Risk Profile And Corporate Governance On Company Performance In The Banking Industry

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Abstract: The purpose of this research is to identify and analyze the connection between the risk profile and performance of public banks on the Indonesian Stock Exchange for the years 2012–2015. This research uses a quantitative method and a purposive sampling technique with a sample population of 128. The results show that Non-Performing Loan and Loan to Deposit Ratio have a significant and negative effect on Return on Assets, while Net Open Position has no significant effect on Return on Assets. The conclusion that taken from this research is that the performance of a bank is dependent on how the bank manages its performing loans and its liquidity.

1 INTRODUCTION

The banking sector has become an intermediary institution that plays an important role in the financial system of society. Bank health is an important aspect that must be understood. To keep the banks in a good health, supervision is undertaken by the Financial Services Authority (OJK), which requires banks to conduct self-assessment on their own health levels and take effective remedial measures.

Basically, the banking policy issued and implemented by the Financial Services Authority aims to create and maintain the health of banks, either individually or consolidated. The health or financial and non-financial conditions of a bank are in the interests of all relevant stakeholders, owners, managers, bank users, and governments.

Along with the banking needs in terms of facing global challenges, Bank Indonesia has made improvements to its method of appraising bank health. Bank Indonesia considers that the previous method of appraisal, CAMELS (Capital, Assets Quality, Management, Earning, Liquidity, and Sensitivity Market), was less able to assess bank health, so it changed the bank health rating method to RGEC (Risk Profile, Good Corporate Governance, Earnings, and Capital), either individually or consolidated, as of January 2012, with the issuance of Bank Indonesia Regulation

No.13 / 1 / PBI / 2011 (Setyaningsih & Herawati, 2013). The difference between RGEC and CAMELS lies in the assessment of risk profile and good corporate governance. Risk profile assessment is a new appraisal relating to the level of bank soundness, while corporate governance, which used to be part of management's assessment of the CAMELS method, is now a standalone component of the RGEC assessment (Dincer, H., Gencer, G., Orhan, N., & Sahinbas, K, 2011; Hardikasari, E., Hardikasari, E., & Pamudji, S, 2011).

RGEC is associated with a health rating assessment that focuses on risk assessment. In the risk profile, there are eight aspects of risk that are of concern in the assessment of the bank's RGEC method of health risk: credit risk, market risk, liquidity risk, operational risk, legal risk, strategic risk, compliance risk, and reputation risk (Permatasari & Nuswantara, 2012).

The first part of this paper will examine the effect between risk profile, represented by Non-Performing Loan (NPL), Net Open Position (NOP), and Loan to Deposit Ratio (LDR), and Return on Assets, representing the Earnings Appraisal Factor. As we know, risk profile is one of the four factors for appraising bank health.

The second part of this paper will examine Good Corporate Governance, represented by components of the board of commissioners, audit quality, and the composition of independent commissioners, with

Return on Assets representing the Earnings Appraisal Factor. Additionally, Good Corporate Governance is one of the four factors for appraising bank health.

2 HYPOTHESIS DEVELOPMENT

Credit risk arises from the failure of the debtor and/or other parties to fulfil obligations to the bank. Credit risk is generally found in all banking activities, the performance of which depends on the performance of the counterparty, the issuer, or the borrower. In managing bank credit risk in Indonesia, Bank Indonesia issued Regulation No.13 / 1 / PBI / 2011, which required banks in Indonesia to conduct bank rating assessments using the RGEC method. The RGEC method includes the rating of bank health by assessing bank credit risk. According to the RGEC method, the effect of credit risk can be measured by the Non-Performing Loan (NPL) ratio, which measures the ability of the company in managing non-performing loans that are substandard, doubtful, or loss-making (Eng, 2013). Based on Bank Indonesia Regulation No.13 / 1 / PBI / 2011, banks have provisions that the NPL should be less than 5%. The lower the NPL ratio in the bank, the better the bank will be in managing the non-performing loans, and the better the bank rating in the risk profile factor. In some previous studies, a small credit risk brings good bank performance (Sabir Muhammad, Ali Muhammad, Habbe Hamid, 2012; Eng, 2013). Based on the description above, the first hypothesis for this research is as follows:

H1: Non-Performing Loan negatively affects Return on Assets.

