

# Determinant of Executive Remuneration in the Indonesian Banking Sector

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## ABSTRACT

The remuneration or the amount of compensation for the board of directors of the banking sector will affect the significance of the relevant banking management and decision-making systems. A sound banking sector management system will be directly proportional to the performance of the banking sector. The research is conducted to analyze the influence of bank performance towards the remuneration of the board of directors in The Indonesia's Stock Exchange Financial Reports using descriptive analysis and to analyze the factors affecting the remuneration of the banking board in Indonesia using static panel modeling analysis. The performance of national banking in 2015 grows moderately with the growth of assets, credit, and Third Party Fund (DPK) of 9.53 persen, 10.85 persen and 7.56 percent per year respectively, so that the profitability of the Indonesian banking industry continues to increase positively, which is an increase of 30 percent – 50 percent per year. The amount of remuneration of the board of directors of public banks in Indonesia is influenced by the number of boards of directors (DIR), number of branch offices (CAB), profit banks (LABA), Loan to Deposit Ratio (LDR), and Operational Income Operating Cost (BOPO) Adequacy Ratio (CAR) and Net Interest Margin (NIM) have no significant effect.

Keywords : Remuneration, Bank performance, Static panel

## I. INTRODUCTION

The current condition of the banking industry shows increased competition. This is indicated by the increasing number of branch offices operating in Indonesia. Recorded until 2015, the number of branch offices that have been opened there are 34,656 branches (Statistic of Indonesia's banking, 2013-2015). The amount increased by 60% from the year 2013 as much as 21,657 branch offices. The data shows that business competition in the banking industry in Indonesia is increasing. Obviously the business competition aims to improve bank profits.

Net Profit (Net Income) is key measurement of a company's success in whole. Profit could affect the Company's capability to get loans and equity funding, the company's position of liquidity and the company's ability to make changes. The amount of profit (earnings) obtained on a regular basis and the tendency or trend of increased profit is a crucial factor and need more attention by the analysts in assessing the profitability of a company.

Table 1 shows the profit of 10 Public Banks which owns the biggest assets of Indonesia's Banking Industry and also represents the 85,1 percent from total population of Public Banks and 67,81 percent of Total Assets in Indonesia's Banking Industry.

Table 1 Profit of 10 Public Banks with the biggest assets 2011-2015

Name of the Bank	Profit (in Billions of Rupiah)				
	2011	2012	2013	2014	2015
BCA	10,818	11,718	14,256	16,512	18,036
Bank Mandiri	12,695	16,043	18,829	20,654	21,152
BRI	15,088	18,687	21,354	24,227	25,411
BNI	5,808	7,048	9,058	10,829	9,141
CIMB Niaga	3,176	4,249	4,296	2,343	427
Bank Danamon	3,402	4,117	4,159	2,683	2,469
Bank Permata	1,038	1,486	1,729	1,587	247
BTN	1,119	1,364	1,562	1,146	1,851
Maybank Indonesia	671	1,230	1,595	722	1,143
Bank Panin	2,053	2,278	2,499	2,594	1,568

Source : The Indonesia's Stock Exchange Financial Reports 2011-2015

Remuneration is a rewards given by the company for their meritorious workforce in helping the company to achieve their goals. For the Banking sector board of directors, Remuneration influence significantly on the management system and the Banking Decision Making. A good banking system management will be directly proportional to the Performance of that Banking sector.

Table 2 shows the Board Director Remuneration from 10 Public Bank with biggest assets 2011-2015. Table 1 and 2 shows the correlation of Profit and Remuneration. For example the Board Directors of Maybank Indonesia Remuneration in year 2012 declined from 2011, while profit of 2012 grows positively for the year before. Bank BTN is experiencing the same in 2014-2015. Its different from what happened to Bank CIMB Niaga, since the profit of Bank CIMB Niaga on 2013-2015 is decreased but the remuneration is still high.

