Journal of Business and Economics December 2014
Vol. 13 No. 2, p 211 - 224
ISSN: 1412-0070

# FACTORS INFLUENCING PERFORMANCE OF BANKING SECTOR LISTED ON INDONESIA STOCK EXCHANGE

**Fanny Soewignyo**
**fanny_soewignyo@yahoo.com**
*Fakultas Ekonomi Universitas Klabat*

*This study investigated some talent factors that can influence Indonesian banking performance to provide a framework by which business leaders could assess their current management capabilities. Using purposive sampling, 30 banks listed on Indonesia Stock Exchange in 2012 were selected. Corporate governance aspects were measured by employing five talent factors and banking performance was measured using profit per employee. Five hypotheses were tested using multiple regression analysis. The author concluded on two things. Firstly, the larger the number of employees the worsen profit per employee and secondly, higher remuneration for commissioners and directors induced better profit per employee. This study is limited in so far as it considers banking sector listed on Indonesia Stock Exchange only and conducted for only one financial year.*

*Keywords: banking performance, corporate governance, profit per employee, talent factors*

## INTRODUCTION

Finance industry in Indonesia is dominated by banking sector, which represents about 79.5 percent of finance industry's total assets (Besar, 2012). Other players in the finance industry within the market have insignificant share (International Monetary Fund, 2012). The remarkable growth achievement of Indonesia's banking sector following 2008/2009 global financial crisis triggered by benign inflation, low borrowing cost and a triving economy. However, Indonesian banks will continue to rely predominantly on domestic market as a result of ongoing uncertainty of the global economy, while domestic economy experienced from weaker foreign investment and broadening current account deficit. Therefore, to attract foreign investors, Indonesian banks must decrease costs and identify new growth areas. Indonesian local banks may seek alliances with experienced foreign players to cut costs and increase operational efficiency in order to increase regional competition (Global Business Guide Indonesia, 2014). The survey conducted by PwC (2013) shows that the Indonesian bankers keep on maintaining their focus on improving their competitiveness in the market and it also shows their optimisms on the growth of Indonesia. Regardless of instability of the world economy, Indonesian economy continues to grow indicated by the increasing importance placed on Indonesia as a foreign investment target.

Banking industry is one of the knowledge intensive industry, however, this industry face the difficulty of limited source of suitable talent within their businesses. Worldwide, the financial services industry is facing a scarcity of talent (PwC, 2012a). High turnover and high recruitment demand with large salary increase are still at rise. Thus far, compensation and benefit become the focus for many corporations (Kelly Services, Inc., 2013). Many companies in the finance industry have asserted that their employees are of vital competitive advantage (Groysberg, 2011). Consequently, as shown by recent findings of PwC global survey, the war for talent is persistent and the talent shortages could hinder business' growth (PwC, 2011). As indicated by Wibisana (2013), finance industry is always in need of talent and the related talent is a crucial challenge in an attempt to implement strategies for regional scale network development. Therefore, talent management becomes a significant issue in Indonesian banking sector. In spite of this, Van der Sluis and Van de Bunt (2009) asserted that even though many organizations have recognized the significance of talent as a powerful force for their success, only some are managing talent strategically.

The motivation for this study came from Bryan (2007), who argued that excellent performance of a number of biggest and the most successful companies over the past decade indicates the value of intangible assets. It becomes imperative to recognize that financial performance increasingly derives from returns on talent. In a competitive environment where talented employees create intangible assets, return on talent is powerful to offer the larger part of new wealth. Therefore, profit per employee is a good proxy for the return on intangibles. Based on these arguments, this study considered profit per employee in measuring banking performance. However, the question that arises is: how do talent factors influence the Indonesian banking performance.

Being majorly dependent on skilled labor, the finance industry is always in need of talent, as indicated by Kneer (2013). Hence, the purpose of this study was to investigate the factors influencing Indonesian banking performance. Strong institutions cannot be created instantly, more research effort should be done. More specifically, based on a thorough review, no prior study has, theoretically or empirically, examined the talent factors measured by corporate governance aspects to predict Indonesian banking performance as measured by per employee metrics. Per employee metrics are applied in measuring banking performance for the reason that they can assess quality as stated by Morgan Stanley (2011) and furthermore, they can give a performance score to each employee. This study is useful to both practitioners and academics in the fields of talent and per employee metric of banking performance.