Market Risk arises in the balance sheet position and administrative accounts, including derivative transactions, due to changes in market conditions, and the risk of change of option price. According to Bank Indonesia Regulation No.13 / 1 / PBI / 2011, market risk includes foreign exchange risk arising from foreign exchange transactions. Net Open Position (NOP) is one of the instruments set by Bank Indonesia in assessing foreign exchange risk to be covered by bank capital. The purpose of the NOP ratio measurement is for bank security from forex risk (hedging risk), mitigation of bank/customer support speculation, managing the bank's forex assets (maintaining balance of sources and use of funds), as a tool for Bank Indonesia to monitor bank health and to manage the stability of the rupiah. The lower the NOP ratio of the bank the better, since the foreign exchange risk is lower so the foreign

exchange risk can be covered by bank capital. In some previous studies, a small market risk resulted in good bank performance. Based on the description above, the second hypothesis for this research is as follows:

H2: Net Open Position positively affects Return on Assets.

Liquidity risk is assessed on a bank's ability to settle its short-term liabilities. According to Bank Indonesia Regulation No.13 / 1 / PBI / 2011, in the assessment of bank soundness by the RGEC method, liquidity risk can be measured by the Loan to Deposit Ratio (LDR) ratio, which measures the bank's ability to repay the withdrawal, which the depositors do by relying on credit as liquidity. Banks with good LDR quality have a small risk, are able to pay their short-term liabilities, or are able to manage their liquidity. The lower the LDR ratio, the better the bank's liquidity risk; a lower liquidity risk reflects the bank's ability to manage its liquidity well. In previous studies, a small liquidity risk results in good bank performance (Sabir Muhammad, Ali Muhammad, Habbe Hamid, 2012). Based on the description above, the third hypothesis for this research is as follows:

H3: Loan to Deposit Ratio negatively affects Return on Assets.

Corporate governance can be described as a set of relationships between the board of commissioners, directors, shareholders, and other stakeholders of a company. This relationship establishes a system that regulates and controls the company concerned. Corporate governance can also be assessed by the RGEC method implemented by Bank Indonesia Regulation No.13 / 1 / PBI / 2011. The board of directors is responsible for the operation of the company in accordance with the intent and purpose of the company. Bank Indonesia requires each bank to have at least three directors. The composition of the board of directors in accordance with the standards of the Bank Indonesia Regulation will affect the rating of a bank. In Dedu & Chitan's (2013) study, the composition of the board of directors that meets the standards will have an effect on the performance of the bank. Based on the description above, the fourth hypothesis for this research is as follows:

H4: The size of the Board of Directors has a positive effect on Return on Assets.

Audit quality is a form of good corporate governance. In accordance with Bank Indonesia Regulation No.13 / 1 / PBI / 2011, corporate governance is assessed by the RGEC method. Audit quality reflects good corporate financial reporting,

with good audit quality expected to increase trust among users such as investors, creditors, or customers. The audit quality in this study is reflected by auditors of the Big Four public accounting firms and the non-Big four public accounting firms, as the auditor's influence in generating audit quality is measured by how many public accounting firms conduct an audit of a bank that has gone public. In some previous studies, the quality of a good audit will affect the performance of the company (Sari, 2010). Based on the above description, the fifth hypothesis for this study is as follows:

H5: Audit quality positively affects Return on Assets.