Table 2 Board Directors Remuneration of 10 Public Bank with biggest assets 2011-2015

Name of the Bank	Board Directors Remuneration from 10 Public Banks per 1 person in a year (Million Rupiah)				
	2011	2012	2013	2014	2015
BCA	16,494	19,434	21,177	27,291	29,793
Bank Mandiri	12,308	14,774	17,460	19,259	22,408
BRI	9,637	11,463	13,298	21,358	23,640
BNI	8,184	11,026	20,062	15,682	15,258
CIMB Niaga	9,934	10,430	11,639	11,786	13,545
Bank Danamon	6,372	7,314	11,218	10,839	11,595
Bank Permata	6,867	7,417	9,704	8,402	7,174
BTN	7,265	7,913	9,190	5,757	5,118
Maybank Indonesia	5,093	4,570	6,219	4,630	4,890
Bank Panin	2,862	3,305	3,949	4,700	4,575

Source : The Indonesia's Stock Exchange Financial Reports 2011-2015

Table 1 and Table 2 shows that there is a correlation between the Bank Performance and the Board Directors Remuneration. Previous Researchs also support this opinion, that there's a significant correlation between Board Directors Remuneration and the Financial Performances. Scott (1997) found that the designing Board Directors Remuneration is based on the managerial performance measure, that is Net Income and Stock Price.

The expertise of Executive Managerial functions is closely related with the Financial performance of an organization. Therefore, it needed a good understanding between the level of executive remuneration with the measure of financial success. Agency Theory (Jensen and Meckling, 1976) explains that the connection between Bank Management with the achieving of company's targets is unseparable. Previously, researches which clarify the correlation between remuneration and company's performance have been done in several country including Indonesia. So it can be used as a guide and reference for next researchs. As the research done by Ayadi and Boujèlbène (2013) on the influence of Board Directors to the Board Directors Remuneration on Banking Industry. The variable used on the research are the number of Board Director, ROA and ROE. The result of the research shows that the number of Board Directors and ROE influenced positively and significant, while the variable ROA has no significant influence to the Board Directors Remuneration at Europe Banking. Other research for reference is the research done by Kurawa and Saidu (2014) on the correlation between the Board Directors Remuneration and the Banking Performance illustrated by profit. The result of the research shows the positive and significant correlation between the banking profit and the Board Directors remuneration.

Up to now the research on the correlation of performance and Board Director Remuneration which has been done in Indonesia focused on commercial companies and other sector but Banking, like the research done by Vidyatmoko et al (2009) about the factors influencing the Executive Remuneration and its correlation with the performance of the state-owned plantation company. Therefore, to expand the research on executive remuneration in Indonesia, this research will focus on the Banking sector. Moreover, past researches only see from the profit or Banking's benefit and also the accounting measurement for Bank performance, like ROA, CAR, LDR and so on. However on this research, will also focus on other factors which influencing the remuneration of Banking Board Director, that is the number of Board director at a Bank and the number of branch office that a Bank has which can shows the expansion efforts of a Bank. The Object of this research are the Public Bank of Indonesia.

The purpose of this research is (1) to analyze the remuneration growth and the performance of Indonesia's public banks. (2) to analyze factors influencing the remuneration of Indonesia's public banks board of directors.

## II. RESEARCH METHODS

The type of data used on this researchs are secondary data. Data used are time-series data and cross section. Time-series data involves yearly data for as long as five years, from 2011 to 2015. While the Cross-section data involves 32 Public Banks which registered at Indonesia’s Stock Exchange (BEI).

This research used qualitative analysis method and modelling analysis. The modelling method used is the Static Panel data analysis with Microsoft Excel 2010 and Eviews 6. The research model used is adopted from the research of Ayadi et al (2013) with additions of 3 more research. As for the differences of this research and the research which was done by Ayadi et al (2013) is (1) Addition variable of numbers branch offices of a bank which applied from the Aduda research (2011). (2) the variable of Bank Profit which applied from the Kurawa et al research (2014). (3) Addition variable of CAR, NIM, LDR, and BOPO which applied from the Chowdhury et al research (2012). To analyze the variable or factors influencing the Remunerations of Board Directors, the model is develops as follows :

$$\ln (REN_{it}) = B0 - B1 \ln (DIR_{it}) + B2 \ln (CAB_{it}) + B3 \ln (LABA_{it}) + B4 (CAR_{it}) + B5 (NIM_{it}) + B6 (LDR_{it}) + B7 (BOPO_{it})$$

Estimate the panel model give a chance to the use of fixed effect model or random effect model (Hausman, 1978)

### Data Processing Techniques and Data Analysis

The data processing at this research used the static panel data regression. There is 3 approach in choosing the estimated model of panel data regression which is pooled least square (PLS), fixed effect or least square dependent variable (LSDV), and random effect (Gujarati 2007). Choosing of estimated methods was done to determine the best approach model, that is to use the Chow, Uji Hausman, and Uji LM testing. Also the evaluation model method used on this research is using the hypothesis testing (Test-F, Test-t, Determination coefficient), Assumption testing (Normality testing, Heteroscedasticity testing, multicollinearity testing, and autocorrelation test), and Economical testing.

