manage credit risk issues and other risky productive assets. This is because a higher CAR indicates a greater ability of the bank to generate profits. It can also be interpreted that a high CAR ratio indicates that the bank has sufficient capital to minimize risks such as non-performing loans. According to Kusuma and Haryanto (2016), public trust in the financial sector can be boosted when there is a high CAR among national banks. As a direct consequence of this, the amount of loans to be distributed is greater, and it is estimated that the amount of loans considered NPL will decrease. Other research on the effect of non-performing loans on profitability was conducted by Dewi et al. (2015) and Bhattarai (2017) with the conclusion that NPL significantly affects ROA. Based on the description above, the following hypothesis can be formulated:

H6: RCredit risk mediates the effect of core capital on BPR profitability

**The Influence of Governance on the Profitability of Rural banks Mediated by Credit Risk**

Better governance was found to have a negative association with excessive risk-taking and a positive association with the performance of US financial institutions, according to the findings of a study published in 2015 titled "Corporate governance and performance of financial institutions". The researchers in this study were Andrey Zagorcheva and Lei Gao. Specifically, good governance practices were associated with a lower total amount of non-performing assets, a lower amount of real estate assets, and a higher Tobin's Q.

According to Aryani (2019), independent commissioners, board of directors, and managerial ownership all affect profitability. In addition, credit risk can act as an intervening variable for GCG in influencing bank profitability. This is because handling or managing risk, especially credit risk, is a vital component in achieving GCG, and the ability to maintain a low level of banking risk is a key indicator of the success of GCG implementation. In addition, according to Puspitasari (2014), good banking governance helps encourage the growth of financial institutions that are financially healthy so that they can then maximize their profits (profitability). Mohamad Bastomi (2017) concluded that credit risk and operational risk positively mediate governance in influencing corporate financial performance, according to his research on the influence on banks listed on the Indonesia Stock Exchange. Considering the description above, the following hypothesis can be formulated:

H7: RCredit risk mediates the effect of governance implementation on the profitability of Bank Perekonomian Rakyat.

**Theoretical Framework**

Based on several references from the literature review, the following is the research framework below.

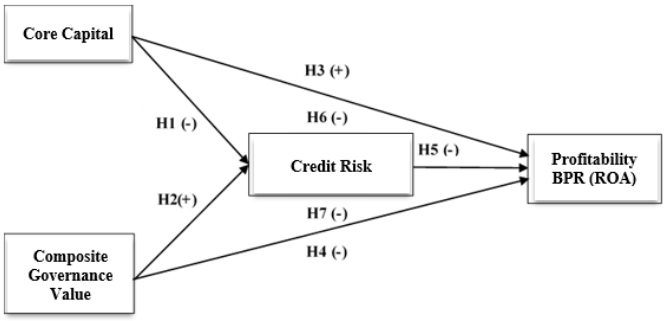


**Figure 4. Framework of Thought**

## RESEARCH METHODS

**Research Design**

This research design is quantitative and aims to analyzethe influence of Core Capital, Implementation of Governance on Return on Assets (ROA) mediated by Non Performing Loan (NPL) at the Rural banks (BPR) headquartered in the Kalimantan Island region between 2016 and 2023.

**Types and Sources of Research Data**

This study uses a quantitative research design, with numerical data obtained and analyzed statistically. This study uses secondary data in the form of Core Capital, the results of the assessment of Governance Implementation, Non Performing Loans (NPL), and Return on Assets (ROA) of BPR in Kalimantan in the period 2016 to 2023. Data sources are obtained from the Publication Report of the Rural banks through www.ojk.go.id and internal OJK supervision data.

**Population and Sample**

The population in this study was a population of 57 Rural banks (BPR) headquartered in the Kalimantan Island region between 2016 and 2023. Determination of the sample using Purposive sampling is a method in which data collection is carried out depending on the specified criteria (judgment sampling):

**Table 3.Sample Determination**

| No | Criteria | Bank |
|---|---|---|
| 1 | Number of Rural banks (BPR) headquartered in the Kalimantan Island region in 2023 | 57 |
| 2 | The Rural banks (BPR) did not report complete financial reports in the Kalimantan Island region for the period 2016-2023. | (6) |
| 3 | The Rural banks (BPR) has reported its complete financial report for eight consecutive years in the Kalimantan Island region for the period 2016-2023. | 51 |
| **Final Sample Size** | | 51 |

Source: Processed secondary data (2023)

From a population of 57 BPRs that meet the sample criteria, there are 51 BPRs. Overall, there are observation data obtained from 51 BPRs with8 year observation data (51x8 years) totaling 408 data.

