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The impact of foreign and independent commissioners on bank performance: empirical evidence from Indonesia

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Abstract

This study aims to empirically prove the influence of foreign commissioners and independent commissioners on bank performance. This quantitative study uses secondary data in the form of annual reports issued by companies in the banking sector. The research sample comprises banking companies operating between 2010-2019. The results show that foreign commissioners have a significant negative effect on bank performance with ROA and ROE proxies and have a significant positive effect on bank performance with NIM proxies. Meanwhile, independent commissioners do not influence bank performance using either ROA, ROE, or NIM proxies.

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1. Introduction

The main goal of a company is to maximize its shareholders' wealth. One way that can be done is to improve the company's financial performance (Wijayati, 2015). To achieve this goal, shareholders or investors transfer the management of the company to professionals such as managers. However, the owners and managers of a company have different interests. For example, managers understand the company's internal information and prospects better than shareholders (Suherman et al., 2019).

Often, the goal of improving company performance is not achieved because agents are more concerned with their personal interests than the interests of shareholders (Suherman et al., 2019). A suitable corporate governance mechanism must be applied to overcome this problem. The Indonesian Institute for Corporate Governance defines corporate governance as a process and structure adopted in running a company with the main goal of increasing shareholder value in the long term while considering the interests of other stakeholders. Corporate governance mechanisms are applied at the company level to solve corporate governance problems (Widyati, 2013)

Corporate governance is a system consisting of a set of structures, procedures, and mechanisms designed to manage a company based on the principle of accountability, which can increase the value of the company in the long term (Velnampy, 2013). Corporate governance systems generate a set of rules and incentives, and managers use these rules and incentives to guide and oversee corporate activities. Therefore, good corporate governance can generate long-term opportunities for shareholders to increase their profits and firm value (Onasis & Robin, 2016)

Diversity within a board of commissioners is beneficial for investors because they believe that companies with such boards of commissioners are independent and open and can receive information from international networks, thereby increasing the value of the company. Members of a board of commissioners who are foreign nationals serve as a benchmark for the diversity of the board. Furthermore, a board of commissioners that directly contacts investors increases these investors' confidence in investing in company shares (Kesaulya & Febriany, 2018).

In addition to foreign commissioners, independent commissioners are needed and are expected to increase the independence of committee members to the benefit of shareholders (the majority) and place the interest of the company above other interests. Independent commissioners signify a board of commissioners that makes decisions objectively. Objective decision-making affects a company's stock price and, thus, increases the company's value; this is especially the case in the banking industry (Widyati, 2013).

Several previous studies have stated that there is a relationship between the presence of foreign commissioners and independent commissioners and bank performance. For instance, Choi et al. (2012) reported that the presence of foreign commissioners had a significant positive effect on the performance of companies listed on the Indonesia Stock Exchange (IDX) in 2011. This finding indicates that foreign commissioners have capabilities that can help improve company performance. This claim is supported by Polovina and Peasnell (2018), who stated that foreign board members positively affect firm value. The existence of foreign and independent commissioners is thought to improve management and bring new attributes that improve company performance, thereby increasing company value. This idea aligns with research conducted by Rahma et al. (2019), who expressed that foreign commissioners had a significant partial effect on firm value in companies listed on the IDX from 2015-2017.

In addition, according to Valensia and Khairani (2019), an independent board of commissioners significantly increases firm value. However, Pasaribu and Sari (2011) mentioned that an independent board of commissioners does not affect firm value.

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In the present study, we used panel data from 41 bank companies from 2010 to 2019 to analyze the effect of foreign commissioners and independent commissioners on bank performance. We found that foreign commissioners have a significant negative effect on bank performance with ROA and ROE proxies and a significant positive effect on bank performance with the NIM proxy. We also found that independent commissioners do not influence bank performance when using either the ROA, ROE, or NIM proxy.

This paper is structured as follows. Section 2 reviews the relevant theoretical concepts and explains how the hypotheses were developed. Section 3 describes the research method, data, sample, variables, and regression model. Section 4 presents the results and discussion. Section 5 summarizes the overall findings and explores the potential for future research.

2. Literature review

2.1. Agency theory

Agency theory explains the relationship between shareholders as principals and managers as agents. The agency relationship is a contract that is formed when the principal employs another person to perform a service and delegates authority rights related to decisions that affect a company (Wulandari, 2006).

