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THE EFFECT OF CREDIT RISK, BANK CAPITAL, INDEPENDENT COMMISSIONER, AND AUDIT COMMITTEE ON BANKING FINANCIAL PERFORMANCE IN INDONESIA FOR THE 2017-2021 PERIOD

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Abstract

This study examines the effect of credit risk, bank capital, independent commissioner, and audit committee on bank's financial performance. The object of this study is to conventional commercial banks listed on the Indonesia Stock Exchange (IDX) in the 2017-2021 period. The sampling method used to determine the sample is purposive sampling. Data analysis techniques are performed using panel data regression (fixed effect model). The results show that there is a negative significant effect of credit risk on the financial performance of banks calculated using Return on Asset (ROA), and there is no significant effect of credit risk on banking financial performance calculated using Net Interest Margin (NIM). Then there is a positive significant effect of bank capital and independent commissioners on the financial performance of banks calculated using Return on Asset (ROA) and Net Interest Margin (NIM). In addition, there is a positive significant effect of the audit committee on the financial performance of banks calculated using Return on Asset (ROA), and there is no significant effect of the audit committee on the financial performance of banks calculated using Net Interest Margin (NIM). The results of such research can contribute to theoretical and practical fields (banking and financial statement users, especially investors).

Keywords: Bank's financial performance, credit risk, bank capital, independent commissioner, and audit committee.

1. INTRODUCTION

Banking plays an important role in economic development in many countries, including Indonesia. The fact that the country's financial sector depends on the banking system requires great attention in ensuring its sustainability, especially from various risks that can disrupt the financial performance of banks. Financial performance assesses the ability of a bank to maximize profits on its corporate assets.(Tassew & Hailu, 2019)(Nwude & Anyalechi, 2018)

To achieve its vision, mission, and goals, banks are always required to provide credit and increase public confidence to contribute to a country's economic growth. However, these institutions in the banking sector often provide credit without accurately selecting prospective debtors to guarantee that the debtor can repay the credit or loan given along with interest. This can burden the bank's financial performance which can ultimately lead to the failure of the bank's business. Therefore, according to Chou & Buchdadi (2016), Lassoued et al. (2016), Leung et al. (2015), and Ng &; Roychowdhury (2014), to maintain the existence and role of carrying out the function of financial intermediary in economic development, in normal situations as well as in even unfavorable situations such as economic and financial crises, most banks should focus on credit risk.

The high level of bank capital increases public confidence in the bank's ability to support its performance. According to Pasaribu & Sari (2011), banks with more capital can channel available funds in business activities and generate high profits. The increase in bank lending to customers during the next period depends on the bank's capital in the current period. A well-capitalized bank will have a relatively high capacity to take credit risk and thus will be able to generate a higher increase in lending than a bank that has relatively low capital (Misra, 2019).

Good Corporate Governance (GCG) is a system used in regulating and managing an industry correctly to be in line with company goals. The results of the corporate governance ranking report in Asia by the *Asian Corporate Governance Association* show that Indonesia occupies the lowest position in terms of *corporate governance* implementation. The factor causing Indonesia's low ranking in the report is due to the low implementation of industrial governance and industrial performance in Indonesia which has yet to be maximized compared to other countries in Asia. This explanation shows that the implementation of GCG in Indonesia still requires more attention from all parties so that the implementation of GCG can be implemented by what should be (Syofyan &; Putra, 2019).

This study combines research by Saleh & Afifa (2020) with independent variables of credit risk, research by Abbas, Iqbal, & Aziz, (2019) with independent variables of bank capital, and research by PeiZhi & Ramzan (2020) with independent variables of GCG. Research by Saleh & Afifa (2020) used the population of banks listed on the *Amman Stock Exchange* from 2010-2018 with a sample number of 117. Research by Abbas, Iqbal, & Aziz (2019) used commercial bank populations in South Korea, Hong Kong, Singapore, Japan, Saudi Arabia, United Arab Emirates, Cyprus, Qatar, Brunei, and Israel with a sample number of 174. PeiZhi & Ramzan's (2020) research uses several companies listed on the *Pakistan* Stock Exchange (*Karachi Stock Exchange*) with a sample of 45 companies selected randomly. This research uses objects, years, and context problems different from previous studies, namely conventional commercial banks listed on the IDX in the 2017-2021 period. Therefore, the author compiled this study with the title "The Effect of Credit Risk, Bank Capital, Independent Commissioners, and Audit Committee on Banking Financial Performance".