This paper is divided into six parts. The fist part was introduction. The second part is the literature review of studies and research in context of Indonesian banking sector. Hypotheses are also developed in this section. The third part is research methods. The fouth part is findings and results. The fifth part is the conclusion, which states the outcomes of this research. The sixth part is the limitations of the present work and directions for future research.

## LITERATURE REVIEW AND THEORETICAL FRAMEWORKS

**Talent Factors.** Talent is claimed as a significant driver of company performance and competitive advantage.According to Mariner7.com. (n.d.), since 1990's the main basis of competitive advantage had shifted from tangible to intangible assets such as talent, brands, and intellectual capital. Talent has obviously emerged as a major source of competitive advantage and a critical driver of company performance. The incremental value of talented people grows continuously as economies become more knowledge based. Many of finance companies reveal that their employees are an important competitive advantage and some companies manage talent proactively to their advantage. However, the research of Groysberg (2011) that focused on the challenges of managing talent within professional service firms, including investment banking, brokerage, and other finance industry confirms that the excellent performance of employees in one company does not guarantee the same level of performance in the other. As indicated by PwC (2012c), the ability to hire, develop, and retain talent has become a major point of competitive differentiation in the developing economies. It is observed that gross domestic product (GDP) is increasingly based on the knowledge, creativity and ability of workers to innovate (Shapiro, 2006). The direct contribution of talent to economic value is expanding. As can be seen in modern industries, talent, innovation, and growth are connected and indicated by greater workforce skills and technology intensities. This relationship is forecasted to be strengthened by more than 70 percent by 2020 (Dirks, Gurdgiev & Keeling, 2010). Despite high level of unemployment and oversupply of job seekers, some companies face shortage of skilled and talented workforce. High level of unemployment does not mean that the talent needed is always available. It is not easy to substitute the loss of critical talent as the shortage of skilled employees continues to grow (Gibson, 2012). Even a large increase in wages will not necessarily lead to many new people ready to fill the jobs. Therefore, according to Groysberg (2011), fair payment to employees is important so as to retain talent. Bryan (2007) asserted that nowadays, intensive talent drives the creation of wealth and must be measured accurately by company management. It is real that so many business leaders change talent strategies in order to solve their problems of skill shortages which could have significant impacts on corporate growth. As customers' needs change rapidly, the workforces and talent needs are changing as well (PwC, 2012b). This study will particularly focus on the following five talent factors related to corporate governance aspects.

***Board of Commissioners Size.*** According to Indonesian board of commissioners principles, the size of the board of commissioners must be sufficient to fit the complexity of the business by taking into account the effectiveness of decision-making. The board shall function and be responsible for overseeing and providing advice to the board of directors and ensuring that the company implements Good Corporate Governance (GCG). However, the board is prohibited to participate in making operational decisions. Each member, including the chairman, has equal position. The duty of the Chairman of the Board of Commissioners is to coordinate the activities of the Board of Commissioners (National Committee on Governance, 2006).

***Board of Directors Size.*** As stated by National Committee on size that suits the complexity of the business by taking into account the effectiveness of decision making. In addition, Ljubojević and Ljubojević (2008) argue that board size may influence the dynamics in board functions. For instance, a large and diverse board of directors may improve board performance in terms of knowledge and talents. In contrast, this form of board would likely face group dynamics dilemma, which in turn makes the board less effective. Smaller boards are more efficient compared with boards with more members as it is easier to attain agreements on decision making (Lublin, 2014).

***Audit Committee Size.*** An audit committee (AC) is assigned to give an independent professional advice to the board of commissioners upon the statement or other matters, which are submitted by the board of directors to the board of commissioners, and identify the matters which need the board of commissioners' attention. An independent committee is the one that consists entirely of outside and independent directors (Rebeiz & Salameh, 2006). The audit committee is at least comprised of three persons, one of whom will be the independent commissioner of the listed company who is also the chairman of the audit committee, while the other members are the external parties who are independent, at least one of whom must be an expert in accounting and/or finance (Capital Market Supervisory Agency, 2004; Jakarta Stock Exchange Inc., 2004). Experience shows that an audit committee is likely to function most effectively with small membership of three to six people (Wallace & Zinkin, 2005).