According to Paulina (2015), this theory is related to firm value in that it indicates a link between shareholders and agents—or, in this study, the members of a board of commissioners and directors of a company. A company's board of directors is fully responsible for the company's survival and, thus, tries to show high company performance so that shareholders do not retract their investments in the company. One way that this can be done is by implementing a sound monitoring system from the principal.

The corporate governance mechanism is considered one of the monitoring systems that are good enough to mitigate the opportunistic nature of managers (Kesaulya & Febriany, 2018). In the context of a company, the agency problems faced by investors relate to the difficulty that investors face in ensuring that their funds are not being misused by the company's managers to fund unprofitable activities (Wulandari, 2011). According to Jensen and Meckling (1976), sources of conflict between managers and shareholders include decisions related to fundraising activities and how funds are obtained (Widyati, 2013)

2.2. Corporate governance

Corporate governance is a structure by which stakeholders, shareholders, commissioners, and managers formulate corporate goals and strategies to achieve them and monitor performance (OECD, 2003). A similar definition is given by the Calbury Committee (2003): "A set of rules that define a relationship between shareholders, managers, creditors the government, employees and other internal and external stakeholders in respect to their and their responsibilities." Every company must ensure that the principles of corporate governance—namely transparency, accountability, responsibility, independence, equality, and fairness—are applied to every aspect of the business and at all levels of the company. These principles are needed for a company to achieve sustainable performance while paying attention to stakeholders.

Guna and Herawaty (2010) stated that proper corporate governance aims to encourage the board and management to achieve these goals, which serve the interest of the company and its shareholders. Concerning agency problems, corporate governance, which is based on agency theory, is expected to function as a tool that gives investors confidence that they will receive a return on their investments. Corporate governance is related to how investors believe that managers will benefit them and will not steal, embezzle, or invest funds or capital that has been invested by investors; it is also related to how investors control managers (Widyati, 2013).

2.3. Hypothesis development

The large number of foreign workers entering will impact the implementation of corporate governance. Diversity on a board of commissioners is attractive to investors because it signifies that the company is independent and open and can receive information from international networks, thereby increasing the value of the company. Members of the board of commissioners who are foreign nationals are a benchmark for the diversity of a board of commissioners. According to Onasis dan Robin (2016), foreign commissioners have a positive influence on firm value. A commissioner is responsible for supervising the company and providing advice to the board of directors, and if a foreign national with broader industry experience is proven to have a positive impact on the company. Suherman et al. (2019) stated that the existence of foreign commissioners has a significant positive effect on company performance. This indicates that a foreign board of commissioners has a better ability and, thus, can improve a company's performance. This idea is supported by Velnampy (2013), who also stated that foreign board members have a positive effect on firm value. The existence of foreign commissioners is thought to improve managerial abilities and add value, thus improving company performance and, in turn, increase company value.

H1: Foreign commissioners had a significant positive impact on the performance of banking companies listed on the Indonesia Stock Exchange (IDX) from 2010-2019.

The independent board of commissioners also influences the implementation of the corporate governance mechanism within a company. Having independent commissioners in a company who oversee managers will improve that company's performance. Valensia and Khairani (2019) concluded that the presence of an independent board of commissioners has a significant positive effect on firm value.

H2: Independent commissioners had a positive and significant impact on the performance of banking companies listed on the Indonesia Stock Exchange (IDX) from 2010-2019.

3. Research methods

3.1. Data and samples

This study examines the influence of foreign commissioners and independent commissioners on bank performance. The sample in this study comprises banking companies in Indonesia. The initial sample of the study consisted of banking companies listed on the IDX between 2010 and 2019. The research was conducted based on secondary data from these banks, collected from annual reports.

We used a purposive sampling method to maintain the same number of observations across the years of observation. Therefore, we eliminated 41 companies with inconsistent (unbalanced) information during the observation period. The following inclusion criteria were used to gather the sample: the sample must be actively listed on the IDX from 2010 to 2019; the sample must be consecutively listed on the IDX from 2010 to 2019; and the sample must publish an annual report that presents complete data. A more detailed sample distribution is presented in Table 1.