Based on the background, this study aims to obtain empirical evidence: the influence of credit risk, bank capital, independent commissioners, and audit committees on bank financial performance.

2. LITERATURE REVIEW

Agency Theory

Agency theory focuses on differentiation of the functions of parties who hold shares to become owners of companies and management as agents who manage companies (Jensen &; Meckling, 1976). Company owners (principals) hire managers (agents) in managing the company and decide what can prosper shareholders. Managers are responsible for making decisions or actions without regard to personal interests/must be professional (PeiZhi & Ramzan, 2020).

Financial Performance

Company performance is an assessment of how effective and efficient a company is in achieving the goals set. The company's financial performance relates to the company's goal to maximize the profits of shareholders and company assets. While the company's operational performance is related to sales and market value (Nwude &; Anyalechi, 2018). The company's performance is influenced by the results of the work, as well as internal and external factors of the company (Agustini, 2018).

Credit Risk

Providing credit to customers has consequences or problems that may result from the customer's delay or failure to repay the principal and interest to the bank (Aliu, Ramadani, Ahmeti, Sahiti, &; Sahiti, 2017). Credit risk on non-performing loans can be measured by the *Non-Performing Loan* Net (NPL Net) ratio. If the NPL Net is greater than 5%, then a bank is considered to have the potential for difficulties that endanger its business continuity (Financial Services Authority Regulation Number 15 / POJK.03 / 2017).

Bank Capital

Several funds invested by bank owners to finance bank business or operational activities are bank capital (Hery, 2019: 166). *Capital Adequacy Ratio* (CAR) describes the ability of banks to become

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providers of funds for operational needs. The minimum level of CAR that banks must own is 8% (Article 2 Paragraph 3a of the Financial Services Authority Regulation Number 11/POJK.03/2016).

Independent Commissioner

The board of commissioners is a board that has the responsibility to supervise, direct, and guide company managers (Lukviarman, 2016: 165). Independent commissioners must ensure that supervisory activities carried out by the board of commissioners are carried out efficiently and by applicable laws (Pamungkas, Chabachib, Puspitasari, &; Hersugondo, 2021).

Audit Committee

The audit committee is a committee that has the responsibility of supervising the performance of external and internal auditors with regular supervision of the financial reporting process. The audit committee also plays a role in minimizing the manipulation of financial statements and improving the accuracy and quality of financial statements (Salehi, Tahervafaei, &; Tarighi, 2017). The audit committee has responsibilities in supervising the financial reporting system, internal control system, internal audit, and risk management (PeiZhi & Ramzan, 2020).

Hypothesis Formulation

Ha1: Credit risk has a significant negative influence on bank financial performance.
Ha2: Bank capital has a significant positive influence on bank financial performance.
Ha3: There is a significant positive influence from the independent commissioner on the financial performance of banks.
Ha4: There is a significant positive influence of the audit committee on the financial performance of banks.

