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Financial Performance of Banking Institutions: The Role of Management Ownership, Independent Commissioners, and Audit Committee

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Abstract

This research examines the impact of implementing effective corporate governance practices on the financial performance of banking firms publicly traded on the Indonesia Stock Exchange (IDX). The study focuses on banking businesses listed on the Indonesia Stock Exchange, including the population for analysis. A purposive sampling method was employed to select eight banking companies for the study. The utilized data source comprises secondary data consisting of annual report information about banking institutions. The employed data analysis methodology involves the application of the classical assumption test, which encompasses a normality test, a heteroscedasticity test, and a multicollinearity test. Additionally, all hypotheses are examined by partial, simultaneous, and determination coefficient tests. This study's findings suggest a favorable relationship between managerial ownership and independent commissioners; however, this relationship does not significantly impact financial performance. The audit committee has a notable and substantial impact on the financial performance of banking firms publicly traded on the Indonesia Stock Exchange (IDX).

Keywords: Financial Performance; Independent Commissioners; Management Ownership; Audit Commitee

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Introduction

Globalization has profoundly impacted various dimensions of society, encompassing culture, politics, and economics. This phenomenon significantly impacts the global economy, with countries such as Indonesia being particularly impacted. Hence, it is imperative to implement robust governance principles across all sectors of the national economy. Within this context, the examination of the banking crisis that occurred in the latter part of 1997 serves as a pertinent case study, showcasing that the necessary modifications are confined to the reaction toward the issue at hand, as well as the maintenance of the principles about Good Corporate Governance (GCG) and ethical conduct. The effectiveness of endeavors to restructure and recapitalize the banking industry will be contingent upon the simultaneous observance of prudential principles, authentic execution of good corporate governance (GCG), and sufficient oversight by the Bank Supervisory Authority. The performance of good corporate governance (GCG) plays a pivotal role in establishing public trust and fostering connections on the global platform, hence facilitating the sustainable development of the banking industry. It is widely acknowledged that weak corporate governance practices in the Indonesian banking sector have reduced unfavorable occurrences, such as inadequate transparency in performance, insufficient scrutiny of management by boards and auditors, and a dearth of external leadership that fosters fair competition. These vulnerabilities have contributed to several financial scandals, necessitating corporate solid governance enforcement measures (Sarafina & Saifi, 2017). The establishment and execution of a robust corporate governance framework is necessary to foster sustainable expansion and instill trust within the Indonesian banking industry.

Within the framework of the evolution of the banking sector, internal enhancements assume a crucial function, with the adoption of Good Corporate Governance (GCG) principles serving as a robust basis for judicious and proficient company conduct. Good corporate governance (GCG) entails the implementation of self-regulatory mechanisms that guide the behavior of management and employees by principles of professionalism, business ethics, accountability, and transparency. The significance of this matter is particularly evident when considering instances of fraud in Indonesia, akin to the notable Barings Bank affair that occurred in Singapore. Consequently, the primary factors contributing to the situation were the absence of a fair allocation of duties, inadequate internal control measures, and insufficient oversight from upper management. Likewise, in instances of financial misconduct, such as the incidents observed at Citibank and Bank Mega, it is evident that the delegation of excessive power to specific individuals, namely the Relationship Manager at Citibank and the Branch Manager in Jababeka at Bank Mega, contributed to the substantial financial losses amounting to hundreds of billions of dollars for the customers involved. Banks can mitigate these risks by sincerely implementing good corporate governance (GCG) principles, enhancing internal governance structures, and refraining from engaging in violations that detrimentally impact all stakeholders.

Implementing Good Corporate Governance (GCG) principles is widely seen as having the capacity to enhance firm performance and value. This perspective is evident in including corporate governance rules in nearly all countries. The Dey Report, referenced in the scholarly work of Salafudin (2016), provides evidence supporting the notion that implementing robust corporate governance practices can positively impact company performance and yield advantages for shareholders in the long run. The enhanced performance yields advantages not only for shareholders but also for the broader public. Steinberg & Bromilow, (2000) concur that establishing effective corporate governance inside a corporation necessitates the formulation and execution of measurable strategies and plans over time. Implementing a well-defined plan facilitates the board of directors' ability to monitor the company's performance constantly. Various corporate governance systems have been identified as potential solutions to agency difficulties. These mechanisms include management ownership, institutional ownership, independent commissioners, and audit committees (Hayati & Gusnardi, 2012). Given their incentive to improve corporate performance, managers with a higher percentage of shares are likely to engage in shareholder-oriented behavior. In corporate governance, there is a prevailing notion that institutions' appeals to curtail earnings management tactics stem from their perceived status as knowledgeable investors capable of effectively monitoring managerial activities. This, in turn, diminishes the motivation for managers to engage in such practices (El-Haq et al., 2019). Therefore, implementing GCG can enhance firm performance and foster increased stakeholder trust.