**Method of collecting data**

The data for this study are sourced from BPR's published financial reports that can be accessed through the official OJK website. In addition, it also uses data from supervisory assessment results and OJK's supervisory system processing output for the 2016 to 2023 data period.

**Data Analysis Techniques**

This study uses a quantitative data analysis approach, using a quantitative data analysis methodology. This involves completing multiple regression tests twice, normality tests, multicollinearity tests, heteroscedasticity, Autocorrelation.

## RESEARCH RESULTS AND DISCUSSION

**Research result**

**Descriptive Data**

From secondary data obtained from the financial report of the Rural banks (BPR) which consistently reported to the OJK from 2016 to 2023, 51 BPR samples were obtained which were headquartered in the Kalimantan Island region (51x8 = 408). However, based on the results of the classical assumption test, it is suspected that due to the unevenness of the data, there were problems with data Normality and Heteroscedasticity, so outliers were carried out on the research data of 82 data. So that the final sample used was 326 research data. Description of the variables thatusedin this study is presented as follows.

**Table 4.Descriptive Statistics**

| Variables | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| Core Capital (in thousands) | 326 | 4,494.00 | 107,872,002.00 | 12,198,383,095 | 15,990,285.42 |
| Quality of Governance Implementation (governance composite score) | 326 | 2.00 | 4.35 | 2,9661 | 0.6076 |
| Credit Risk (%) | 326 | 0.00 | 24.60 | 10,0408 | 5,6792 |
| Profitability (%) | 326 | -8.40 | 10.60 | 2,1902 | 3,1699 |

**a. Core Capital**

The average amount of Core Capital at Rural banks (BPR) headquartered in the Kalimantan Island region in the financial reporting period from 2016 to 2023, measured using the total main core capital plus additional core capital. Core capital has significant variations, with a minimum value of IDR44,494.00 thousand and a

maximum value reaching IDR107,872,002.00 thousand. This disparity indicates a significant difference in core capital capacity between BPRs in this region. The fairly high standard deviation, which is IDR15,990,285.4265 thousand, indicates that core capital data tends to be widely spread from the average value.

**b. Quality of Governance Implementation**

The average number of Quality of Implementation of Governance of Rural banks (BPR) headquartered in the Kalimantan Island region in the financial reporting period 2016 to 2023, measured usingComposite rating of OJK supervisory assessment results with the following criteria;Composite Value (a) 1.0 - < 1.8 Very Good, (b) 1.8 - < 2.6 Good, (c) 2.6 - < 3.4 Fair, (d) 3.4 - < 4.2 Less Good, (e) 4.2 - 5.0 Not Good. The Quality of Governance Implementation has a value ofminimum 2.00, maximum 4.35, marksaverage for the whole amounted to2,9661with a standard deviation of0.60763.

**c. Credit Risk**

The average amount of Credit Risk from the Rural banks (BPR) headquartered in the Kalimantan Island region in the financial reporting period from 2016 to 2023 had a value ofminimum 0.000, maximum value24.60, markaverage for the whole amounted to10,0408with a standard deviation of5.67922. This means that the average credit risk of 10.0408 indicates a moderate level of credit risk, but the relatively high standard deviation indicates significant variation among BPRs in the Kalimantan region.

**d. Profitability**

The average profitability of the Rural banks (BPR) headquartered in the Kalimantan Island region in the financial reporting period from 2016 to 2023, measured using ROA, has a value ofminimum-8.40, maximum value10.60, markaverage for the whole amounted to2,1902with a standard deviation of3,16991.

**Classical Assumption Test of Normality Before Outlier**

The results of the first and second regression normality tests are presented as follows.