Research Framework

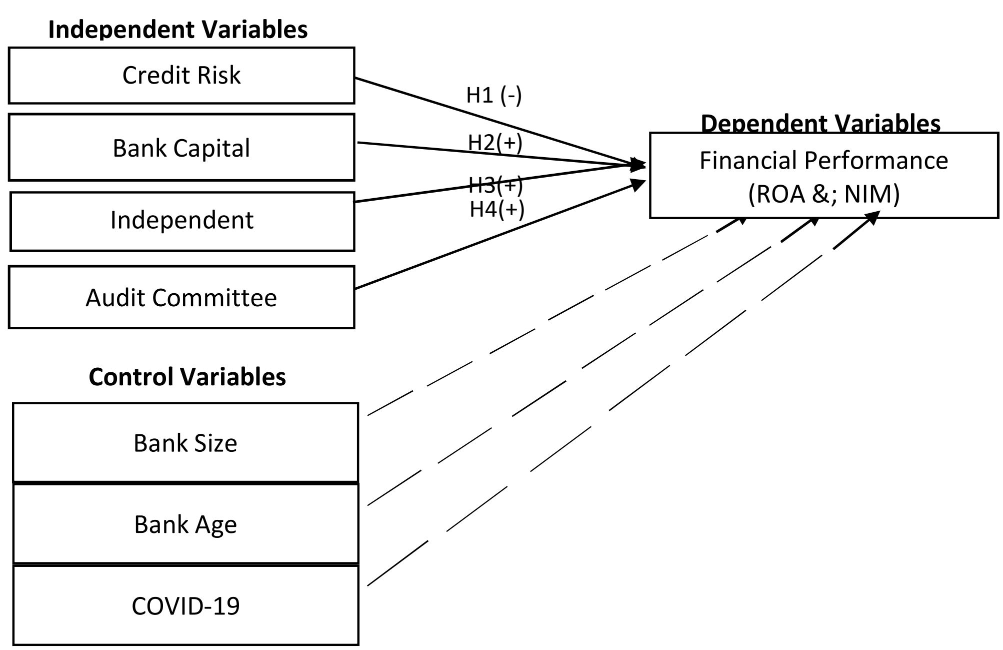

Figure 1. Schematic Conceptual Framework

3. METHODS

Data Collection Methods

A quantitative approach is used to analyze the influence between the four independent variables on their dependents. The method of collecting this research data is secondary, obtained from the annual report of each conventional commercial bank listed on the Indonesia Stock Exchange (IDX) for the 2017-2021 period. This review period amounted to 5 years (from 2017-2021). Sample criteria in this study:

1. Conventional commercial banks listed on the IDX in the 2017-2021 period.
2. Conventional commercial banks whose annual report data is complete in the 2017-2021 period.

Variable Operational Definition

Financial Performance

The measurement of bank financial performance in this study is proxied by *Return on Asset* (ROA) and *Net Interest Margin* (NIM). ROA shows the ability of bank management to create profits from bank assets (Al-Qudah, Azzam, Aleqab, &; Shakhatreh, 2019). NIM shows bank management's ability when it becomes a manager of productive assets to obtain net interest income (Saleh &; Afifa, 2020).

$$Return\ on\ Asset = \frac{Net\ Profit}{Total\ Asset}$$

$$Net\ Interest\ Margin = \frac{Net\ Interest\ Income}{Average\ Earning\ Assets}$$

Credit Risk

Non-Performing Loan Net (NPL Net) is considered a proxy and as an early warning indicator of credit risk. NPL Net refers to the percentage of non-performing loans from all loans provided by banks (Financial Services Authority Regulation Number 15/POJK.03/2017).

$$\text{NPL Net} = \frac{\text{NPL} - \text{Cadangan Kerugian Penurunan Nilai (CKPN)}}{\text{Total Kredit}}$$

Bank Capital

Sufficient bank capital or bank capital can be measured by managing the *Capital Adequacy Ratio* (CAR). CAR is an important indicator used by regulators in assessing the health of bank capital (Ramasamy, Sinnakannu, &; Ramasamy, 2021).

$$\text{CAR} = \frac{\text{Modal}}{\text{Aktiva Tertimbang Menurut Risiko (ATMR)}}$$

Independent Commissioner

The independent commissioner variable in this study is measured by the proportion of independent commissioners (the number of independent commissioners from all members of the board of commissioners) because independent commissioners must be at least 50% of all members of the board of commissioners (Article 24 Paragraph 2 of the Financial Services Authority Regulation Number 55 / Pojk.03 / 2016 concerning the Implementation of Governance for Commercial Banks).

$$\text{Komisaris Independen} = \frac{\text{Jumlah komisaris independen}}{\text{Jumlah anggota dewan komisaris}}$$