The configuration of the board of commissioners is a determinant factor associated with the caliber of earnings information within an organization. The board's makeup influences the financial statement preparation process, impacting the quality of earnings reports (Anggraeni & Hadiprajitno, 2018). The audit committee plays a crucial and strategic role in upholding the integrity of the financial statement preparation process and implementing effective corporate governance practices. According to R. et al. (2000), the proper functioning of the audit committee leads to enhanced oversight within the company, reducing the potential adverse effects of agency conflicts that may arise due to management's self-interest in pursuing personal financial gains.

Tjager (2003) asserts that State-Owned Enterprises (SOEs) frequently exhibit suboptimal financial performance due to inefficient capital utilization and a failure to adhere to the tenets of effective corporate governance. Every corporation's distinct vision and mission are the fundamental principles underlying its establishment and operation. The attainment of these objectives necessitates the formulation and execution of meticulous strategies and initiatives, which can be realized through establishing and implementing a robust corporate governance framework. Furthermore, effective collaboration among diverse stakeholders, particularly employees and senior executives, is crucial. The effective functioning of a governance system necessitates incorporating sound corporate governance (GCG) principles into managerial practices. By adhering to these generally applicable principles, the organization has the potential to achieve sustainability and deliver advantages to all stakeholders.

According to Sari (2010), throughout the specified time frame, the utilization of

Economic Value Added (EVA) by both local and foreign investors was limited, and there was no substantial association observed between EVA and Market Value Added (MVA) in companies listed on the Jakarta Stock Exchange (BEJ). The potential cause of this issue could be attributed to the need for more ability of the Indonesian capital market to incorporate and disseminate information effectively. According to the findings of Agustina (2019), it was observed that implementing effective corporate governance procedures favorably impacts a company's financial performance. In this scenario, it is seen that organizations that exhibit superior governance processes generally show excellent performance. The findings of Sujana's (2015) study indicate no statistically significant impact of variables such as management ownership, board size, and share of independent commissioners on the financial performance of Rural Banks (BPR).

According to the findings of Kumaat's (2018) study, the composition of a board that includes independent commissioners and a shared ownership structure has been shown to have a good impact on financial performance. Conversely, the presence of management ownership tends to have a detrimental effect. According to a study conducted by Suryanto Refianto, (2019) it was found that the implementation of Good Corporate Governance (GCG) practices has a significant positive impact on financial performance indicators such as Capital Adequacy Ratio (CAR), Return on Assets (ROA), Return on Equity (ROE), and Financing to Deposit Ratio (FDR). However, it was also observed that GCG practices significantly negatively affect financial performance regarding Operating Costs to Operating Income (BOPO). Several study findings presented in this discourse provide a diverse portrayal and viewpoint about the correlation between different elements and the performance of firms. Additionally, these findings shed light on the influence of market conditions and corporate governance procedures on business performance.

A company's performance is indicative of its ability to attain objectives through the execution of actions that demonstrate the advancement of the business. One of the primary aims of starting a corporation is to enhance shareholder wealth and augment the organization's value (Brigham & Houston, 2015). Yulianawati (2016) asserts that a firm's financial performance may be assessed by examining its financial state using various financial analysis methods. These techniques provide insights into the company's operational effectiveness over a specific timeframe. This analysis facilitates the determination of the company's financial performance, indicating its positive or negative state within a specific period.

Moreover, firm performance encompasses the outcomes and accomplishments generated by the organization during a designated timeframe, as measured against predetermined criteria. This performance assessment aims to evaluate the outcomes derived from the study to inform future decision-making processes (Buallay et al., 2017). Financial performance analysis allows for identifying the company's financial status, profitability, and capacity to meet both short-term and long-term obligations. Adopting effective corporate governance practices is anticipated to facilitate the formation of a more resilient economy for enterprises, enabling them to navigate intricate problems and competition. The use of Good Corporate Governance (GCG) principles in a consistent manner yields favorable outcomes for companies, notably in terms of attracting both domestic and foreign investors. This advantage, in turn, facilitates the company's ability to enhance its future commercial prospects using additional investments or project expansions, thereby fostering sustainable growth of the organization.