***Total Number of Employees.*** As asserted by Bryan (2007), annual Governance (2006), the composition of board of directors must be of sufficient reports are filled with information regarding capital utilization but present insufficient information about the number of employees. Therefore, according to Bapepam and LK Rulebook (2006), annual report of a public company as an important source of information for shareholders and general public in making investment decision is required to discuss the number of employees as well.

***Board of Commissioners and Board of Directors Remuneration.*** Board of commissioners and board of directors remuneration is an important information regarding the implementation of Good Corporate Governance in Indonesia, which are required to be disclosed in the annual report of publicly listed company (National Committee on Governance, 2006). The principles of corporate governance indicate that the remuneration of commissioners and directors is an important aspect for effective implementation of corporate governance (Oviantari, 2011). According to Talha, Sallehhuddin, and Masuod (2009), remuneration of directors (executive and non-executive) which includes the basic salary and other monetary or non-monetary benefits received during their tenure, should be included in the corporate governance process.

Non-executive directors are independent directors as they are not directly engaged in operational function but they are given tasks to oversee the executive directors, for example by chairing remuneration committee, audit committee and nomination committee (Talha, Sallehhuddin, & Masuod, 2009). In two tier board system like in Indonesia, the function of non-executive directors is conducted by board of commissioners.

**Company Performance.** Performance measurement is a complex phenomenon, which is related to the objectives of a company. Neerly, et al., as cited in Veltri (2009) define performance measure as a metric used to quantify the efficiency and/or the effectiveness of an action. The efficiency measures are productivity measures, variously calculated, but based in any case on accounting measures. The effectiveness measures, a proxy measure of value, can be distinguished into: profitability measures, based on accounting and/or financial data. The accounting measures are easy to apply, available and certified by auditors. Financial ratios are used as a tool to measure financial performance and if calculated accurately and timely, it could provide important information to business owners (Alvarado, 2011). Financial performance analysis is conducted to determine the efficiency and performance of management to ensure that the business is run in a realistic way, to provide enough returns to its stockholders and maintain at least its market value (Bhunia, Mukhuti, & Roy, 2011). Barton, Hansen, and Pownall (2010) examine the value of a comprehensive set of performance measures. They find that no single measure dominates around the world. The results suggest that, when it comes to equity valuation, accounting researchers and standard-setters should focus not on what performance measure is best at a given point in time, but on the underlying attributes that investors find most relevant.

Financial performance indicators based on balance sheets, cash flow reports, and income statements will remain the primary metric for assessing a company and its management. However, to improve the capability for wealth creation, corporate executives must adopt the idea of changing financial performance metrics to focus on knowledge intensive people rather than on capital alone. By looking at performance in this new way, business executives will change the internal measurements of performance and hence encourage managers to make better business decisions. Company's real wealth could be created by profit per employee. Therefore, profit per employee becomes a measure for how efficiently a company manages complexity (Bryan, 2007). Evidence from Europe in 2001-2002 revealed that companies who made more money per employee did extremely better than their labor heavy peers. However, the situation has contracted since the credit crisis. Moreover, using simple analysis of US Companies, Markit (2013) found that by outsourcing most of their work they actually moved close to the top of list in terms of protitability per employee.

**Talent Factors and Company Performance.** Talent in the workforce continually provides economic benefits at many levels, generates wealth and hence needs to be measured more accurately by business executives (Bryan, 2007; Society for Human Resource Management, 2012). In today's economy, business performance is critically driven by talent. Talent has become the key competitive factor of every business and the incremental value of talented people keep on growing whilst the supply lags behind the demand (Mariner7.com, n.d.). Therefore, every organization must make sure they have the talent needed to achieve the expected performance since talented people could be available but not always in the position where they are needed. The right talent could be somewhere in the world (Craig, Thomas, Hou, & Mathur, 2011).

The collaboration of talented people in a company creates intangible value and subsequently increased revenues. More specifically, in thinking intensive companies that rely on the skills of knowledge workers, the average net income per employee is approximately 3.5 times higher than the labor intensive companies and sometimes, even more than 10 times (KPMG, LLP, 2010). According to Bryan (2007), profit per employee focuses on talented people who can produce valuable intangibles and one way to increase a company's profit per employee is to drop unprofitable employees.

