Financial Performance Of Indonesian's Banking Industry: The Role Of Good Corporate Governance, Capital Adequacy Ratio, Non Performing Loan And Size

Nisrul Irawati, Azhar Maksum, Isfenti Sadalia, Iskandar Muda

Abstract: The implementation of Good Corporate Governance (GCG) in Indonesia has been running for 15 years since 2000. Good Corporate Governance is one of the pillars of the economic market system. GCG application provides an opportunity in creating and providing healthy completion environment and conducive investment climate. Based on this thinking, the GCG application by Indonesian banking become very important issue in order to produce economic success. This research aim is to get empirical test on GCG factors and other regulatory driven factors that is Capital Adequacy Ratio (CAR) and Non Performing Loan (NPL) and bank Size. Source of data is secondary data from 30 banking that is registered in BEI of year 2011-2015. Then using tools of analysis Eviews until the research get proceed that Capital Adequacy Ratio, Managerial Ownership and bank Size influence positive significantly on financial performance while other variable NPL has a insignificant negative effect and Committee Audit influence positive but insignificant on banking financial performance.

Keywords : Market Systems, Good Corporate Governance, bank Size, Capital Adequacy Ratio, Managerial Ownership, Non Performing Loan, Financial Performance

1. INTRODUCTION

THE implementation of Good Corporate Governance (GCG) in Indonesia has been running for 15 years with the signing of LOI (Letter Of Intent) between Indonesian government and IMF (International Monetary Fund) due to the economic crisis in 1997. The economic crisis that hit Indonesia caused by the economic crisis in Asia. One of the causes is the failure of GCG implementation so that the economic crisis hit Asia and Latin America. (Daniri, 2005). Then, Indonesian Government establish a special institution handling GCG policy based on the decision of the minister of state coordinator of economy, finance and industry No. KEP-31/M.EKUIN/06/2000. Banks as an institution play a role not only determine the size of economic development but also the social development and political development in a country so that the performance of the Bank will be generally evaluated by many parties, among others, investors, government. If the bank is experiencing liquidity difficulties due to mismanagement may result in loss of public confidence in the bank concerned. Measuring the mismanagement of a bank can be seen from the financial performance.

- *Nisrul Irawati, Department of Management, Faculty of Economic and Business, Universitas Sumatera Utara, Medan, Indonesia. Email : nisrul@usu.ac.id*
- *Azhar Maksum, Department of Accounting, Faculty of Economic and Business, Universitas Sumatera Utara, Medan, Indonesia. Email : azhar@usu.ac.id*
- *Isfenti Sadalia, Department of Management, Faculty of Economic and Business, Universitas Sumatera Utara, Medan, Indonesia. Email : isfenti@usu.ac.id*
- *Iskandar Muda, Department of Accounting, Faculty of Economic and Business, Universitas Sumatera Utara, Medan, Indonesia. Email : iskandar1@usu.ac.id*

Banks are financial institutions whose operational activities depend on funds entrusted by their service users or customers. The stability of a country's economy is also influenced by the health of its banking system. Without a bank institution that can collect, manage and channel funds from the people, economic sectors will not develop. Therefore, it is very important if operational management and working principles are well developed and systematic. In carrying out its duties, banks must be able to make work programs and responsibilities for each task force clearly reflecting the company's vision and mission and strategy. Therefore, it is very important for banks to choose competent workforce in accordance with their respective responsibilities. Likewise, in terms of the system of supervision and risk management, bank institutions must be able to apply high discipline to each task force with a clear and transparent system of reward and punishment. In carrying out these assessments, banks are required to fill out the GCG Self Assessment Working Paper and determine the ranking value of each criterion by comparing it with the indicators set by Bank Indonesia. The implementation of GCG is one of the tools to build customer, community and international trust which is an absolute requirement for a bank institution to develop. The bank's main product is money management services for the community, of course without full trust, the public will not want to allow a bank to save and manage the deposited funds. The GCG guidelines also continue to be reviewed and monitored by the Bank for International Settlements (BIS) so that the system used develops in accordance with technological progress and the global economic situation. In other words, the implementation of GCG will have an effect on the banking code of ethics which is an important factor in carrying out daily bank operations.