The Study by Hardikasari (2011) examined how corporate governance transparency affected the financial performance of manufacturing companies publicly listed on the Indonesia Stock Exchange (IDX) from 2009 to 2011. This research examines the impact of exemplary corporate governance implementation on the financial performance of banking firms publicly listed on the Indonesia Stock Exchange. Given the variations among industrial sectors and research timeframes, this study anticipates offering novel and pertinent perspectives on the significance of effective governance within the banking sector. The present study aims to offer a comprehensive analysis of the correlation between effective governance procedures and financial performance within the specialized banking sector.

Managerial ownership is defined as the proportion of shares held by the management team about the overall share capital of the company. The often-employed metric for assessing managerial ownership is the proportion of shares held by management about the overall number of shares issued. Dewi & Nugrahanti, (2016) posits that managerial ownership encompasses shares held by individual members of management, either directly or indirectly through subsidiaries and affiliates. According to a study by Eldenburg et al., (2014), an inverse relationship exists between the proportion of managerial ownership and the integrity of financial statements. Furthermore, this relationship could impact a firm's overall success. This phenomenon can be attributed to inherent human tendencies towards self-interest, motivating managers to manipulate financial reports to present a more favorable depiction of the company's performance to stakeholders. In the given situation, it is seen that managers may exhibit opportunistic behavior, wherein they tend to prioritize their interests (Savero et al., 2017). The propensity for seizing opportunities prompts managers to engage in earning management within the context of financial reporting. Due to their extensive knowledge of the company's internal affairs and prospects, individuals can strategically manipulate earnings to influence the outcomes reflected in financial statements. The study conducted by Xie et al., (2003) indicates that management ownership has the potential to serve as a motivating factor for enhancing firm performance. This pertains to the correlation between the rise in profitability and substantial value and the ownership of shares by managers. The purpose of managerial ownership is to enhance managers' motivations to improve the firm's overall performance.

H1: Managerial ownership positively affect the performance of banking companies.

Independent commissioners are essential in counterbalancing the corporate decision-making process (Riniati, 2015). This function encompasses safeguards for minority shareholders as well as affiliated entities of the corporation. The presence of independent commissioners serves the purpose of safeguarding the inclusive consideration of all stakeholders' interests in a firm's decision-making process. According to Savero (2017), independent commissioners are external individuals responsible for comprehensively assessing the company's performance. This position guarantees that the company's performance is evaluated impartially and autonomously, free from any internal conflicts of interest. Including independent commissioners is vital to effectively implementing sound corporate governance principles, as they play a crucial role in overseeing and regulating organizational activities. Based on Beasley's study conducted in 1996, the inclusion of independent commissioners within the board of commissioners has been shown to enhance the efficacy of managerial oversight, particularly in deterring fraudulent activities about financial reporting. Implementing independent commissioners within a corporation instills a sense of assurance that the financial statements put forth by management possess a high level of integrity. The presence of autonomous commissioners ensures oversight and safeguards external stakeholders' rights from any infringements by corporate executives. Numerous scholarly investigations, exemplified by Fadillah's (2017) research, substantiate that including autonomous commissioners within a firm might yield advantageous outcomes for its performance. Contrarily, Yulianawati (2016) asserts that the impact of independent commissioners on a firm's financial performance may occasionally exhibit significance while also serving as a mere procedural requirement to comply with regulations.

H2: Independent commissioners positively affect the performance of banking companies.

The audit committee plays a crucial role in the execution of supervision and control functions related to corporate governance. According to Savero et al. (2017), the audit committee bears the responsibility of ensuring adherence to generally accepted accounting principles in the presentation of financial statements, the establishment of sufficient internal controls, the arrangement of internal and external audits by relevant standards, and the execution of management-led actions in response to audit findings. The audit committee functions as an integral component of the Board of Commissioners, providing support in the execution of supervisory responsibilities. When the audit committee fulfills its responsibilities with efficacy, it enhances the supervisory role over the company, resulting in a strengthened impact on company performance, particularly within the banking sector. The study by Leonardo (2016) provides empirical evidence about the influence of audit committee composition and corporate management control on the effectiveness of audit committees. This study examines additional factors that have a substantial impact on the role of the audit committee. These elements include the degree of control the Board of Commissioners exercises, the existence of independent commissioner representatives on the Board of Commissioners, and the length of the audit committee's tenure. The Sitanggang (2021) study emphasizes the possibility of the audit committee's involvement in enhancing the organization's financial performance. This statement underscores the crucial function of the audit committee in upholding transparency, accountability, and integrity inside a company. Through adequate supervision and control, the committee plays a significant role in influencing company performance and fostering stakeholder trust.