An independent board of commissioners is responsible for and authorized to oversee management action, and it advises management if it is deemed necessary. Independent commissioners may not have financial, management, share ownership, and/or family relationships with other members of the board of commissioners, directors, and/or other controlling shareholders or relationships that may affect their ability to act independently. According to Bank Indonesia Regulation No.13 / 1 / PBI / 2011, the composition of the board of commissioners shall consist of independent commissioners and commissioners, with a minimum composition of 50% of the total members of the board of commissioners required to be independent commissioners. In Noverio & Dewayanto's (2011) study, the control of independent commissioners influenced the bank's performance. Based on the description above, the sixth hypothesis for this research is as follows:

H6: Percentage of the Indepndent Board of Commissioners have a positive effect on Return on Assets.

3 DATA

3.1 Samples

The population in this research is banking companies that have gone public on the Indonesian Stock Exchange (BEI) during the period 2012–2015. Sampling in this research was carried out by a purposive sampling method, with the aim of obtaining a representative sample with four criteria: [1] banks that have gone public and are listed on the Indonesian Stock Exchange; [2] banks that have published financial statements regularly during the period 2012-2015; [3] banking companies whose shares are actively traded on the Indonesian Stock

Exchange for the four periods of the research; [4] banking companies that were not in the process of delisting during the period of observation.

Based on the list of samples above, the researchers used a sample of 32 commercial banks. The list of 32 bank samples was observed for four periods (2012 to 2015). Consequently, there was 128 sets of data.

3.2 Variables

This study uses risk profile and corporate governance as independent variables and bank performance as measured by Return on Assets (ROA) as a dependent variable. Risk profile is defined as credit risk, market risk, and liquidity risk, in accordance with a quantitative measurement of risk profile regulated in Bank Indonesia Regulation Number 13/1 / PBI / 2011. Corporate governance is defined as the composition of the board of directors, the quality of the audit, and the components of the board of commissioners. The following is an outline of the six independent variables in this study:

1. Credit risk is the risk of failure of the debtor in fulfilling the bank's liabilities (Sabir Muhammad, Ali Muhammad, Habbe Hamid, 2012; Eng, 2013), measured by the Non-Performing Loan (NPL) ratio.
2. Market risk is the risk that occurs due to foreign exchange transactions, which can be measured using the Net Open Position (NOP) ratio.
3. Liquidity risk is the risk of possible loss due to the inability of the bank to meet the obligations due. Liquidity risk can be measured using the Loan to Deposit (LDR) ratio.
4. Board size (BOARDSIZE) is the total number of board directors and commissioners. In this study, the Board of Commissioners is one of the measurement variables of corporate governance.
5. Audit quality is used to detect and report material errors in financial statements. The quality of audit in this study is measured by the company using the services of Big Four public accountancy firms or non-Big four public accountancy firms (Sari, 2010). In this study, the quality of audit is measured by how many public accounting firms audit the listed banks in the period 2012-2015. We define Big Four auditors if they are in the top four in term of number of clients in banking industry within the sample period. Audit Quality (AQ) is the second measurement variables of corporate governance in this research.

6. The third governance variable is percentage of independent commissionaire (INDCOM). INDCOM is the total number of independent commissioners scaled by total number of board commissioners. Independent commissioners in the company have duties and responsibilities related to quality control information contained in the financial statements (Utama & Musa, 2011).

The control variables used in this study are the ratio of Capital Adequacy Ratio (CAR) and firm size. CAR is one of the ratios used in the health rating assessment based on Bank Indonesia Regulation Number 13/1 / PBI / 2011 in the RGEC method of Capital Bank assessment, while firm size is measured by net total assets log (Astutik & Djazuli, 2014).