2. LITERATURE REVIEW

2.1. Good corporate Governance (GCG).

The paradigm of "good governance" is based on agency theory (Jensen and Meckling 1976).Consistent with agency theory, "good governance implies the use of "good governance" mechanisms that focus primarily on managing managerial decision making. Good corporate governance (GCG) is definitively a system that regulates and controls companies that create value added for all stakeholders (Monks, 2003). One of GCG system is the equity ownership structure. The equity ownership structure is the foundation in the corporate governance problem. The structure of equity helps in deciding the company's decision making and incentive mechanism, which affects the company behavior as well as business performance. According to Lee (2008) ownership structure to be an internal mechanism of corporate governance. Ownership structure can be divided as public ownership, private ownership, institutional ownership, managerial ownership. The influence of managerial ownership on firms' value is related to the perspective that firms' value depends on the distribution of ownership between managers and other owners, first underlined by the Berle and Means (1932) and Jensen and Meckling (1976). Within this contest and the so-called 'incentive argument', giving managers corporate shares makes them behave like shareholders. When the managers become owners, manager concentrate on the maximization of the cash flow in order to gain an opportunity to expropriate the corporate fund in producing profit on their own behalf. Berle and Means (1932) emphasize that potential conflicts of interest arise between manager and dispersed shareholder, when manager do not have an ownership interest in the firm. This statement support by Jensen and Meckling (1976) that suggest that as managers own the firm more, the managers are less likely to divert resources away from value maximization, as a result the firm performance is predicted to increase with the managerial ownership. To be an effective corporate governance, the company should have several pillars which is the central pillar is the audit committee. The audit committee is in the best position to offer effective oversight of the performance, independence and objectivity of the auditor and the quality of the audit. Empirically, several researches have found that audit committee play an effective role in enhancing the corporate governance standards. The role of audit committee can increasing a more reliable financial reporting (Mc Mullen & Raghunandan,1996 and Sadalia et al., 2017). The audit committee presence in the process of producing financial data and its internal control in the company, so that the audit committee existence is in producing high quality financial reporting. In 2006, Bank Indonesia as a central bank embarked on a step towards realizing Good Corporate Governance (GCG) in the banking environment, particularly Commercial Banks by issuing Bank Indonesia Regulation n0.8 /4/PBI/2006 on the Implementation of GCG for Commercial Banks. Then refined by BI regulation no.8/m/PBI/2006. The implementation of GCG for Commercial Banks is considered very important because GCG is used as the implementation of high risk banking activities so that the performance of banking activities should be based on consistency, transparency, accountability, independence and equity and fairness.

2.2. Financial Performance

Performance is the result of overall operations and organizational strategy. Measuring performance accurately is very important and become the center of attention for every organization. In an organization there are two groups: one group is the owner and the other group is the management (manager). The existence of separation of owner and management in a company require existence of clarity function of management. Management is required to provide periodic reports to the owners of shareholders. Management should provide clarity of their actions and use of company assets and resources. Although the report can be in various forms but the most dependable is financial report. The annual report of finance provides the clarity information needed for shareholders to evaluate the performance of the company and the board of directors. According to Gilbert (1984) the appropriate measure of banking performance is profitability.

2.3. Non Performing Loan

One of risk management indicators in banking industry is Non Performing Loan (NPL). NPLs provide valuation information on capital, profitability, credit risk, market risk and liquidation. NPL is used to assess the quality of banking assets which is an indication of a problem in a bank which if not immediately get a solution will have a negative impact on that bank. According to Greuning and Bratanovic (2003) credit risk is the most common cause of nonperforming loans and bank failures, causing virtually all regulatory authorities to prescribe minimum standards for credit risk management. Bank Indonesia as the central bank issuing Bank Indonesia Regulation no.17/11/PBI/2015 that said every conventional commercial bank in Indonesia must have a NPL <5%.