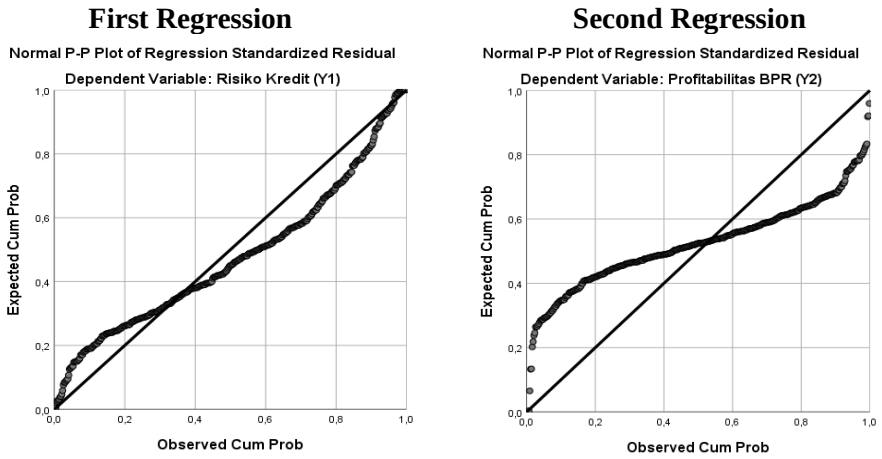


**Figure 5.PP Plot Normality Test Before Outlier**

In Figure 5. above, the P-plot normality test shows that the points are irregularly far from the diagonal straight line, which means that the data is not normally distributed. So it is necessary to do outliers on data that are indicated as not normal.

**Classical Assumption Test of NormalityAfter Outlier**

In the normality test after the data outliers are carried out to ensure that the data has been distributed normally. The results of the first and second regressions are presented as follows.

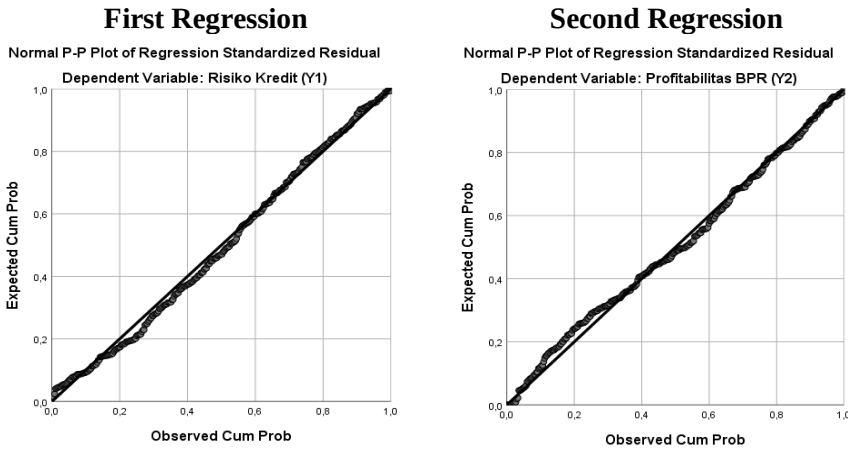


**Figure 6. *PP Plot* and Histogram Normality Test After Outliers**

In Figure 6. above, the normality test of regression 1 and regression 2 after the outliers in the histogram proves that the graph is straight with a bell line and in the P-plot image, it is known that the points are spread along the diagonal line, which means that the data is normally distributed.

**Multiple Regression Analysis**

The results of multiple regression analysis to see how much influence the independent variables have on the dependent variables by considering the coefficient values. The results of the first and second regressions are presented as follows.

**Table 5. Multiple Regression Analysis of the First Equation**

| Variables | B | Std. Error | t | Sig. |
|---|---|---|---|---|
| (Constant) | 28,205 | 6,966 | 4,049 | ,000 |
| Core Capital (X1) | -1,299 | ,415 | -3,134 | ,002 |
| Quality of Governance Implementation (X2) | ,881 | ,512 | 1,721 | ,086 |
| R Square 0.142 Fcount 7.049 | | | | |
| Adjusted R2 0.136 Probability F 0.001 | | | | |

Dependent Variable: Credit Risk (Y1)
Source: processed data, 2024

In table 5. above, the results of the first model regression equation will be discussed, the results of the coefficient significance test are displayed as follows.

**First Equation;**

Credit Risk= 28,205-1.299 MI + 0.881KPTK + e

a. Constant values are positive (+)This means that if the independent variable is considered constant, it will increase the credit risk value.at the Rural banks (BPR) headquartered in the Kalimantan Island region for the financial reporting period 2016 to 2023.
b. It is known that Core Capital (MI) shows a coefficient value with a negative sign (-). This result shows that at a significance level of 10% (0.10), the influence of the MI variable on credit risk, the direction of the relationship is negative. The direction of this relationship gives meaningthatthe effect is inversely proportional, namely the increase in Core Capital or the greater the capital owned by the BPR, the credit risk at the Rural banks (BPR) will decrease.
c. It is known that the Quality of Governance Implementation (KPTK) has a coefficient value with a positive sign (+). This result shows that at a significance level of 10% (0.10), the influence of the KPTK variable on Credit Risk has a significant positive relationship.The direction of this relationship gives meaningthat the effect is directly proportional, namely the increase in the composite value which means a decrease in the quality of governance, then the credit risk will increase. This statement is proven because it is indicated by the Sig. value of 0.086 <0.10.