By utilizing sample firms listed on New Zealand Stock Exchange over a four year period from 2004 to 2007, Bathula (2008) found that board size is positively associated with firm performance. Likewise, based on a randomly selected sample of 75 companies listed on Bursa Malaysia, Abidin, Kamal and Jusoff (2009) examined the association between board structure and corporate performance, they found that board size have a positive impact on firm performance. On the other side, using a sample of 93 non-financial firms listed on Dhaka Stock Exchange in 2006, Rouf (2011) found that there is no significant relationship between board size and firm value measured by return on equity and return of assets as dependent variables. Angaye, Gwilliam, Marnet, and Thomas (2009) employed board structure as proxy of corporate governance measured by board size, board composition, ownership structure, leadership structure and duality, board diversity, and CEO nationality status. The empirical findings do not generally indicate any significant associations between the investigated board size and corporate performance measured by profitability as well as other performance measures.

The management of a limited liability company in Indonesia adopts a two board system, namely the Board of Commissioners and the Board of Directors. Each of which has a clear authority and responsibility based on their respective functions as mandated by the articles of association and laws and regulations. Yet, they both have the responsibility to maintain the company sustainability in the long term and have the same perception regarding the company's vision, mission and values. The Board of Commissioners performs the supervisory and advisory roles, and the Board of Directors performs the executive role (National Committee on Governance, 2006). Responding to the different findings related to board structure and the two tier board system in Indonesia, the following research hypotheses are set:

***H*1: Companies with a greater number of board of commissioners size will have greater profit per employee.** Total number of board of commissioners members was used to measure board of commissioners size and net profit divided by total number of employees was used to measure profit per employee.

***H*2: Companies with a greater number of board of directors size will have greater profit per employee.** Total number of board of directors members was used to measure board of directors size.

Kajola (2008) asserted that the relationship between the audit committee and the two performance measures are not statistically significant. However, the study of Mohd Saat, Karbhari, Xiao, and Heravi (2012) found that audit committee governing increased firm performance when there is high proportion of independent audit committee members with practicing accountant experience on the committee. These findings lead to the following research hypothesis:

***H*3: Companies with greater number of audit committee members will have greater profit per employee.** Chhinzer and Ghatehorde (2009) analyzed academic research to investigate the relationship between HR metrics (e.g. headcount, salaries, recruitment) and organizational financial performance (e.g. revenue, costs, profit). They concluded that most firms decrease their workforce through layoffs or downsizing to improve financial performance and rarely react to poor financial performance by increasing its workforce. On the contrary, regardless of their performance or cost related to workforce, companies do not downsize when doing well financially. Based on these conclusions, the following hypothesis is set:

***H*4: Companies with greater number of employees will have greater profit per employee.** Total number of permanent and non permanent employees reported in 2012 annual report was used to measure the number of employees. The study of Oviantari (2011) investigated the relationship between Indonesian board of commissioners and board of directors' remuneration and firm performance using a sample of 100 listed companies throughout the period of 2008-2009. The study found that the return on assets and the remuneration of commissioners and directors shows a negative direction. It could be argued that the negative direction is significant because the observation period is the period of global financial crisis. Therefore, even if the direction is negative, shareholders keep on increasing the remuneration to motivate management to maintain the business processes in a going-concern condition. The study also found that sales positively affect remuneration. On the contrary, the relationship between variable remuneration and earnings per share is not significant. In fact, the principles of corporate governance requires that directors remuneration should be linked to corporate performance. In line with that result, using panel data for the 1992-2005 period, Doucouliagos, Haman and Askary (2007) explored the relationship between board of director's pay and performance of Australian banking. The results indicate that Australian directors' pay does not relate to performance with a one year lag. However, with a two year lag, total directors' pay had robust positive association with earnings per share, as well as with ROE. Likewise, the study of Ghosh and Aggarwal (2011) in India focused on the effectiveness of the boards to the firm's performance with the financial data of twenty five companies for seven years. They found that directors' remuneration does not have any significant relationship with firm's profitability. Based on the requirement of corporate governance principles the following hypothesis is set:

***H*5: Companies with greater board of commissioners and board of directors remuneration will have greater profit per employee.** Board of commissioners and directors remuneration was measured by total compensation for commissioners and directors such as salaries, allowances, bonuses, and other facilities. The reason for utilizing total remuneration amount for both commissioners and directors is because some companies do not report the remuneration for commissioners and directors separately. As far as this study was conducted, there was no previous study found by utilizing talent factors measured by corporate governance aspects specifically and their relationship with profit per employee to measure banking performance.