Table 1. Sample selection criteria

No	Criteria	Number
1	Banking companies listed on the Indonesia Stock Exchange	41
2	Companies in the banking sector that are not listed on the IDX in a row from 2010-2019	12
	Total sample used	29

3.2. Research variables

3.2.1. Dependent variables

The dependent variable is bank perfomance. In this study, we employed three measures of firm performance (ROA, ROE, NIM) by referring to the studies of and Ahmadi et al. (2018). ROA is a profitability ratio that measures a company's ability to generate profits by using all its resources or assets (Tristiningtyas & Mutaher, 2016). ROE is a measure that signifies the company's ability to generate profits from shareholders' investments in the company (Saidu 2019). NIM measures a company's ability to manage its productive assets to generate net interest income (Saidu, 2019).

3.2.2. Independent variables

The main independent variables considered in this study are the presence of foreign commissioners and the presence of independent commissioners on companies' boards of commissioners. Foreign commissioners are measured as the ratio of the number of commissioners with foreign citizenship status to the total number of commissioners. Meanwhile, independent commissioners are measured as the ratio of the number of independent commissioners to the total number of commissioners (Valensia & Khairani, 2019).

Table 2. Variable definition

No.	Variable	Definition	Formula	Data Form
Dependent variable				
1	ROA	Return on asset	Net income/total asset	Continuous
2	ROE	Return on equity	Net income/total equity	Continuous
3	NIM	Net interest margin	Net interest income/average earning assets	Continuous
Independent variables				
1	FOREIGN	The proportion of foreign commissioners	Number of foreign commissioners	Continuous
2	INDEN	The proportion of independent commissioners	Number of independent commissioners	Continuous
Control variables				
1	BCOM	Board of commissioner size	Number of members of the company's board of commissioners	Continuous
2	FSIZE	Firm size	Natural logarithm of total assets	Continuous
3	FGROWTH	Firm growth	Calculated in years since the year the firm was incorporated	Continuous
4	DIV	Dividend policy	1 if the firm paid the dividend, 0 otherwise	Binary
5	FAGE	Firm age	Calculated in years since the year the firm was incorporated	Continuous
6	NPL	Net performing loan	Bad credit to the total credit granted	Continuous
7	LDR	Loan to deposit ratio	Total credit to total equity	Continuous

3.2.3. Control variables

We recognize that our proposed empirical model is free of endogenous problems. In anticipation of this, we include a control variable to avoid biased estimations. We meticulously selected our control variables by referring to prior studies (Ahmadi et al., 2018) on related topics. These control variables are board of commissioner size, firm size, firm growth, dividend policy, firm age, net performing loan (NPL), and loan to deposit ratio (LDR).

3.3. Regression model

To estimate whether foreign commissioners or independent commissioners influenced the performance of banking companies listed on the IDX from 2010-2019, we used regression

analysis panel data by combining time-series (10 years) and cross-sectional (29 companies) data. The relationships of foreign commissioners and independent commissioners with company performance were investigated through panel data regression based on the following equation model:

$$BP = \beta_{0it} + \beta_1 FOREIGN_{it} + \beta_2 INDEN_{it} + \beta_3 BCOM_{it} + \beta_4 FSIZE_{it} + \beta_5 FGROW_{it} + \beta_6 DIV_{it} + \beta_7 FAGE_{it} + \beta_8 LDR_{it} + \beta_9 NPL_{it} + e_{it},$$

where the dependent variable is the bank's performance, which is measured by two models; ROAi,t is the ratio of net income divided by total assets; ROEi,t is the ratio of net income divided by total shareholder equity; and NIMi,t is the ratio of net interest income divided by the average earning assets. The subscript i represents the company, and the subscript t indicates the time period. As previously explained in the definitions of the variable, FOREIGN and INDEN are the main independent variables. The Sigma control variables are BCOM, FSIZE, FGROWTH, DIV, FAGE, NPL, and LDR.

4. Results and discussion

4.1. Descriptive statistics

Descriptive statistical analysis is a useful tool for analyzing data by describing or describing data that has been processed to make it easier to understand. The descriptive analysis consists of the average (mean), median, maximum value, minimum value, and standard deviation obtained from each sample of banking companies listed on the IDX from 2010-2019 period. The data comprise as many as 29 banking companies and a total of 290 observations as result of winsorizing, which was carried out using Stata 16 with a winsorizing level of 1-99% to minimize data outliers.