Next, the second regression will be explained after the mediation variable is present as follows.

**Table 6. Multiple Regression Analysis of the Second Equation**

| Variables | B | Std. Error | T | Sig. |
|---|---|---|---|---|
| (Constant) | ,596 | 3,520 | ,169 | ,866 |
| Core Capital (X1) | ,475 | ,207 | 2,290 | ,023 |
| Quality of Governance Implementation (X2) | ,288 | ,254 | 1,241 | ,338 |
| Credit Risk (Y1) | -,205 | ,027 | -7,485 | ,000 |
| R Square 0.225 F count 36.748 | | | | |
| Adjusted R2 0.248 Probability F 0.000 | | | | |

Dependent Variable: BPR Profitability (Y2)

Source: processed data, 2024

From table 6, the results of the second model regression equation with the presence of mediating variables are obtained as follows.

**Second Equation;**

Profitability = 0.598 + 0.475 MI + 0.288 KPTK - 0205 RK + e

a. The positive constant value of 0.598 means that if all independent variables are considered constant, it will be followed by an increase in the profitability of the Rural banks (BPR) headquartered in the Kalimantan Island region in the financial report period from 2016 to 2023.
b. It is known that Core Capital (MI) shows a coefficient value with a positive sign (+). This result shows that at a significance level of 10% (0.10), the influence of the MI variable on Profitability, the direction of the relationship is positive.This can be interpreted that the influence is in one direction, namely an increase in Core Capital or the greater the core capital, the greater the profitability of the Rural banks (BPR) for the period 2016-2023.
c. It is known that KPTK shows a coefficient value withpositive sign (+)with a sig. value of 0.338 or 33.8% which is higher than 10% (0.10) so that KPTK has no effect on profitability and hypothesis 4 is rejected..
d. It is known that Credit Risk shows the coefficient value with a signnegative (-).These results show that at a significance level of 10% (0.10), the influence of the Credit Risk variable on Profitability is negative. This means thatwhenCredit risk increases, which will be followed by a decreaseProfitability.This can be interpreted thatthe effect is inversely proportional, namely an increase in credit risk or the increasing number of debtors fulfilling their obligations.BPRthen profitability at the Rural banks (BPR) will experiencedecline.

**Intervening Test/ Sobel Test (Indirect Effect)**

Sobel test to determine whether the mediating variable Credit Risk can significantly be a mediating variable between Core Capital and the Quality of Governance Implementation on Profitability. Sobel test statistics if the two-tailed probability value <0.10with a t-count value >1.652, then Credit Risk can mediate between independent variables and dependent. The results of the Sobel test will be presented as follows.

**a. Core Capital Variables AgainstProfitability (ROA) through Credit Risk**

The results of the Sobel test of Core Capital againstProfitability is mediated by credit risk as follows.

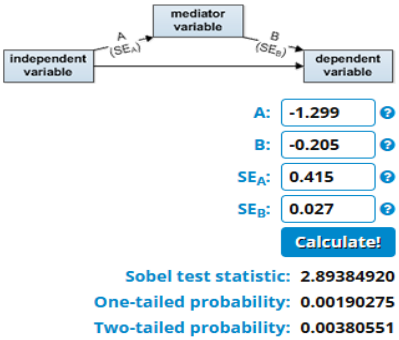

Figure 7. Results of Sobel Test 1

Based on the results of the Sobel test calculations, the two-tailed probability value obtained was 0.00380 < 0.10with a t-value of 2.893 >1.652. Ameaning of variableCredit Riskcan be a mediating variable between Core Capital andProfitability of Rural banks (BPR).The direct effect of Core Capital on Profitability remains significant at (sig. = 0.023), although the indirect effect through Credit Risk is also significant (Sobel test probability = 0.00380). Therefore, the mediation that occurs is partial mediation. Hypothesis Six is accepted.

**b. Quality of Governance Implementation Variables onProfitability through Credit Risk**

The results of the Sobel test on the Quality of Implementation of Governance againstProfitability is mediated by credit risk as follows.