## RESEARCH METHODS

***Population and sample.*** The listed banks in general offer an ideal sector is always in need of talent that is heavily relied on skilled labor; (3) the governance and performance. There were 31 banks listed according to IDX as of 2012, however, not all banks were used for this study. One company whose income statement degenerated into negative profit was eliminated from analysis. Given this limitation, all other remaining companies were selected which yielded a final sample of 30 companies.

***Data Collection.*** This study used secondary data: annual reports of the listed banks which are available on the Indonesia Stock Exchange (IDX) website. Campbell and Abdul Rahman (2010) noted that the company has total editorial control over the annual report and it is usually the most widely issued of all public documents produced by the company. Logarithm of profit per employee to measure banking performance was used and five talent factors related to corporate governance aspects as independent variables were employed in this study. Data needed to measure the five talent factors are available in the annual reports as well as net profit.

***Statistical Analysis.*** The multiple regression analysis was performed to test the influence of independent variables to dependent variables. The regression models are presented below:

Talent factors predict profit per employee.

$$\text{LogNetP} = \beta_0 + \beta_1\text{BOCSize} + \beta_2\text{BODSize} + \beta_3\text{ACSize} + \beta_4\text{LogTNEm} + \beta_5\text{LogBoar} + \varepsilon$$

where:

LogNetP: Logarithm of Net Profit per Employee

area of talent factors research, because: (1) there are reliable data available in the form of published annual reports; (2) the business nature of banking participants of stock exchange are deeply concerned with the corporate

BOCSize: Board of commissioners size

BODSize: Board of directors size

ACSize: Audit committee size

LogTNEm: Logarithm of total number of employees

LogBoar: Logarithm of board of directors and board of commissioners remuneration

$\beta_0$: Intercept coefficient

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5$: Coefficient for each of the independent variables

$\varepsilon$: Error term

Linearity assumption was verified through examination of scatter plots of residuals that indicates linear relationship between the independent variable (s) and the dependent variable. Normal probability plots has given evidence to the normality of data used. The plots appear as a straight line all the way through. These results supported by Chan (2003) that small sample sizes of $n<30$ are always assumed as not normal and moderate sample size is in between 30 to 100. With these reasons the sample size of 30 is assumed as normal. Multicollinearity between the independent variables was checked with variance inflation factors (VIFs). The VIF values indicate that multicollinearity is not a problem for this analysis as the VIF values are below the recommended cutoff of 10. The plots of profit per employee have no pattern, which implies that no heteroskedasticity caused by these variables. As stated by Gupta (2000), heteroscedasticity implies that the variances of the residuals are not constant.

## FINDINGS AND RESULTS

Table 1 presents the results of multiple regression analysis. The regression model of the study with profit per employee as dependent variable shows that the calculated value of *F*-statistic is 3.378 and the significant *F* is at *p*-value of 0.019. This suggests that the overall model is significant and the adjusted $R^2$ of the model indicates that 29.1% of the variance in profit per employee can be explained by the five talent factor predictor variables. Each hypothesized talent factor is examined further below.

The empirical results show that *H*1, *H*2, and *H*3 are not supported with *p*-value > 0.05. Hence, board of commissioners size, board of directors size, and audit committee size do not have a significant influence on profit per employee. The results support the view in the literature that there is no significant relationship between board size and corporate performance measured by profitability (Angaye et al., 2009; Rouf, 2011). Hypothesis 3 (*H*3) predicts that companies with greater number of audit committee members will have a stronger positive profit per employee. The result is not consistent with the expectation, the audit committee size does not have a significant influence toward profit per employee ($\beta$ = .144, *p*-value > 0.05). This result supports the finding of Kajola (2008). These findings may support the conclusion of Craig et al. (2011) that every organization must make sure they have the right talent needed to achieve the expected performance since talented people could be available but not always in the right position where they are needed.