4.2. Multicollinearity test

Table 4 presents the results of the correlation analysis. These results present no multicollinearity and no correlation coefficient between variables with a value of more than 0.8000. Thus, it can be concluded that there is no correlation between the independent variables.

Table 3. Descriptive statistics

	MEAN	STD DEV	MIN	P25	P50	P75	MAX
ROA	0.014	0.022	-0.096	0.008	0.017	0.026	0.052
ROE	0.102	0.181	-0.838	0.059	0.109	0.184	0.572
NIM	0.053	0.024	0.009	0.041	0.050	0.060	0.140
FOREIGN	0.144	0.211	0.000	0.000	0.000	0.375	0.571
INDEN	0.563	0.135	0.000	0.500	0.571	0.667	1.000
BCOM	0.427	0.066	0.267	0.400	0.429	0.471	0.600
FSIZE	31.523	1.631	28.364	30.171	31.716	32.777	34.799
FGROWTH	0.326	1.762	-0.985	0.025	0.115	0.218	16.111
DIV	0.466	0.500	0.000	0.000	0.000	1.000	1.000
FAGE	3.675	0.574	1.099	3.332	3.807	4.043	4.644
LDR	0.848	0.138	0.506	0.787	0.860	0.918	1.407
NPL	0.016	0.013	0.000	0.007	0.013	0.023	0.050

Source: The data were processed by the researchers using Stata 16. Winsorizing was done with the smallest q% of observation data from 1% to 99%.

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Table 4. Pearson correlation

	FOREIGN	INDEN	BCOM	FSIZE	FGROWTH	DIV	FAGE	LDR
FOREIGN	1							
INDEN	-0.20***	1						
BCOM	0.25***	-0.08	1					
FSIZE	0.07	-0.06	-0.22***	1				
FGROWTH	0.07	-0.11*	-0.04	0.12**	1			
DIV	-0.23***	0	0.03	0.42***	0.06	1		
FAGE	0.25***	-0.07	0.19***	0.30***	-0.02	0.19***	1	
LDR	0.27***	-0.05	0.13**	0.22***	-0.09	0.17***	0.21***	1
NPL	-0.09	0.04	-0.03	-0.33***	-0.10*	-0.33***	-0.32***	-0.13**

Source: *, **, and *** indicate significance at the 10%, 5%, and 1% levels.

4.3. Regressions

Table 5 presents the regression results. In this research, it is hypothesized that foreign commissioners and independent commissioners have a positive and significant effect on bank performance. Because the dependent variable (bank performance) is divided into three indicators (ROA, ROE, and NIM), we made three sections to facilitate a regression analysis with two different dependent variable proxies. The researcher tested the research hypothesis by providing empirical evidence for the relationship between foreign commissioners and independent commissioners on bank performance. The results of the regression section of the dependent variable with the ROA proxy show that the foreign commissioner variable (FOREIGN) has a negative and significant relationship to ROA. The first proxy (FOREIGN) showed negative ($\beta = -0.012$) and significant ($p = 0.025 < 0.05$).

Furthermore, ROE was tested. Similar to the results obtained for the first dependent proxy, the independent commissioner variable (FOREIGN) had a negative effect on ROE ($\beta = -0.158$) that reached statistical significance ($p = 0.001 < 0.05$). However, the test results for the third dependent variable proxy (NIM) showed different results, namely that foreign commissioners had a positive influence ($\beta = 0.014$) on NIM ($p = 0.060 < 0.10$).

Furthermore, according to the second hypothesis, independent commissioners were expected to significantly positively affect ROA. Because the dependent variable (bank performance) used three proxies (ROA, ROE, and NIM), we constructed three sections to facilitate a regression analysis with three different dependent variable proxies. The researcher tested the second research hypothesis by providing empirical evidence for the effect of independent commissioners on bank performance. The results presented in the regression section for the dependent variable with the ROA proxy revealed that the independent commissioner variable had an insignificant effect on ROA. As shown in the table, INDEN had insignificant effects on ROA ($\beta = 0.009$; $p = 0.198 > 0.10$), ROE ($\beta = 0.097$; $p = 0.151 > 0.10$), and NIM. ($\beta = -0.014$; $p = 0.139 > 0.1$.