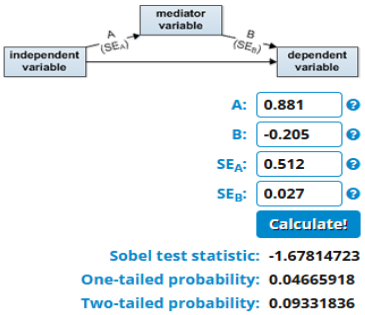


Figure 8. Results of Sobel Test 2

Based on the results of the Sobel test calculations, a two-tailed probability value of0.0933 < 0.10with a t-count value of -1.678 > -1.652 meaning of variableCredit Riskcan be a mediation between the Quality of Governance Implementation andProfitability of Rural banks (BPR).The direct effect of Quality of Governance Implementation on Profitability is not significant (sig. 0.338). The indirect effect through Credit Risk is significant based on the Sobel test with a t-value of -1.678 and a p-value of 0.0933 <0.10. Since the direct effect is not significant and the indirect effect is significant, the type of mediation that occurs is Full Mediation. Hypothesis Seven is accepted.

## DISCUSSION OF RESEARCH RESULTS

### The Influence of Core Capital on BPR Credit Risk

The research that has been conducted proves that Core Capital has a significant negative effect on the Credit Risk of Rural banks (BPR) headquartered in the Kalimantan Island region in the financial report period from 2016 to 2023. The greater the core capital of the BPR, the stronger the capital of the BPR, so that the BPR has the opportunity for greater credit expansion, strengthening supporting infrastructure to build better information technology, being able to improve the quality of human resources to strengthening the implementation of credit risk mitigation. Thus, the greater the core capital of the BPR will reduce credit risk. When the Core Capital of the Rural banks (BPR) increases, it will affect the decrease in Credit Risk in the Bank.The findings of the research conducted are in accordance with the findings ofAfriyanto (2021), Mohammad Bitar et al. (2018), Enteriadi (2024) found that Core Capital has a negative impact on credit risk.

The higher the core capital owned by BPR, the lower the level of credit risk they face. This finding is important for risk management in the small banking sector such as BPR, which is generally more vulnerable to economic instability and credit risk than large banks that have larger capital reserves and more diverse investment portfolios. Core capital is the main component of a bank's capital structure, consisting of the most liquid and reliable capital to absorb losses and protect the bank from potential default or other losses (Berger & Bouwman, 2013). In previous studies, core capital has been shown to play an important role in suppressing credit risk, especially during the financial crisis, where banks with stronger core capital are able to survive better and maintain their operational stability. The results of this study are consistent with findings in the literature showing that strong capital plays a critical role in maintaining bank stability and reducing credit risk, especially in banks located in areas with high economic volatility. Adequate core capital not only serves as a buffer in facing financial risks but also as an instrument for banks to operate more confidently in distributing quality credit. Therefore, optimal core capital management is an essential aspect in BPR's efforts to maintain healthy financial performance and increase their resilience to credit risk.

**The Influence of the Quality of Governance Implementation on BPR Credit Risk**

This research shows that improved governance quality, as reflected by a lower governance composite value, reduces credit risk in BPRs headquartered in Kalimantan from 2016 to 2023. The decline in the composite value is attributed to enhancements in key areas, including the duties and responsibilities of the Board of Directors and Commissioners, conflict-of-interest management, compliance functions, audit effectiveness, and risk management, all of which contribute to reducing credit risk. The findings of the research conducted are in line with the findings of Bastomi (2017) and Puspitasari (2014) who found that the quality of governance implementation has an effect on credit risk.

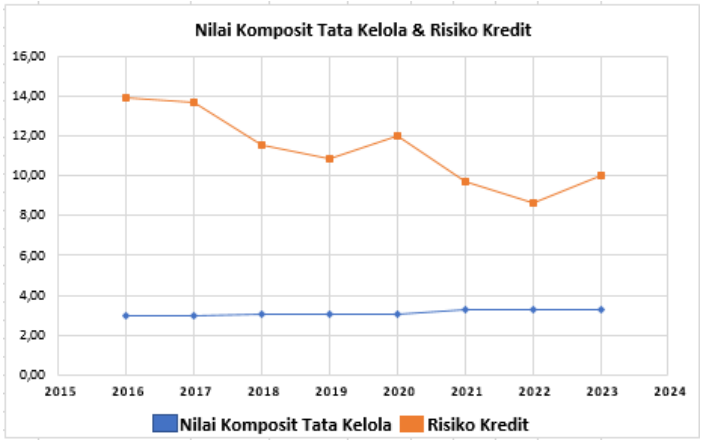


Figure 9. Composite Value Graph of Governance and Credit Risk
Source: Excel Data Processing, 2024