Hypothesis 4 (*H*4) predicts companies with greater number of employees will have a stronger positive profit per employee. The result shows a negative and statistically significant influence of total number of employees towards profit per employee ($\beta$ = -.893, $p < .05$), indicating that listed Indonesian banking performance measured by profit per employee tends to decrease when the number of employees is increased. This finding is in agreement with Chhinzer and Ghatehorde's (2009) findings which showed that most firms decrease their workforce to improve financial performance.

Hypothesis 5 (*H*5) predicts companies with greater board of commissioners and board of directors remuneration will have a stronger positive profit per employee. The empirical result shows that the coefficient for board of commissioners and board of directors remuneration is positive and statistically significant with profit per employee ($\beta$= 1.328, $p < .05$). Hence, when the board of commissioners and board of directors remuneration increased, profit per employee is likely to increase. Thus, hypothesis *H*5 is fully supported. Although, this result differ from those studies of Doucouliagos et al. (2007), Ghosh and Aggarwal (2011) and Oviantari (2011), however, this is consistent with the principles of corporate governance that directors remuneration should be linked to corporate performance (Oviantari, 2011).

Table 1
Results of Multiple Regression Analysis for (*H1*-*H5*)

| Variables (with hypothesized relationships in parentheses) | Net Profit per Employee Unstandardized $\beta$ (*p-value**) |
|---|---|
| (Constant) | -1.022 (.472) |
| *Hypotheses:* | |
| *H1*: Board of Commissioners size (+) | -.077 (.332) |
| *H2*: Board of directors size (+) | .023 (.797) |
| *H3*: Audit committee size (+) | .144 (.179) |
| *H4*: Total number of employees[a] (+) | **-.893 (.027)** |
| *H5*: Board of commissioners and directors remuneration[a] (+) | **1.328 (.009)** |
| $R^2$ = | .413 |
| Adj. $R^2$= | .291 |
| *F* – value = | 3.378 |
| Prob. *(F)*= | .019 |
| No. of companies/observations = | 30 |

*Predictors: (Constant), BOCSize, BODSize, ACSize, LogEmpSize, LogBoardRm*
*Dependent Variable: LogNetProf*
**Significant at the 0.05 level*
[a]*Transformed variable with logarithm*

## CONCLUSION

Empirical data from this study provides support for the importance of talent factors in determining Indonesian banking performance. The findings from this study have several implications for banking sector employers, shareholders, regulators, board of commissioners, board of directors, and managers. First, the results provide evidence that in Indonesian context the size of board of commissioners, board of directors, and audit committee do not have any significant influence toward profit per employee. This finding should be particularly informative to shareholders, regulators and board of commissioners in their evaluation of the desirable size of board of commissioners, board of directors, and audit committee that could have positive influence on the banking profit. Second, the findings indicate that directors and managers should pay particular attention to the number of employees, as the greater the number of employees, the lesser the profit per employee. Third, employers should understand that increasing the board of commissioners and board of directors remuneration is needed to improve profit per employee. Individuals responsible for developing a company's board of commissioners and board of directors remuneration should be mindful of its significance. Finally, these findings provide several contributions to accounting, finance and management academic research. Prior studies have examined the influence of talent factors measured by corporate governance aspects on firm performance, however, none of those studies has, theoretically or empirically, examined the five talent factors related to corporate governance aspects simultaneously to predict banking performance measured by net profit per employee. The findings obtained are important to be used by the banking sector to give better understanding of performance and its drivers and lead to managerial practices that can improve the performance of this significant sector of economic activity. This study also provides a basic reference and guide to analyze banking performance and as a useful eye-opener for scholars and policy makers.

## LIMITATIONS OF THE PRESENT WORK AND DIRECTIONS FOR FUTURE RESEARCH

This study is limited in so far as it considers banking sector listed on Indonesia Stock Exchange only and was conducted for only one financial year. To support the robustness of the conclusions to confirm the applicability of the findings of this study, future research can build on this work by investigating data from other sectors, other markets, and longitudinal data analysis to better understand which talent factors matter and when they matter most. Despite the possible limitations of using a single nation and one financial year data, the results from this study provide an interesting and valuable insights about potential path for further in depth studies to complement on-the-ground knowledge to make the result more illuminating. Future studies on the current topic are therefore recommended.

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