4.4. Robustness test

Table 6 presents the robustness tests. We used lag as the independent variable in these tests. Specifically, we applied a time lag of one year and produced what is called the "independent variable lagging one year." The results of the regression analysis presented in Table 6 show that some of the lag variables support the effect of the main variable, while others do not. The effect of FOREIGN on ROA, ROE, and NIM is consistent with the results without lag, as well as the

influence of INDEN on ROA and ROE. Differently, INDEN has a significant negative effect on NIM.

Table 5. Panel data regression results

Y	ROA	ROE	NIM
Model Approach	Regression 1 REM	Regression 2 FEM	Regression 3 REM
Intercept	(-0.063)	(-0.899)	(0.103)
	0.014	0.000	0.003
FOREIGN	(-0.012)**	(-0.158)***	(0.014)*
	0.025	0.001	0.060
INDEN	(0.009)	(0.097)	(-0.014)
	0.198	0.151	0.139
BCOM	(-0.015)	(0.079)	(-0.054)**
	0.342	0.587	0.012
FSIZE	(0.003)***	(0.028)***	(-0.001)
	0.000	0.000	0.524
FGROWTH	(0.001)	(0.006)	(0.001)
	0.162	0.226	0.319
DIV	(0.007)*	(0.047)**	(0.013)***
	0.003	0.028	0.000
FAGE	(0.001)	(0.036)**	(-0.001)
	0.609	0.037	0.606
LDR	(0.005)	(-0.038)	(0.006)
	0.508	0.589	0.547
NPL	(-0.801)***	(-3,675)***	(-0.426)***
	0.000	0.000	0.000
R Square	0.464	0.316	0.179
Obs	290	290	290

Source: Data Processed by Researchers Using Stata 16. Numbers in brackets are coefficient values. Numbers in italics are probabilities. *, **, and *** indicate significance at the 10%, 5%, and 1% levels.

4.5. Discussion

We developed two hypotheses regarding the effect of foreign commissioners on bank performance and the effect of independent commissioners on bank performance using ROA, ROE, and NIM as proxies. The following is an explanation of the effect of the independent variables on the dependent variable (while considering the control variable) on a sample of banking companies listed on the IDX from 2010-2019.

4.5.1. Influence of foreign commissioners on company performance (ROA, ROE, and NIM)

The evidence shows that foreign commissioners have a negative and significant effect on ROA and ROE but a significant positive effect on NIM. The significant negative effect of foreign commissioners on ROA and ROE shows that having more foreign nationals on a board of commissioners decreases a company's performance, both as measured by ROA and ROE. The two regression results are in line with the research conducted by Ujunwa et al. (2012). This is because foreign commissioners have relatively little information about social and economic issues in the countries where the company operates, which reduces the effectiveness of foreign commissioners in conducting supervision.

However, the evidence also shows that foreign commissioners have a significant positive effect on company performance according to the NIM proxy. This is in line with the results of Polovina and Peasnell (2018), who found that foreign nationals on a board of commissioners improve that company's performance. A commissioner is responsible for supervising the company and providing advice to the board of directors; thus, it is reasonable to assume that a foreign national with extensive industry experience will positively impact the company they work for.

Table 6. Panel data regression results using lagged independent variables

Y	ROA	ROE	NIM
Model Approach	Regression 1	Regression 2	Regression 3
	REM	FEM	REM
Intercept	(-0.042)	(-0.853)***	(0.109)***
	0.132	0.001	0.003
FOREIGN	(-0.013)**	(-0.203)***	(0.012)
	0.033	0.000	0.104
INDEN	(-0.007)	(-0.045)	(-0.028)***
	0.331	0.502	0.005
BCOM	(-0.008)	(0.180)	(-0.055)**
	0.629	0.226	0.014
FSIZE	(0.002)***	(0.024)***	(0.000)
	0.003	0.001	0.837
FGROWTH	(0.001)	(0.011)**	(0.000)
	0.202	0.037	0.587
DIV	(0.007)***	(0.033)	(0.011)***
	0.007	0.132	0.001
FAGE	(0.002)	(0.055)***	(-0.002)
	0.413	0.002	0.446
LDR	(-0.007)	(-0.015)	(-0.004)
	0.427	0.851	0.738
NPL	(-0.791)***	(-3,019)***	(-0.429)***
	0.000	0.001	0.001
R Square	0.426	0.312	0.171
Obs	261	261	261