H_3: The audit committee positively affect the performance of banking companies.

Research Design and Method

The primary objective of this study is to examine the banking firms publicly listed on the Indonesia Stock Exchange from 2019 to 2022. The population under investigation consists of a total of 49 banking companies. The employed sampling technique is purposive sampling, which involves deliberately selecting samples based on preset criteria. The criteria encompass the successive listing of banking businesses for four years, the provision of financial reports for the fiscal year ending on December 31, and the fulfillment of further stipulated prerequisites. Based on the specified criteria, eight banking companies were selected as samples. The study utilizes secondary data sourced from the annual reports of banking companies. This dataset encompasses various aspects of corporate governance, such as managerial ownership, the presence of independent commissioners and audit committees, as well as financial metrics, including Return on Equity (ROE) and total assets.

The process of data analysis involves the implementation of multiple stages of testing. The first phase consists of a descriptive study, which presents a comprehensive summary of the acquired data's attributes. The subsequent step involves conducting a series of classical assumption tests. These tests encompass the normality test, which assesses the normal distribution of the data; the multicollinearity test, which examines the presence of multicollinearity among independent variables; and the heteroscedasticity test, which evaluates the company of heteroscedasticity within the data. The subsequent phase involves conducting tests on the hypotheses put forward in this research. This entails conducting a partial test to assess the impact of each independent variable on the dependent variable, a simultaneous test to evaluate the collective influence of all independent variables on the dependent variable, and a coefficient of determination test to quantify the extent to which the independent variables account for the variation observed in the dependent variable.

Table 1. Sample Company List

No	Company Code	Company Name
1	INPC	Bank Artha Graha Internasional, Tbk.
2	SDRA	Bank Woori Saudara Indonesia 1906 Tbk
3	BMRI	Bank Mandiri (Persero) Tbk.
4	BBNP	Bank Nusantara Parahyangan Tbk
5	PNBN	Bank Panin Syariah Tbk
6	BKSW	Bank QNB Kesawan Tbk.
7	BBRI	Bank Rakyat Indonesia (Persero) Tbk.
8	BVIC	Bank Victoria International Tbk.

Table 2. Operational Variables

Variable	Indicator	Reference
Managerial Ownership	$MANJ = \frac{\text{shares owned by directors and commissioners}}{\text{total shares outstanding}} \times 100\%$	(Savero et al., 2017)
Independent commissioners	$INDEP = \frac{\text{number of independent commissioners}}{\text{number of board of commissioners members}} \times 100\%$	(Putra, 2015)
The audit committee	KA = Total Audit Committee Members	(Widyati, 2018)
Return On Equity	$ROE = \frac{EAT}{\text{Total Equity}} \times 100$	(Safitri, 2018)

Results and Discussion

Statistical Result & Discussion

The normality test aims to test whether the regression model, dependent and independent variables both have a normal distribution or not using the Normal Probability Plot of Regression Standardized Residual if the distribution of the plot is around and along the line or follows the diagonal line; then the regression model meets the normality assumption.

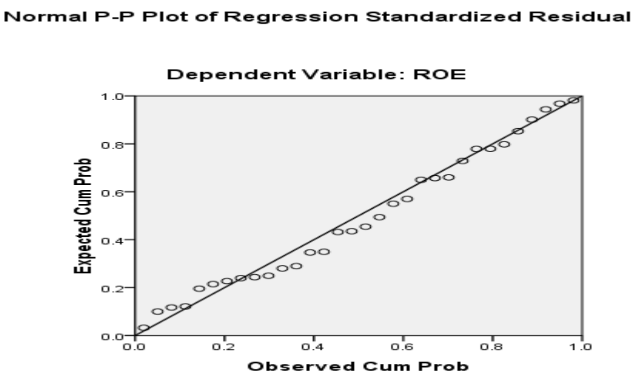

Figure 1. Normal P-P Plot

Based on Figure 1, the normal plot graph shows that the points spread around the diagonal line and the distribution follows the direction of the diagonal line, and the data looks evenly distributed and quite good. The regression model fulfills the normality assumption, meaning the data is normally distributed.