The graph above shows the movement of the Governance Composite Value on the blue line and Credit Risk on the orange line in BPR from 2016 to 2023. The Governance Composite Value tends to be stable throughout the period, in the range of 2 to 4. There are no significant changes from year to year, indicating a relatively consistent quality of BPR governance. On the other hand, Credit Risk shows more varied dynamics. In 2016, the credit risk value was at its highest, around 14, then experienced a gradual decline until it reached its lowest value below 10 in 2021. However, since 2022, credit risk has increased again approaching 10 and has remained stable until 2023. In conclusion, although governance is relatively stable, credit risk shows fluctuations that can be influenced by factors other than governance. The decline in credit risk until 2021 indicates an improvement in risk management, but the increase again after 2021 indicates new challenges that need further study.

In the context of BPR, good governance usually involves strict internal supervision, transparent reporting, and systematic risk control mechanisms (OECD, 2019). This is in line with the concept of Agency Theory, which explains that effective governance can minimize conflicts of interest between management and bank owners through more efficient risk control (Jensen & Meckling, 1976; Freeman, 2020). However, improved governance can also give rise to previously unidentified risk disclosure effects, leading to a temporary increase in credit risk.

**The Influence of Core Capital on Profitability (ROA) in BPR**

The research that has been conducted proves that Core Capital has a significant positive effect on the profitability (ROA) of the Rural banks (BPR) headquartered in the Kalimantan Island region in the financial reporting period from 2016 to 2023. When the Core Capital of the Rural banks (BPR) increases, it will affect the increase in profitability (ROA) at the Rural banks (BPR).The results of the research findings are in accordance with the findings of Ajayi et al. (2019), Kanga (2020), Dendawijaya (2009)found that Core Capital has a significant positive effect on the profitability of BPRs headquartered in the Kalimantan Island region in the financial reporting period from 2016 to 2023.

In addition, strong core capital can help BPRs adopt technology and improve service quality, which also contributes to increased profitability. According to a study by Lee and Hsieh (2018), increasing core capital allows banks to be more innovative and adapt operations to market needs, which ultimately has a positive impact on revenue and efficiency. This is relevant for BPRs in Kalimantan that may face stiff competition in the local sector; higher core capital provides greater ability to strengthen competitiveness by utilizing capital optimally. Overall, these results emphasize the importance of good core capital management for BPRs to maintain and improve profitability. By increasing core capital, BPRs can maintain financial stability, strengthen capital structures, and expand credit services more safely. This is also in line with findings in the literature showing that strong capital is

key to maintaining the resilience and financial performance of banks, especially for small banks operating in more limited markets.

**The Influence of Quality of Governance Implementation on Profitability (ROA)**

The research that has been conducted shows that improving the quality of Governance Implementation does not have a significant effect on the profitability (ROA) of the Rural banks (BPR) headquartered in the Kalimantan Island region in the financial reporting period from 2016 to 2023. In descriptive statistics, it can be seen that the standard deviation ofQuality of Governance Implementation is 0.60763lower than the average by2.9661 which means that the increase and decrease in the quality of governance are unable to affect the increase or decrease in profitability. This is possible because in the research period (2016 to 2023) there was the Covid-19 Pandemic (2020 to 2022) where most of the banking industry experienced a decrease in profitability due to the high credit failure of debtors affected by the Covid-19 pandemic. In the research period affected by the Covid-19 Pandemic (2020 to 2023), external factors from the worsening economic conditions due to the Covid-19 pandemic which had an impact on the high credit failure became more dominant in influencing the decline in profitability of most BPRs on the island of Kalimantan. The standard deviation of the composite governance value (0.60763) is lower than the average value (2.9661), with this condition indicating that variations in the BPR governance composite value are unable to influence profitability.