4.5.2. Influence of independent commissioners on company performance (ROA, ROE, NIM)

The data in regression 1 of Table 5 (along with other independent variables and considering multiple control variables) show that the INDEN coefficient value is 0.009 with a probability value of 0.198> 0.10. This indicates that independent commissioners do not affect company performance (ROA). That is, commissioners who do not have family or business relationships with directors or shareholders in a company do not affect the company's performance (ROA).

Similarly, the data for regression 2 (along with other independent variables and considering various control variables) show that the INDEN coefficient value is 0.097 with a probability value of 0.151 > 0.10. This suggests that independent commissioners do not affect company performance (ROE). In other words, commissioners who do not have family or business relationships with directors or shareholders in a company do not affect the company's performance (ROE).

Meanwhile, the data in regression 3 (along with other independent variables and applying different control variables) show that the INDEN coefficient value is -0.014 with a probability value of 0.139> 0.05. This indicates that commissioners who do not have family or business relationships with directors or shareholders in a company have a negative but insignificant effect on company performance (NIM). Thus the hypothesis predicting that the independent commissioner has a positive and significant effect on company performance (NIM) is rejected.

The absence of independent commissioners' influences on companies' performances (as proxied by ROE, ROA, and NIM) may have been caused by companies' compulsion to comply with specific mandatory rules and regulations. This situation restricted the involvement of independent commissioners in decision-making. This decision-making limitation is caused by the neglect of the integrity and competence of independent commissioners to the extent that they do not affect banks' performances (Kesaulya & Febriany 2018). The high and low percentages of independent commissioners will not affect companies' performances if they are not balanced with the supervision abilities of these commissioners, whose competence does not align with the company's needs.

Likewise, a company's performance will not be affected if an independent commissioner performs less than optimally when carrying out their duties and responsibilities (e.g., encouraging the implementation of appropriate corporate governance principles). This can be done by encouraging other commissioners to carry out their supervisory duties and provide advice to other directors.

5. Conclusion

This study was conducted to determine the effects of foreign commissioners and independent commissioners on the performance of banking companies listed on the IDX, as proxied by return on assets (ROA), return on equity (ROE), and net interest margin (NIM), from 2010-2019. According to the results, foreign commissioners have a significant negative effect on company performance when considering the ROA and ROE proxies. That is, having a higher percentage of foreign commissioners on a board of commissioners lowers that company's performance. This is because foreign commissioners—despite being expected to bring diverse opinions and perspectives, languages, beliefs, family backgrounds, and professional experiences from their country of origin—did not improve the company's performance. Meanwhile, the influence of foreign commissioners on NIM is significant and positive.

Meanwhile, independent commissioners did not affect the performance of banking companies listed on the IDX from 2010-2019, regardless of the proxy considered. This may be due to the companies' compulsion to comply with mandatory rules or regulations. Independent commissioners do not have much involvement in decision-making, and the possibility of appointing an independent commissioner is not based on the competence of the independent board of commissioners required by the company. Moreover, the integrity aspect of the appointed independent board of commissioners might be neglected such that they do not carry out their duties and authorities properly. Thus, the percentage of independent commissioners on a board of commissioners does not affect the company's performance.

5.1. Implications

For companies, this research provides an alternative scientific and informative recommendation and consideration for banking companies in Indonesia. Specifically, the findings of this study could help these companies make the best decisions when hiring foreign and independent commissioners. Commissioners should be selected based on thorough considerations that can positively impact the decisions and actions of managers to maximize company performance. For shareholders, this research provides an informative alternative

recommendation that investors can follow to ensure they invest in the right companies by considering information about banks' performances that is influenced by their commissioners.

5.2. Suggestions for future research

Based on the present, we offer the following suggestions for further research. First, researchers should consider additional proxies (e.g., CAR) when determining company performance. Furthermore, researchers should use sample data that separates state banks from non-government banks; doing so could yield results that have high specifications based on ownership type.

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