Audit Committee

The audit committee variables in this study are calculated by the number of audit committee participants contained in the company (PeiZhi & Ramzan, 2020).

$$\text{Komite Audit} = \text{Jumlah anggota komite audit}$$

Bank Size

Bank size or bank size is a scale that measures the total assets owned by a bank (Saleh &; Afifa, 2020):

$$\text{Bank Size} = \text{Ln (Total Aset)}$$

Bank Age

The age of the bank refers to the number of years the bank has been in operation. The bank's experience in running a business, which can be seen from the age of the bank, will affect the bank's existence against its competitors (Haryati, Burhany, &; Suhartanto, 2019).

$$\textit{Bank}\ \text{Age} = \ \text{Ln (jumlah tahun sejak berdirinya bank)}$$

COVID-19

The *COVID-19* pandemic, as one of the causes of the world financial and economic crisis, as a control variable affecting bank financial performance is calculated using an *index*, namely *the World Pandemic Uncertainty Index* (Ho &; Gan, 2021).

World Pandemic Uncertainty Index (Quarter 4)..........(9)

Analysis Techniques

This study uses panel data regression analysis that accommodates *cross-section* and *time series* data types (Ajija, Sari, Setianto, &; Primanti, 2019: 31). The selected panel data regression model is the *fixed effect model* (FEM). Research model:

$$ROA_{i,t} = a + \beta 1RK_{i,t} + \beta 2MB_{i,t} + \beta 3KI_{i,t} + \beta 4KA_{i,t} + \beta 5SZ_{i,t} + \beta 6AGE_{i,t} + \beta 7CVD_{i,t} + e$$
$$NIM_{i,t} = a + \beta 1RK_{i,t} + \beta 2MB_{i,t} + \beta 3KI_{i,t} + \beta 4KA_{i,t} + \beta 5SZ_{i,t} + \beta 6AGE_{i,t} + \beta 7CVD_{i,t} + e$$

4. RESULTS AND DISCUSSION

Regression Results and Hypothesis Test

The following are the results of the regression analysis of panel data in this study:

Table 1 Results of FEM Regression Estimation of ROA Dependent Variables

Variable	ROA Coefficient &; Robust Std. Err.	ROA t-Statistics	NIM Coefficient &; Robust Std. Err.	NIM t-Statistics
Credit Risk	-0,4121*** (0,1295)	-3,18	-0,1808 (0,1461)	-1,24
Bank Capital	0,0872** (0,0333)	2,62	0,0669*** (0,0211)	3,17
Independent Commissioner	0,0206** (0,0090)	2,29	0,0190** (0,0105)	1,80
Audit Committee	0,0030** (0,0014)	2,16	0,0019 (0,0015)	1,32
Firm Size	0,0054** (0,0024)	2,22	-0,0000 (0,0021)	-0,01
Firm Age	-0,0168 (0,0192)	-0,88	-0,0343 (0,0244)	-1,41
COVID-19 pandemic	-0,0003*** (0,0001)	-2,50	-0,0003*** (0,0001)	-2,58

Note: * p<0.1; ** P<0.05; p<0.01

Discussion

1. **Credit Risk t-Test**

Credit risk (RK) as measured by Non-Performing Loan Net (NPL Net) significantly negatively affects Return on Assets (ROA). However, there is no significant effect on Net Interest Margin (NIM). The results of this study are in line with research from Katusiime (2021) and Saleh & Afifa (2020) which states that credit securities measured by NPL Net have a significant negative effect on financial performance (ROA). However, it did not support this study by Nwude & Okeke (2018) who stated that NPL Net had a significant positive effect on financial performance. By allocating the source of funds without cost to part of the amount of new credit expansion, the interest income it receives every month along with the multiplier effect which is a distinct advantage that can strengthen the bank's ability to replace interest income lost due to additional new NPLs. Therefore, in the event of credit risk, large banks have interest income substitution power that is relatively able to maintain the stability of NIM. Thus, credit risk does not significantly affect NIM.