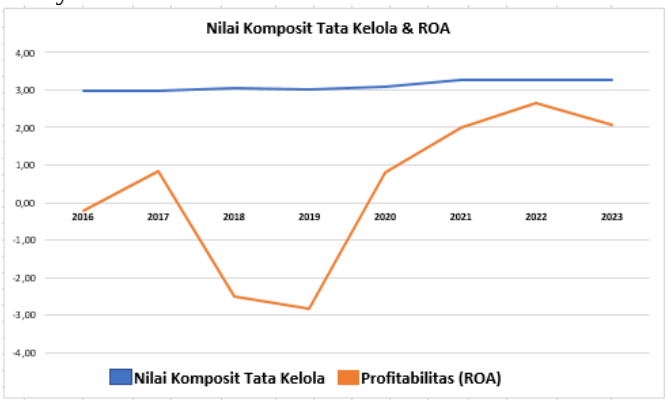


Figure 10. Composite Value Graph of Governance and ROA
Source: Excel Data Processing, 2025

From the data in Figure 10, the classification of composite ratings based on categories is given as follows:

In 2016, the majority of BPRs were in the Fairly Good category with a total of 22 out of 51 BPRs. A total of 17 BPRs were in the Good category, while 8 BPRs were in the Less Good category. The Not Good category recorded 4 BPRs, and none of the BPRs were in the Very Good category. Based on the total BPR assessment during the period 2016–2023, out of 408 assessments conducted, no assessments were in the Very Good category, indicating that the highest standard has not been achieved. A total of 91 assessments were in the Good category, although there has been a significant decline in recent years. The Fairly Good category dominated with 224 assessments, indicating that most evaluations were at an adequate level but required further improvement. The Less Good category recorded a total of 80 assessments, with an increase in recent years, while the Not Good category had a total of 23 assessments, reflecting aspects that still require special attention for improvement. This data confirms the need to focus on improving the quality of assessments to reduce the number in the low category and increase achievements to a higher category.

This means that changes in governance quality, as measured by the composite rating of the Financial Services Authority (OJK) assessment results, are not directly correlated with an increase in BPR profitability as measured by ROA. In the OJK assessment, high governance quality should reflect good management discipline in risk management and financial stability, where banks with a composite value between 1.0 and less than 1.8 are considered very good, and banks with a value above 4.2 are considered poor. However, in BPRs that have limited capital and more local customer coverage, improving governance quality does not necessarily have a direct impact on profitability. Recent research by Chen, Lu, and Sougiannis (2022) found that good governance does increase stakeholder trust, but its direct impact on ROA is mainly seen in large banks operating in broader and more complex markets, compared to smaller, simpler banks such as BPRs.

**InfluenceCredit Risk RatioTowards Profitability (ROA)**

The research that has been conducted proves that Credit Risk has a significant negative effect on profitability (ROA). The t-count value is known to be -7.485> (-1.96) with a Siq value. 0.000 < 0.10 which means it is significantly negative. When Credit Risk increases, it will be followed by a decrease in profitability (ROA) at the Rural banks (BPR) headquartered in the Kalimantan Island region in the financial report period from 2016 to 2023. The negative impact of credit risk on profitability is in line with findings in banking research, where high credit risk tends to reduce profits due to increased bad debt burden and loss reserves. For example, research by Chen, Lu, and Sougiannis (2022) observed that credit risk significantly limits banks' ability to generate stable profitability, as banks must set aside more loan loss reserves, which reduces investable resources. In the context of BPRs operating in local markets, increased credit risk hampers liquidity and creates pressure on operating cash flow, which ultimately reduces profitability. Overall, these findings underscore the importance of effective credit risk management to maintain BPR profitability. In a risky economic environment, banks need to enhance their credit management capacity to prevent negative impacts on profitability and ensure financial resilience.

**InfluenceCore CapitalOn Profitability (ROA) in Mediation byCredit Risk**

The results of the research that has been conducted show that Credit Risk can mediate the influenceCore Capitalon profitability (ROA) at Bank Perekonomian Rakyat (BPR) headquartered in the Kalimantan Island region in the financial report period from 2016 to 2023. These results provide the meaning that increasing core capital can reduce BPR credit risk, then reducing credit risk will increase profitability. It is known that the Sobel test t-test value is 2.893> (1.652) with a Siq value. 0.0038 <0.10 which means it is significantly positive. When credit risk is used as a mediating variable, it will be able to increase profitability (ROA) at Bank Perekonomian Rakyat (BPR).