4 Empirical Analysis

4.1 An Overview of Subject and Object Research

The research subjects used are banking companies listed on the Indonesian Stock Exchange during the period 2012–2015, i.e. banking companies that meet the predetermined criteria of sampling. Banking is part of the financial sector of the Indonesian Stock Exchange. Since the issuance of Bank Indonesia Regulation No.13 / 1 / PBI / 2011, bank health is expected to have a more representative assessment method. If the bank has a good bank health rating, then it will have a good performance (Leventis, S., Dimitropoulos, P. E., & Anandarajan, A, 2012). Bank performance can be measured by using earnings in the rating of the bank soundness RGEC method. In this study, the authors use the variable Return on Assets in measuring the earnings of a bank. Good or bad performance of the bank will affect the users of financial statements. A good bank soundness should have a good overall level of the four existing assessments, namely Risk Profile, Good Corporate Governance, Earnings, and Capital. The object of this research is the effect of risk profile and corporate governance on the performance of banks that go public in BEI, as regulated in Bank Indonesia Regulation No.13 / 1 / PBI / 2011, based on the RGEC method (Risk Profile, Good Corporate Governance, Earnings, Capital). In this study, the authors measure the risk profile with the variables Non-Performing Loan, Loan to Deposit Ratio, and Net Open Position. Corporate governance is measured by the composition of the board of directors, the quality of the audit, and the components of the board of commissioners. The author uses company size and Capital Adequacy Ratio as control variables.

As presented in Table 1, Return on Assets (ROA) of the sample companies obtained an average of 1.773. This means that the average sample company is able to get a net profit of 1.773% of the total assets owned by the company in one period. The median for ROA is 1.71, with the median indicating a mean value. The maximum value of 6.41 means that the highest ROA from a sample company is 6.41% of total assets owned by the company in one period, while the minimum value of ROA is 5.37% of total assets.

Table 1: Descriptive Statistics

Variable	Mean	Median	Min	Max
ROA	1.773	1.71	-5.37	6.41
NPL	2.451	2.11	0.21	9.95
NOP	1.669	1.115	-10.72	9.61
LDR	82.89	82.24	0	112.54
BOARDSIZE	7.085	6	3	11
AQ	0.765	1	0	1
INDCOM	0.578	0.571	0.461	0.733
CAR	16.95	16.5	10.05	26.56
SIZE	17.57	17.403	15.063	20.593

The Non-Performing Loan sample obtained an average of 2.451. This reflects the risk of failure of the debtor in fulfilling the bank's obligation of 2.451%. The median for Non-Performing Loans is 2.11, where the median indicates a median value. The maximum value of 12.28 means that the highest Non-Performing Loan of the sample company can reach 9.95, while the minimum value of Non-Performing Loan is 0.21.

With respect to Net Open Position, the sample companies obtained an average of 1.669. This reflects the risks arising from foreign exchange transactions of 1.669%. The median for Net Open Position is 1.115, where the median indicates a mean value. The maximum value of 9.61 means that the highest Net Open Position of the sample company can reach 9.61, while the minimum Net Open Position value is -10.72.

Loan Deposits to Ratio of the sample company obtained an average of 82.89. This reflects the risks arising from foreign exchange transactions of 82.89%. The median for Loan Deposits to Ratio is 82.24, where the median indicates a median value. A maximum value of 112.54 means that the Loan Deposits to the highest Ratio of the companies

sampled can reach 112.54, while the minimum value of Loan Deposits to Ratio is 0.

Based on the results of the data processing in Table 4.2, the components of the board of commissioners of the sample companies obtained an average of 7.085. This reflects the components of the board of commissioners of bank companies reaching 7.085%. The median for the board component is 6, where the median represents the mean value. The maximum value of 3 means that the highest audit quality of the sample company can reach 3, while the minimum value of the commissioner's component is 12.

The audit quality of the sample companies obtained an average of 0.765. This reflects the audit quality of bank companies reaching 0.765%. The median for the composition of the board of commissioners is 1, where the median denotes the middle value. A maximum value of 11 means that the highest audit quality of the sample company can reach 11, while the minimum value of audit quality is 3.