## III. RESEARCH RESULT

### Descriptive statistics of Research Variables

Table 3 shows the descriptive statistic of all variable that serve as a general overview of internal and external factor condition that influence the amount of Indonesia’s public bank Board director’s remuneration. In five year time from 2011 to 2015, the average of board directors remuneration at Indonesia’s Public Bank is 21,99 percent with minimum of 19,73 percent and maximum of 26,23 percent. The average number of board director per board director remuneration is 1,90 percent, the average number of branch offices per board directors remuneration is 5,51 percent, the average of bank profit per board directors remuneration is 28,32 percent, the average of CAR per publin bank board directors remuneration is 18,60 percent, the average of NIM per public bank remuneration board directors is 6,83 percent, the average of LDR per public bank board directors remuneration is 84,19 percent, and the average of BOPO per public bank board directors remuneration is 84,69 percent.

Table 3 Descriptive statistic

	REN	DIR	CAB	LABA	CAR	NIM	LDR	BOPO
Mean	21.99159	1.905915	5.514717	28.32536	18.60050	6.834750	84.19263	84.69619
Median	21.85862	1.945910	5.766550	28.10835	16.36500	5.310000	84.96000	84.94500
Maximum	26.23062	2.564949	9.269741	30.90994	87.49000	68.58000	140.7200	173.8000
Minimum	19.73517	1.098612	2.564949	13.81551	8.020000	0.240000	43.46000	33.28000
Std. Dev.	1.237722	0.396643	1.546258	1.443185	10.45408	8.289801	12.84819	16.44565
Skewness	0.862029	-0.30195	0.248232	-6.04039	4.580529	6.077071	0.172082	1.235614
Kurtosis	4.396155	2.066535	2.446882	65.30424	28.05086	42.50954	5.632630	9.383185
Jarque-Bera	32.81084	8.240376	3.682777	26851.75	4743.138	11391.52	46.99459	312.3467
Probability	0.000000	0.016241	0.158597	0.000000	0.000000	0.000000	0.000000	0.000000
Sum	3518.655	304.9464	882.3548	4532.058	2976.080	1093.560	13470.82	13551.39
Sum Sq. Dev.	243.5808	25.01481	380.1555	331.1624	17376.77	10926.61	26247.06	43003.04

### The Correlation of Bank Performance to the Board Directors Remuneration of Public Banking in Indonesia.

In banking industry sector the high and competitive remuneration that was given to the employees especially the board directors are expected to make productivity, profit, and business growth. Table 4 shows that the Indonesia’s banking performance is growing positively, shown by the increasing CAR compared to the year 2014 become 21,39 percent and the total assets is increasing on the year of 2015 as much as 9,53 percent so that the level profitability of indonesia’s banking industry is having a positive increase by average of 30 percent to 50 percent per year.

Table 4 General condition of the Indonesia's Banking Sector

Rasio	2014	2015			
		TW I	TW II	TW III	TW IV
Total assets (Billion rupiah)	5.404.403	5.577.929	5.732.978	5.943.259	5.919.406
Credit (Billion rupiah)	3.521.831	3.527.817	3.677.335	3.805.326	3.904.158
DPK (Billion rupiah)	3.940.494	4.028.755	4.156.933	4.297.649	4.238.349
CAR (Percent)	19,57	20,98	20,28	20,62	21,39
ROA (persent)	2,85	2,69	2,29	2,31	2,32
NIM (percent)	4,23	5,3	5,32	5,32	5,39
BOPO (percent)	76,29	79,49	81,4	81,82	81,49
LDR (percent)	89,42	87,58	88,46	88,54	92,11

Source : Statistic of Indonesia's banking, 2015

The consequences of the financial performance of the banking industry have an impact on the appreciation of the board directors in form of increasing remuneration or higher remuneration. Table 5 shows the interval of the board directors remuneration of public bank from the year of 2011 to 2015. The data from the table shows that there is an increase number of banks with the amount of board directors remunerations higher than 10 billion rupiah.