Core Capital has a significant direct influence on Profitability, while also showing an indirect influence through Credit Risk which is also significant.This finding indicates the existence of partial mediation, where Credit Risk acts as a partial mediator that strengthens the relationship between Core Capital and Profitability. Theoretically, this partial mediation suggests that Core Capital not only affects Profitability directly, but also contributes through the role of Credit Risk as an intermediary mechanism. In other words, although Core Capital has the ability to increase profitability directly, improvements in Credit Risk can further optimize the impact. This approach is in line with the mediation model proposed by Baron and Kenny (1986), which asserts that partial mediation occurs when the direct effect remains significant, although there is an indirect path of influence through the mediating variable. The findings of this study are supported by the findings ofKuncoro and Suhardjono (2002) stated that credit risk is one aspect that contributes to overall bank profitability. On the other hand, when the bank's non-performing loan (NPL) ratio decreases, the bank's profitability will increase, which is reflected in the increase in ROA (Olweny, 2015), Dewi et al. (2015) and Bhattarai (2017).

**InfluenceQuality of Governance ImplementationOn Profitability (ROA) in Mediation byCredit Risk**

Research that has been conducted proves that Credit Risk can mediate the influenceQuality of Governance Implementationon profitability (ROA) at Bank Perekonomian Rakyat (BPR) headquartered in the Kalimantan Island region in the financial report period from 2016 to 2023. It is known that the Sobel test t-test value is -1.678> (-1.652) with a Siq value. 0.093 <0.10, which means it has a significant effect. The results of this study provide meaning that increasing the quality of governance implementation as indicated by a decrease in the composite value of governance will be able to reduce credit risk which will then increase profitability.

The direct effect of Governance Implementation Quality on Profitability is not significant, while the indirect effect through Credit Risk is significant. This indicates that the relationship between Governance Implementation Quality and Profitability is fully mediated by Credit Risk, so it is included in the full mediation category. In other words, Governance Implementation Quality has no direct effect on Profitability. However, governance that affects the reduction of credit risk, which will be able to increase profitability. The decrease in credit risk, due to the increase in the quality of governance, is an important cause of increased profitability.Credit Risk acts as the main mechanism that mediates the impact of Governance Implementation Quality on Profitability, so that the relationship between these two variables can only be significantly explained through this mediation pathway.

In addition, this study also shows that the Credit Risk variable functions as a channel connecting the Quality of Governance Implementation with profitability. In other words, although the Quality of Governance Implementation itself plays an important role, its effect on profitability will be more significant if credit risk is managed well. This finding is relevant to previous literature that underlines the importance of risk management in improving the financial performance of the banking sector (Shin, 2018; Wang & Wu, 2019).

## RESEARCH LIMITATIONS

This study has several research limitations as follows.

1. Based on the results of the classical assumption test, it is suspected that due to the unevenness of the data, there are problems with data Normality and Heteroscedasticity, so that outliers are carried out on the research data from a total of 408 data, then there are 82 outlier data. So that the data processed is 326 data.
2. The results of this study only apply to Bank Perekonomian Rakyat (BPR) headquartered in the Kalimantan Island region, so the results obtained cannot be generalized to all BPRs in Indonesia. Regional characteristics and differences in policies implemented by BPRs in other areas may affect different results.
3. This study uses a composite rating from OJK to measure the quality of governance implementation. Although this rating provides a good picture, the measurement may not fully cover all dimensions of governance, such as operational transparency, management ethics, or employee satisfaction.

## FUTURE RESEARCH AGENDA

Referring to the limitations of researchers for future research activities that need to be considered include:

1. Further research may consider expanding the scope to other regions in Indonesia, or even to cover all BPRs in Indonesia. This can provide a more representative picture and allow for comparisons between regions with different policies and economic conditions.
2. This study only considers several internal factors such as core capital, governance quality, and credit risk in its analysis. For future research, it is recommended to include external factors that may affect BPR performance, such as macroeconomic conditions, changes in regulatory policies, and broader market factors.

## CONCLUSION

From the results of research on the influence of Core Capital, Quality of Governance Implementation on profitability with Credit Risk as a mediating variable, the following conclusions can be drawn. This study found that core capital has a significant effect on the profitability (ROA) of Rural Banks (BPR) in Kalimantan Island during the period 2016–2023. Higher core capital helps reduce credit risk, provides financial protection, and supports operational efficiency, thereby increasing bank profitability. Meanwhile, governance quality has a significant effect on credit risk, but does not show a significant direct relationship to profitability. In addition, credit risk is proven to have a significant negative effect on profitability, indicating that increasing credit risk reduces the bank's ability to generate profits. Credit risk is also found to be a significant mediating variable in the relationship between core capital and profitability, as well as between governance quality and profitability. This shows that good credit risk management is an important key to increasing profitability, both through strengthening core capital and implementing effective governance.

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