The board of directors, defined as IC2 in the table, is calculated by the total composition of the board of directors coupled with the number of components of the board of commissioners divided by the total of both. The total IC2 of the sample firms obtained an average of 0.578. This reflects IC2 reaching 0.578%. The median for the composition of the board of directors is 0.571, where the median indicates a mean value. The maximum value of 0.733 means that the highest IC2 of the companies sampled can reach 0.733, while the minimum value of IC2 is 0.461.

The Capital Adequacy Ratio of the sample companies obtained an average of 16.95. This reflects CAR reaching 16.95%. The median for the composition of the board of commissioners is 16.5, where the median denotes the middle value. The maximum value of 26.56 means that the Capital Adequacy Ratio of the sample company can reach 26.56%.

With respect to size, the sampled companies obtained an average of 17.57. This reflects the company's size reaching 17.57%. The median for the composition of the board of commissioners is 17.403, where the median denotes the median value. The maximum value of 20,593 means that the highest company size of the sampled companies is 20,593, while the minimum value of 15,063 firm size is 15,063.

4.2 Model Analysis and Evidence of Hypotheses

This study used multiple linear regression analysis techniques to test the hypotheses that were built. A multiple linear regression test using software STATA version 14 was used to examine the relationship between the variables. The independent variables are reflected by three variables, namely proxy risk profile to Non-Performing Loan, Loan to Deposit Ratio, and Net Open Position.

Table 2: Results of regression of risk profile on performance

Variables	[1]	[2]	[3]	[4]
NPL	-0.266*** (-3.65)			-0.267*** (-3.76)
NOP		-0.098* (-1.77)		-0.100* (-1.94)
LDR			-0.017* (-1.92)	-0.020** (-2.44)
CAR	0.103** (2.53)	0.123*** (2.92)	0.112*** (2.65)	0.092** (2.30)
SIZE	0.330* (1.87)	0.277 (1.52)	0.273 (1.50)	0.367** (2.14)
CONSTANT	-5.703* (-1.93)	-6.371** (-2.08)	-4.131 (-1.26)	-3.140 (-1.02)
R-squared No obs	0.389 128	0.339 128	0.342 128	0.432 128

Corporate governance is proxies by the size of board commissionaire, the audit quality, and percentage of independent commissionaire. The dependent variable used by the author is the measurement of company performance (ROA). For control variables, the author used the Capital Adequacy Ratio (CAR) and company size. Regression analysis was used to determine the direction of the relationship between independent variables and the dependent variable, whether each independent variable is positive or negative, and to predict the value of the dependent variable if the value of the dependent variable increases or decreases.

Based on Table 2 model 1, the regression of the NPL variable has a negative and significant association to ROA (*t*-value -3.65). In model 2, we find that NOP has a negative and significant association to ROA, with significance equal to 10% (*t*-value -1.77). In model 3, the LDR variable has a negative and significant association to ROA, with a significance level of 10% (tvalue -1.92). These

results are remain significant when we run in model 4.

Table 3: Results of regression of corporate governance on performance

Variables	[1]	[2]	[3]	[4]
BOARDSIZE	0.270** (2.26)			0.155 (1.35)
AQ		0.020 (0.06)		-0.169 (-0.51)
INDCOM			-2.083 (-0.76)	-2.643 (-1.03)
CAR	0.103** (2.53)	0.123*** (2.92)	0.112*** (2.65)	0.092** (2.30)
SIZE	0.330* (1.87)	0.277 (1.52)	0.273 (1.50)	0.367** (2.14)
CONSTANT	-5.703* (-1.93)	-6.371** (-2.08)	-4.131 (-1.26)	-3.140 (-1.02)
R-squared No obs.	0.389 128	0.339 128	0.342 128	0.432 128

Table 3 presents the results of regression of corporate governance variables on performance. In model 1, the coefficient of *COMSIZE* has apositive and significant associations to performance (*t*-value 2.26). In models 2 and 3, we find no significant associations between *AQ* and *INDCOM* to performance.