Table 5 the interval of board directors remuneration of Public bank 2011-2015

Interval Remuneasi	2011	2012	2013	2014	2015
x > 10 M (Rp)	6%	16%	19%	25%	25%
5 M (Rp) < x < 10 M (Rp)	31%	19%	19%	9%	13%
x < 5 M (Rp)	63%	65%	62%	66%	62%

Source: The Indonesia's Stock Exchange Financial Reports 2011-2015

Table 6 shows that in year 2015 there are 5 banks which has the remuneration of board directors above 10 billion rupiah, that is Bank BCA, Bank Mandiri, BRI, BNI, and CIMB Niaga. Meanwhile the remuneration of board director of Bank Danamon, BTPN, Bank Bukopin, Bank Permata, OCBCNISP, BTN and Maybank Indonesia is at the interval of 5 billion to 10 billion rupiah. And the remuneration of board director from the rest of the 20 public banks is ad the interval below 5 billion rupiah.

Table 6 The remuneration interval of the Board Directors of public bank 2015

x >10 M (Rp)	5 M (Rp) < x <10 M (Rp)	x < 5 M (Rp)
		Bank JATIM, Bank Mega, PANIN Bank, QNB Indonesia, BNP, ArthaGraha, WSI, Bank Windu, Bank Mestika
BCA, Mandiri, BRI, BNI dan CIMB NIAGA	Danamon, BTPN, Bank Bukopin, Bank Permata, OCBC NISP, BTN dan BII (Maybank)	Dharma, Jtrust Indonesia, Bank Ganesa, Bank MNC, Bank Pundi, Bank Victoria, Bank Sinarmas, Bank BumiArta, BJB, BRI Agro, Bank Ina Perdanadan Bank Nationalnobu

Source: The Indonesia's Stock Exchange Financial Reports 2011-2015

### Selecting the best model

Estimating best model selection is done with the Chow Testing and Hausman testing to choose random-effect model, fixed-effect model, or pooled least square. The result on the Chow testing is the p-value 0.000 is less than 0.05, then decline  $H_0$  and the choosen model is Fixed-effect model. Hence, the best model selection based on Chow Testing and Hausman Testing is fixed-effect model.

Table 7 the estimationresult of the best model selection shows that the variable number of bank board directors, bank profit, LDR, and BOPO significantly affected the remuneration of board directors of public banks.

Table 7 The estimation result of factor model of the determinant factor of board directors remuneration

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Ln DIR	-0.430612***	0.049086	-8.772572	0.0000
Ln CAB	0.151763**	0.082669	1.835795	0.0688
Ln LABA	0.069426***	0.021580	3.217213	0.0017
CAR	0.000227	0.002398	0.094545	0.9248
NIM	0.000322	0.002116	0.152028	0.8794
LDR	0.016246***	0.003005	5.406828	0.0000
BOPO	0.006693***	0.002290	2.922668	0.0041
C	18.06779	0.930100	19.42565	0.0000
<i>R-squared</i>	0.982213			
<i>Adjusted R-squared</i>	0.976628			
<i>F-statistic</i>	175.8393			
<i>Prob(F-statistic)</i>	0.000000			

Remarks:

\*\*\* Significant at 1 percent real level

\*\* Significant at 10 percent real level

Based on the estimation result of factor model shown on table 8, then the research model is:

$$\ln (REN_{it}) = 18.068 - 0.431 \ln (DIR_{it}) + 0.151 \ln (CAB_{it}) + 0.069 \ln (LABA_{it}) + 0.0002 CAR_{it} + 0.0003 NIM_{it} + 0.016 LDR_{it} + 0.0067 BOPO_{it}$$

keterangan

$REN_{it}$  = The remuneration of board directors at bank i at year t (Rupiah)

$DIR_{it}$  = The numbers of board directors of bank i at year t (people)

$CAB_{it}$  = The number of branch offices of bank i at year t (pieces)

$LABA$  = Net profit of bank i at year t (rupiah)

$CAR_{it}$  = Capital Adequacy Ratio bank i at year t (percent)

$NIM_{it}$  = Net Interest Margin bank i at year t (percent)

$LDR_{it}$  = Loan to deposit ratio of bank 1 at year t (percent)

$BOPO_{it}$  = The Operating costs of Operational revenue bank i at year t (percent)