2.4. Capital Adequacy

Bank as a company needs to be assessed health with the aim of knowing the real condition of the bank whether in good health, ill health or illness. Based on the assessment of the health of a bank, it can be seen from the performance of the bank (Kasmir, 2004). The measurement of Bank health used is Capital Adequacy Ratio. Capital Adequacy Ratio (CAR) is the adequacy of bank equity capital to cover unexpected circumstances. The CAR describes the bank's ability to withstand losses or face financial risks (Syahyunan et al., 2017). The CAR limit is determined by the government of a State in which the bank operates which indicates the health of the banking system should be viewed from its capital. A bank with a high CAR will have a higher power to deal with financial risks. According to Bank Indonesia Circular Letter No. 15/11/DPNP dated April 8, 2013, Bank Indonesia stipulates that the Capital Adequacy Ratio at Commercial Bank is at least 8%.

2.5. Size

The Size of a company can determine by its total asset. Total asset indicate how much money the company has and how much money the company invested in the things that make more money. Larger firms expected to perform better because of the advantage of economy of scale

(Klapper & Love, 2004). Furthermore, larger firms would be able to adopt good practices stemming from the huge resource at hands.

3. METHODS

The sample used by researcher in this research is determined by using purposive sampling technique, that is sample determination technique with certain consideration. (Palys, 2008). The considerations determined by the researcher are as follows:

1. Banks are listed continuously listing on BEI in 2011 until 2015.
2. Having a Financial Statement audited by a Public Accountant published and opinion obtained is unqualified opinion.

This research uses secondary data with time series data type over 5 year period from 2011 until 2015. The data used in this research is taken from several sources between sourced from Indonesia Stock Exchange (BEI) with address www website. idx.co.id and Indonesia Capital Market Directory (ICMD). Data analysis method used to test the hypothesis in this study is

$$Y\ (ROA) = \alpha + b_2x_1 + b_2x_2 + b_2x_3 + b_2x_4 + b_2x_5 + e$$

Whereas: Y = Return On Asset
x_1 = Capital Adequacy Ratio
x_2 = Non Performing Loan
x_3 = Managerial Ownership
x_4 = Audit Committee
x_5 = Size

4. RESULT AND DISCUSSION

4.1. Result

Based on the test results, there are in the following Table 1 :

TABLE 1. *REGRESSION RESULT ROA*

Dependent Variable: ROA
Method: Panel Least Squares
Sample: 2011 2015
Periods included: 5
Cross-sections included: 29
Total panel (balanced) observations: 145

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-4.132968	2.243630	-1.842090	0.0679
CAR	0.099042	0.047227	2.097127	0.0381
NPL	-0.116572	0.064927	1.795418	0.7510
MGR OWN	0.006533	0.003259	2.004528	0.0473
AUDIT COMITTE	0.063878	0.271373	0.235390	0.8143
SIZE	0.205489	0.086141	2.385505	0.0186

R-squared	0.125964	Mean dependent var	2.347310
Adjusted R-squared	0.089545	S.D. dependent var	3.440707
S.E. of regression	3.283045	Akaike info criterion	5.261868
Sum squared resid	1293.406	Schwarz criterion	5.396929
Log likelihood	-325.4977	Hannan-Quinn criter.	5.316739
F-statistic	3.458812	Durbin-Watson stat	0.830855
Prob(F-statistic)	0.005901		

Source: *Research Calculation (2017)*

The equations produced are as follows:
ROA = -4.132968 + 0.099042 CAR -0.116572 NPL + 0.006533 Man Own +0.063878 Au.Com+ 0.205489 Size

From this equation means:

1. If there is no CAR, NPL, Managerial Ownership, Audit Committee and Size then ROA becomes - 4.132968.
2. If the CAR value increases 1unit while the other variable is fixed then the ROA value increases 0.099042.
3. If the value of NPL increased 1 unit then the value of ROA decreased 0.116572.
4. If the value of Managerial Ownership increases 1 then the value of ROA increases 0.006533.
5. If the Audit Committee value increases 1 then the ROA value increases 0.063878.
6. If the value of Size increases 1 unit then the value of ROA increases 0.205489.