Table 4: Results of robust regression of risk profile on performance

Variables	[1]	[2]	[3]	[4]
NPL	-0.266** (-2.00)			-0.267*** (-2.69)
NOP		-0.098 (-1.25)		-0.100* (-1.70)
LDR			-0.017* (-1.89)	-0.020 (-1.64)
CAR	0.103** (2.51)	0.123*** (2.74)	0.112** (2.36)	0.092** (2.17)
SIZE	0.330* (1.76)	0.277 (1.51)	0.273 (1.41)	0.367* (1.97)
CONSTANT	-5.703* (-1.67)	-6.371* (-1.75)	-4.131 (-1.02)	-3.140 (-0.79)
R-squared No obs	0.389 128	0.339 128	0.342 128	0.432 128

Table 4 presents results of robust regression of risk profiles on performance. Consistent with OLS regression results, we find that NPL, NOP, and LDR are negatively correlated to performance. However, the result for NOP is insignificant.

Table 5 shows the results of robust regression of corporate governance variables on bank performance. The findings confirm the OLS regression results that *BOARDSIZE* is positive and significantly associated to *ROA*. With regards to audit quality and percentage of independent commissionaire, we find no significant association to bank performance.

Table 5: Robust regression result of corporate governance on performance

Variables	[1]	[2]	[3]	[4]
BOARDSIZE	0.270* (1.95)			0.155 (1.14)
AQ		0.020 (0.05)		-0.169 (0.41)
INDCOM			-2.083 (-0.71)	-2.643 (-0.87)
CAR	0.103** (2.51)	0.123*** (2.74)	0.112** (2.36)	0.092** (2.17)
SIZE	0.330* (1.76)	0.277 (1.51)	0.273 (1.41)	0.367* (1.97)
CONSTANT	-5.703* (-1.67)	-6.371* (-1.75)	-4.131 (-1.02)	-3.140 (-0.79)
R-squared No obs	0.389 128	0.339 128	0.342 128	0.432 128

In model 4, regression of the KDK variable has a positive influence, with significance to ROA equal to 10% (t count: 1.95). This model has a positive control variable, i.e. CAR, with a significance level of 5% (t arithmetic: 2.51) and SIZE with a significance level of 10% (t count: 1.76). In models 5 and 6, the regressions of the KA and IC2 variables have no effect on ROA. In model 7, the NPL has a negative effect, with a strong significance to ROA of 1% (t count: -2.69), the NOP has a significant negative effect on the ROA of 10% (-1.70), and LDR, KDK, KA, IC2 have a significant influence on ROA.

5 CONCLUSION

This study aimed to determine the effect of the independent variables Non-Performing Loan, Net Open Position, and Loan to Deposit Ratio on Return on Assets in banking companies in Indonesia listed on the Indonesian Stock Exchange during 2012-2015. The variables used in this study were Non-

Performing Loans, Net Open Position, and Loan to Deposit Ratio, Board of Directors composition, Board of Commissioner components, Audit Quality, Size, Capital Adequacy Ratio, and Return on Assets.

Based on the analysis of the research results, the following conclusions can be drawn:

a. Regression test results show that risk profile variables measured using Non-Performing Loan and Loan to Deposit Ratio have a significant and negative effect on Return on Assets. This means that, when the values of the Non-Performing Loan and Loan to Deposit ratios of the company increase, the Return on Assets will decrease, and vice versa; if the Non-Performing Loan and Loan to Deposit ratios are down, then Return on Assets will experience an increase; however, the Net Open Position has no effect on Return on Assets, meaning that when the value of the Net Open Position of a company experiences an increase, then Return on Assets has no effect.

b. The result of the regression test shows that corporate governance variables measured using Components of Board of Commissioners have a significant and positive effect on Return on Assets, while Audit Quality and Board of Directors Composition have a non-significant positive effect on Return on Assets.

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