Table 3. Kolmogorov Smirnov Test Result

		Unstandardized Residual
N		32
Normal Parameters[a]	Mean	.0000000
	Std. Deviation	5.93683323
Most Extreme Differences	Absolute	.097
	Positive	.097
	Negative	-.058
Kolmogorov-Smirnov Z		.542
Asymp. Sig. (2-tailed)		.932

In Table 3, the result of the Komolgorov-Smirnov test, the Komolgorov-Smirnov value is 0.542 with a significance of 0.932. Thus, the regression model used has a standard data distribution because it is more significant than 0.05. Furthermore, a multicollinearity test is carried out to detect the presence or absence of multicollinearity in the regression model by looking at the relationship between the independent variables as indicated by the Tolerance and Variance Inflation Factor (VIF) numbers.

Table 4. Multicollinearity Test Results

Model		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	MANJ	.709	1.420
	INDP	.909	1.107
	AUDT	.757	1.329

Based on the test results shown in Table 4, there is no multicollinearity because the Tolerance value is > 0.10 and the VIF value < 10, so it can be concluded that in this regression model, there is no multicollinearity. Furthermore, the heteroscedasticity test is carried out to determine whether the variables are homogeneous) or heterogeneous). To detect the presence or absence of heteroscedasticity by looking at the scatterplot graph. Heteroscedasticity occurs if the image shows the dots spreading above and below zero on the Y-axis.

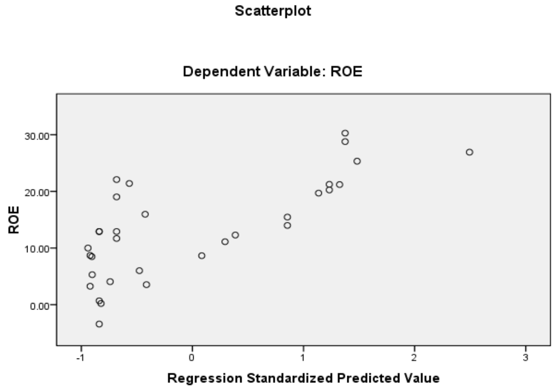

Figure 2. Scatterplot Graph

Based on Figure 2, it can be seen that the data (dots) spread evenly above and below the zero line, do not gather in one place, and do not form a specific pattern, so it can be concluded that this regression test does not occur heteroscedasticity problems. After the results of the classical assumption test are carried out, and the overall results show that the regression model meets the classical assumptions, the fourth stage is to evaluate and interpret the multiple regression model. The multiple linear regression analysis test aims to test the effect of the independent variable on the dependent variable.

Table 5. Multiple Regression Analysis Results

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-36.839	31.802		-1.158	.255		
	X1	.248	.577	.088	.430	.691	.709	1.420
	X2	7.689	7.419	.166	1.036	.308	.909	1.107
	X3	4.561	.918	.779	4.968	.000	.757	1.329

$$Y = -36.839 + 0.248X1 + 7.689X2 + 4.561X3 + e$$

The constant is -36.839, meaning that if the managerial ownership variable (X1), independent commissioner (X2), and audit committee (X3) are constant values, then the value of Y (Financial Performance) is -36.839. The regression coefficient of the managerial ownership variable (X1) is 0.248. This means that if the other variables are constant and the managerial ownership variable (X1) increases by 1 percent, the financial performance (Y) will increase by 0.248. The coefficient is positive, meaning there is a positive relationship between X1 and Y; the more X1 increases, the more financial performance increases. The regression coefficient of the independent commissioner variable (X2) is 7.689. This means that if the other independent variables remain constant and X2 increases by 1 percent, financial performance (Y) will increase by 7,689. The positive coefficient means a positive relationship between independent commissioners and financial performance; the more X2 increases, the more the resulting financial performance value increases. The regression coefficient of the audit committee variable (X3) is 4,561. This means that if the other independent variables are constant in value and X3 increases by 1 percent, the financial performance (Y) will experience an increase of 4,561. The coefficient is positive, meaning there is a positive relationship between the audit committee and financial performance; the more X3 increases, the more the resulting financial performance value increases.