From the regression result can known that variable of Capital Adequacy Ratio, Managerial Ownership and Size have positive and significant influence on financial performance, while other variables audit Committee has positive influence but not significant to financial performance. The result of Capital Adequacy Ratio has positive and significant influence on financial performance supported empirically by O, Agbeja et al, 2015. This condition suggest that the bank with more capital equity perceived to have more strength in facing financial risk and therefore can be more produce profitability.

4.2. Discussion

The managerial Ownership also has a positive significant influence on financial performance. This finding not supported by Himmerberg et al, 1999 because they cannot conclude econometrically that the changes in managerial ownership affect firm performance. Whereas, Ongore (2011), Uchida (2008) found that managerial ownership has significant positive relations with firm performance. Zakaria, Purhanudin and Palanimally (2014) examined ownership structure and firms' performance of Malaysian Trading and Service Sector for the period of six years 2005 to 2010. Their study revealed a positive significant impact between managerial shareholding and firm's performance. Then, the bank size has positive and significant influence on financial performance was supported by the research done by Chege (2017) in Kenya but on the contrary to the finding of Kagecha (2014) that show bank size doesn't matter toward financial performance of bank. Meanwhile NPL has a negative effect but insignificant on the financial performance. This NPL result contrary empirically by the research of Ugoani, 2016 but supported by Nursiana (2017). The Determinant Coefficient (R squared) is used to measure the proportion or percentage of model capability in explaining the dependent variable. R = 0.125964 which means the relationship of GCG characteristics consist of managerial ownership and audit committee combined with CAR and NPL factors as the dependent variables to financial performance is 12.5964%. The rest of 87.4036% can be explained by another variables not examined in this study. The application of the principles of Good Corporate Governance is a necessity for an institution, including financial institutions such as banks Banks are responsible to many parties (stakeholders), namely depositing customers, shareholders, bond investors, correspondent banks, regulators, employees, suppliers, society, and the environment, so that the implementation of GCG is a necessity for Islamic banks. The implementation of GCG is a form of accountability to the public that the Shari'ah bank is managed well, professionally and carefully while still trying to increase shareholder value without ignoring the interests of other stakeholders. Thus, the application of GCG principles in a company's operations, especially those engaged in finance such as banks, is very important. Because in its operations, bankers are required to always implement the principle of bank prudence in providing financial services and services to the public. Bank Indonesia as the holder of the banking authority must be able to carry out assessments and actions against the implementation of bank GCG. Banks are required to implement the principles of GCG in each of their business activities at all levels or levels of the organization including when preparing their vision, mission, strategic plans, implementing policies and internal supervision measures.

5. CONCLUSION AND RECOMMENDATION

Capital Adequacy Ratio, Managerial Ownership and Size Variable have positive influence and significantly on financial performance, while other variables that is Audit Committee have positive but not significant influence on financial performance. The CAR has positive influence on financial performance suggest that the bank with more capital equity should have more advantage in managing its operation in facing financial risk. The managerial ownership also has positive influence and significantly on financial performance. This finding suggest that as the managers own the firm more, the managers are less likely to draw away firm resources from value maximization. If the firm has more resources to use, the increase in firm performance is expected. The variable Bank Size being positively influence in financial performance suggest that an increasing in bank size leads to an increase in bank profitability. The bigger the bank size make the bank get more competitive advantage in facing the competition because the bank have relatively high capital to respond to the competition. In addition, this research revealed that Non Performing Loan even though has an influence on financial performance in negative way but insignificantly. It means that if Non Performing Loan getting bigger, it will direct the financial performance to decline. However, the influence is not significant since Bank Indonesia as the Central Bank continuously control the NPL condition of every bank in Indonesia regularly in short period of time so that there is a little likelihood that a bank will experience NPL bigger than its regulated. This research model can be developed further by considering other factors in risk managerial factors and also consider other factors that exist in good corporate governance and other factors that are within the organization factors. The government is advised to develop banking policies that can further control the banking industry which is an important element for the economy of the State as well as to protect the users of bank services that are banking customers.

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