$\alpha$  = Intercept

$\beta_n$  = koefisienregresi

$\varepsilon_{it}$  = Error

## Deciding factor of remuneration of board director at public bank in Indonesia

### Number of bank board director (DIR)

The variable number of director of a bank is affecting significantly on real level as much as 1 percent of the board directors remunerations of a bank (REN) as much as -0,431. These shows that with increasing the number of directors by one percent, the remuneration will decrease by 0,43 percent. The estimation result is in accordance with the initial hypothesis and in accordance with the research of Ayadi et al. (2013)

The more or less number of board directors is unable and has no effect on the management actions in generating profits. This is because the number of board directors is unable to guarantee the effectivity in performing the monitoring functions to the management performances as explained on the research of Widyati (2013). This shows that the performance of the Bank Board Directors in generating profits is not influenced by the number of board directors so that the addition of board directors will only decreasing the percentage of the divisions of board directors remuneration.

### Bank Profit (Profit)

Bank profits affecting significantly on real level at one percent to the remuneration (REN) with the coefficient value estimated at 0,069. This shows that in every increased profits by one percent there will be an increase of remuneration by 0,069 percent. This estimation results is in accordance with the initial hypothesis and in accordance with the research done by Kurawa et al. (2014). This results is also shows that the higher of the profit gained surely will effect on boards remunerations.

In accordance with the letters from the Financial Services Authority Number 40/SEOJK.03/2016 on the implementation of governance on the provision of remuneration for public banks on clause 19 arranged that the provision of remuneration is adjusted with the financial condition of a bank, in case of loss, the variable amount of remuneration given to board directors can be suspended or given with the relatively smaller amount. The increased profits generated by a banks will increase the variable remuneration received by board directors.

### Loan to Deposit Ratio (LDR)

Loan to Deposit Ratio influence significantly on the real level by one percent to the remuneration (REN) with coefficient value estimated by 0,016. This shows that in every increase of LDS by one percent will increase the remuneration by 0.016 percent. The estimation result is in accordance with the initial hypothesis and with the research done by Chowdhury et al. (2014).

LDR is the ratio used to measure the ability of a bank to do expansion or to distribute credits to community, that is if the value of LDR is high it means that the Bank is able to distribute credits to community. Hardiyanti (2012) states that the profit is positively and significantly influenced by LDR. In results the increase of LDR gives the bank a chance to generated profits from the credit distribution. The increase of profit will make the amount of remunerations that received by the board directors higher.

#### **The Operating costs of Operational revenue bank**

The operational cost of operating income (BOPO) influence significantly on the real level by one percent to the remuneration (REN) with coefficient value by 0.0067. This shows that in every increase of BOPO by one percent will increase the remuneration by 0.0067 percent. The estimation results is in accordance with the initial hypothesis and also the research done by Chowdhury et al (2014).

Based on the letter from Bank Indonesia no.6/23/DPNP dated 31 May 2004 states that one indicator of a bank categorized healthy is banks with BOPO value by 76-93%. The condition of banking industry in Indonesia by 2015 state that the average of BOPO value is 82%. This condition shows that the indonesia banking industry is healthy. This healthy condition states that BOPO value at banking industry is efficient or bank is said in good condition on managing its operational costs in generating profits so that the increase of BOPO value will affect also on the increase of bank profits. The long-term effect is that the bigger of profit will maximize the remuneration received by the Bank Board Directors.

#### **IV. CONCLUSION**

Based on the research that has been done, we can conclude that using descriptive analysis to shows the general picture of the internal and external factors which influences the amount of remuneration for board directors of public banks in Indonesia. In five year time from 2011 to 2015, the average of board directors remuneration of public banks in Indonesia is 21,99 percent with minimum value at 19,73percent and maximum value at 26,23percent.

Several factors influencing the remuneration of board director of public banks is the number of board directors, the number of branch offices of a bank, net profit of a banks, Capital Adequacy Ratio (CAR), Net Interest Margin (NIM), Loan to Deposit Ratio (LDR), Operational costs of operating income (BOPO).

The result of the research with static panel model of analysis shows that the amount of remuneration of the board directors in public bank of indonesia is influenced significantly by the number of board directors (DIR), bank profit (Profit), Loan to Deposit Ratio (LDR), and operational costs of operating income (BOPO).

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