The F statistical test shows whether all independent variables included in the model jointly influence the dependent variable. The basis for decision-making is F-count> F-table or less than significance. 0.05 or 5, then the independent variables together (simultaneously) significantly affect the dependent variable.

Table 6. Simultaneous Testing Result

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	1262.208	3	420.736	10.782	.000[a]
Residual	1092.66	28	39.024		
Total	2354.868	31			

Based on Table 6, managerial ownership (X1), independent commissioners (X2), and the audit committee (X3) simultaneously affect financial performance (Y). It can be proven by the F-calculated value of 10.782, which means greater than F-estimated = 10.782> 2.95 or with a significant value = 0.000 <0.05. This shows that X1, X2, and X3 significantly affect financial performance (Y). The good corporate governance variable can also be included as a dimension that significantly affects financial performance. Furthermore, the coefficient of determination analysis is used to determine the percentage of the independent variables' influence on the independent variable.

Table 7. Determination Coefficient Test Results

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.732[a]	.536	.486	6.24679	2.554

Based on Table 7, it can be seen from the R square value of 0.536, or 53.6%. Thus, Financial Performance can be explained by the three independent variables in this study by 53.6%. In contrast, other factors not accounted for in the research model account for the remaining 46.4%.

Discussion

The findings of the regression analysis conducted to test the first hypothesis indicate a positive regression coefficient between management ownership and the financial performance of banking organizations. However, the statistical test results showed that the effect was not significant. This observation suggests that the current degree of management ownership in the research sample may still need to be increased to substantially influence the financial performance of banking organizations. Managers who own shares in banking enterprises may need more power to shape strategic decisions that impact firm performance. This study's findings align with earlier research by Wiranata & Nugrahanti (2016), which concluded that managerial ownership had a positive yet statistically insignificant impact on the organization's financial performance.

The results of testing the second hypothesis indicate that the regression coefficient associated with the independent commissioner variable is positive. However, the impact of this variable on financial performance does not show statistical significance. The observed outcome may be attributed to various contributing factors. One notable finding is that the research sample suggests a requirement for greater strength in the influence of independent commissioners to affect financial performance significantly. This observation suggests that other variables or a more specific context may be necessary to establish the significance of independent commissioners in determining economic success. This finding is consistent with the research conducted by Yulianawati (2016), which demonstrates that the presence of independent commissioners has a beneficial yet statistically negligible effect on the organization's financial success.

The results of testing the third hypothesis indicate a statistically significant and positive relationship between the audit committee and financial performance. These results are consistent with the principles and responsibilities associated with the audit committee's role in promoting effective corporate governance. The audit committee plays a crucial role in safeguarding the integrity and reliability of financial statements and verifying the effectiveness of the company's internal control systems. The primary responsibility of the audit committee is to ensure the fair presentation of financial statements by relevant accounting principles. Additionally, the committee plays a crucial role in overseeing the execution of internal and external audits in compliance with applicable standards. This function holds significant importance in fostering solid financial performance. A robust audit committee can effectively mitigate the potential for errors or fraudulent activities in financial reporting, enhancing the accuracy and reliability of the presented information. These findings are consistent with the study conducted by Utama & Leonardo (2016), indicating that the makeup of the audit committee has a positive and statistically significant influence on its efficacy. This study demonstrates that various elements, including design features and shareholder control, the presence of independent commissioner representatives on the board of commissioners, and the authority wielded by the board of commissioners, can impact the efficacy of the audit committee in fulfilling its responsibilities. The findings of this research offer empirical evidence that underscores the significant impact of audit committees on enhancing the financial performance of banking institutions. The efficacy of the audit committee in overseeing and regulating the financial and accounting facets of the organization plays a pivotal role in fostering sound corporate governance, hence yielding favorable outcomes for company performance.

Conclusions

This study's findings provide a comprehensive Review of the factors that can influence the financial performance of banking institutions. Even though some relationships did not reach statistical significance, these findings provide a crucial basis for banks to optimize management ownership, independent commissioners, and the role of audit committees to improve financial performance. In addition, this study highlights the need for developing a more holistic decision-making strategy and for additional research to delve deeper into the dynamics that impact the interaction between these variables. Banks can more effectively manage their financial performance and establish a solid foundation for long-term development if they take the appropriate measures.

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