2. Bank Capital t Test

Bank capital calculated by *Capital Adequacy Ratio* (CAR) significantly influences financial performance calculated by ROA. The same effect was also found on financial performance as measured by NIM. The results showed that bank capital has a positive on financial performance. The amount of bank capital affects the level of financial performance. Meanwhile, the decline in bank capital so that financial performance also decreased. It can be summarized that banks' high and low capital can affect the company's financial performance. The results of this study support research conducted by Peizhi & Ramzan (2020), Saleh & Afifa (2020), and Nguyen (2020) which proves that bank capital (CAR) has a relevant positive influence on financial performance.

3. Independent Commissioner t Test

Independent commissioners influence significantly positively with financial performance calculated by ROA and NIM. The results of the review show that independent commissioners have a significantly positive influence on financial performance. The proportion of independent commissioners affects the level of financial performance of the company. Conversely, the smaller the proportion of independent commissioners, the lower the company's financial performance. The results of this study support the assessment carried out by Salehi, Tahervafaei, &; Tarighi (2017), Peizhi & Ramzan (2020), and Pamungkas, Chabachib, Puspitasari, &; Hersugondo (2021) which stated that independent commissioners (IC) significantly negatively affect financial performance. However, it does not support the results of the study conducted by Alsartawi et al. (2019) which states that independent commissioners (IC) significantly negatively affect financial performance.

4. Audit Committee t test

There is a significant positive influence between audit committees on financial performance as measured by ROA. However, the audit committee has no effect on NIM. The results of the study support research conducted by Peizhi & Ramzan (2020) which proves that the audit committee (KA) has a significant positive effect on financial performance (ROA), and supports the results of the study conducted by Salehi, Tahervafaei, &; Tarighi (2017) which proves that the audit committee (KA) has no effect on financial performance (NIM). The Audit Committee has no effect on NIM which may occur because NIM is more related to Management's authority in the implementation of bank asset and passiva management management by taking management policies and decisions to plan and regulate the structure of productive assets (credit) to obtain optimal interest income, the structure of sources of funds for efficiency of interest costs and the amount of assets from time to time. Any changes in market interest rate trends that occur occasionally will encourage management to reorganize the structure of assets and liabilities to maintain NIM and a good level of liquidity for banks.

5. CONCLUSION

Based on the results of this study, it can be concluded that there is a significant negative impact on credit risk on banking financial performance (ROA) and no significant effect of credit risk on banking financial performance (NIM). Then there is asignificant positive impact on bank capital on bank financial performance (ROA and NIM). In addition, anindependent commissioner has a significant positive impact on the bank's financial performance (ROA and NIM). Finally, there is a significant positive effect of the audit committee on banking financial performance (ROA) and no significant effect on the audit committee's financial performance (NIM).

Managerial Implications

Based on the results of the analysis, it can be proven that there is a significant negative influence of credit risk on banking financial performance (ROA), then there is a positive influence of bank capital and independent commissioners on banking financial performance (ROA and NIM), as well as a positive influence from the audit committee on banking financial performance (ROA) at Conventional Commercial Banks listed on the Indonesia Stock Exchange in the 2017-2021 period. Aspects that have an influence on banking financial performance must be considered so that banks can continue to improve their financial performance and the bank has more value in the eyes of investors so that investors believe in investing in the company. As for this assessment, credit risk significantly negatively affects the company's financial performance (ROA and NIM). For this reason, it is recommended that the management of Conventional Commercial Banks can reduce the occurrence of credit risks that hinder or the occurrence of bad loans so that the company's financial performance continues to increase. In addition,there is a positive influence of bank capital and independent commissioners on bank financial performance (ROA and NIM) and a positive influence from the audit committee on bank financial performance (ROA). In this regard, companies must pay attention to the number of independent commissioners and audit committees so that they can carry out their functions optimally and achieve corporate governance and banks must pay attention to the number of audit committees as well so that internal control and internal audit will be better.

Users of financial statements, especially investors, need to know several things that can affect bank results. By considering credit risk, bank solvency, the composition of independent commissioners and audit committees, users of financial statements, especially investors, can assess that the company's performance and supervision are going well.

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