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THE IMPACT OF BOARD DIVERSITY ON EARNINGS QUALITY OF INDONESIAN BANKS

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ABSTRACT

The aim of the research is to empirically demonstrate how the size of the board, duality, experience, independence, and gender in the board of directors can affect the quality of the profits generated by banks listed on the Indonesian Stock Exchange. The research method used is quantitative description by regressing annual report panel data using eviews 12 software. The sample of the research is a banking company in the period 2019-2022. Research results show that the size/quantity of the Board of Directors can reduce the quality of profits, the duality of the board of directors does not decrease/ improve profit quality, the experience that the board has can improve the value of profit, the independence of the boards of directions does not affect the quality and the gender of bank profits. The implication of this research is to provide input to shareholders to consider the characteristics of the board of directors that they possess can generate reliable/quality bank profits such as the independence of the Board of Directors.

Keywords: *Earnings quality, Board diversity*

1. INTRODUCTION

Financial information contained in financial statements is becoming increasingly important for investment decision making, especially when there is uncertainty that impacts the business. The information in question is the net profit generated by the company during the company's business/operations in one period/year. Earnings quality, according to recent research (Dempster & Oliver, 2019), is an important measure of the reliability of financial information used by interested parties such as investors, lenders, creditors, and others. Where the quality of net income is very helpful for decision makers (Li, 2014); (Dempster & Oliver, 2019).

Earnings quality is the ability of reported earnings to reflect the company's actual earnings, as well as the usefulness of reported earnings to predict future earnings (Saleh et al., 2020). Therefore, decision makers need more sensitive and high-quality information to make the right decisions. According to the research results of (Francis et al., 2005)states that creditors often use earnings quality information because earnings quality is negatively correlated with the cost of capital (Easley & O'hara, 2004). Companies with high earnings quality also receive discounts in the cost of equity and debt (Ecker et al., 2006).

Earnings quality provides information about financial misstatements and increases investor confidence in earnings information. Previous studies, such as (Cheng et al., 2019) and (Chan et al., 2015), also found that it can be used to predict future corporate returns. Earnings quality provides information about a company's assets in place and future earnings, as shown by (Beyer et al., 2019)and (Perotti & Wagenhofer, 2014). This suggests that earnings quality contributes to significant investor uncertainty management. (Mitra, 2016) adds that earnings quality is strongly negatively associated with firm-specific return uncertainty. Management discretionary behavior and economic fundamentals have an impact on firm-specific return uncertainty, and current earnings provide useful information to predict future earnings and the ability to pay dividends in the future.

Current earnings provide useful information to predict future earnings and the ability to pay dividends in the future, and managerial discretionary behavior and economic fundamentals have an effect on firm-specific return volatility (Dempster & Oliver, 2019). Therefore, we can note that users consider earnings quality as one of the reliable and most important indicators to make financial forecasts about returns and to indicate information asymmetry.

The current banking conditions began to experience an increase in profits after facing the Covid-19 pandemic conditions, where during the Covid-19 pandemic conditions banking profits decreased due to investor perceptions that the government at that time had not taken serious action against Covid-19. Investors prefer to withdraw their funds from the capital market after the health crisis that occurred, which caused a decrease in profits (Mayasari et al., 2020). Banks facing the Covid-19 pandemic conditions yesterday faced the following two problems: (1) Closure or restrictions on banking service offices, so that branch offices (KC) take over services previously provided by sub-branch offices (KCP). (2) Increased operational costs due to the need to provide project support tools such as masks, disinfectants, multivitamins, and hand sanitizers in sufficient quantities to maintain environmental health (Fauziah et al., 2020).

The phenomenon in this research is a bank's attempt to improve the quality of its profits after two more years of covid 19 pandemic, namely by finding a board of directors that has the right characteristics (described as diversity) with the aim of attracting confidence, persuading shareholders to remain fixed investors and also attract new shareholder. In addition, the selection of board of directors based on diversity (characteristics) can also control management performance so as not to form a conflict of agency between management and stakeholders. Because the board of directors is responsible for monitoring the quality of the profit information contained in the financial statements, and thus the board can control the behaviour of managers to ensure that their actions are in the interests of stakeholders.

The research gap in this research is that there is no consistency between the results of the research and the diversity of the board of directors that banks have with the quality of the profits generated in any country. Therefore, the researchers are interested in reviewing the diversity of the board of directors to the quality of the profits of the banks listed on the Indonesian Stock Exchange, which have different characteristics than companies in the manufacturing sector.The reason for the takeover of the banking sector is that banking is an industry that has gained policy stimulus in the National Economic Recovery Programme by 2020 which is expected to improve the quality of profits so as to gain the confidence of investors and give its future impact is able to restore the economic condition of Indonesia after the Covid-19 pandemic.

From the explanation above it is concluded that the research problems are: 1) Does board gender have a positive impact on earnings quality?; 2) Does board duality have a negative impact on earnings quality?; 3) Does the experience of the board of directors have a positive impact on earnings quality?; 4) Does board independence have a positive impact on earnings quality?; 5) Does board size have a positive impact on earnings quality?

By providing empirical evidence of the effect of board diversity on the quality of earnings owned by Indonesian banks. Where good earnings quality can increase investment and improve banking performance after experiencing the Covid-19 pandemic. The board of directors' diversity used is board size, duality, experience, independence, and gender of board members.

Earnings Quality

The earnings quality in this research is a dependent variable, which is defined by (Al-Momani & Almomani, 2018) earnings stability, namely the extent to which earnings performance persists into the next period. Meanwhile, (Dechow & Schrand, 2004) state that earnings quality is realized when earnings reflect the company's operating performance and when they provide an indication of the company's future operating performance. Earnings quality is stated when earnings reflect business performance and when they provide an indication of future business performance (Al-Othman & Al-Zoubi, 2019) defines earnings quality as the company's current ability to provide a true picture of the company's future performance and survival. According to users of financial statements, creditors consider profitability as a measure of lending decisions, while shareholders consider earnings as a measure of management effectiveness.
The significance of earnings itself makes the idea of profit quality crucial. Financial statements are utilized, as previously said, to make financial and investment decisions as well as to assess the overall and specific efficacy of the company's management. Investors have been more cautious when analyzing net profits as a result of concerns about the quality of profits growing over the last ten years after numerous multinational businesses disclosed unrealized and fluctuating profits in their triennial reports (Al-Othman & Al-Zoubi, 2019). Earnings quality and earnings management are important issues that currently concern investors, in addition to the issue of scandals and financial crises. Quality and earnings management issues emerged at the turn of the century, when user confidence in financial statements declined or even lagged (Al-Momani & Almomani, 2018).

This study uses the earnings quality formula from (Penman, 2013) research with the formula:

Earnings Quality = Operating Cash Flow / Net Income

Where, the results of operating cash flow are divided by net income, if the results of the earnings quality ratio are greater than 1.0
earnings quality ratio is greater than 1.0 indicates high earnings quality, while if the ratio is less than 1.0 indicates low earnings quality.

Board Size

Board size of directors or the number of management members on the board is a crucial element in the existence of the board. Increasing board size will increase organizational adequacy to help management reduce agency costs arising from mismanagement and lead to better financial results resulting in quality earnings to provide investor confidence (Jensen & Meckling, 1976);(Al-Momani & Almomani, 2018); (Khudhair et al., 2019).

Duality

The term "duality of the board of directors" refers to the board's duty for two positions that it occupies, such as the board's position and the audit committee position inside the same organization (Putri & Devie, 2017). According to agency theory, having two CEOs is bad for the business since it can impede the supervisory board's ability to evaluate and oversee the board of directors' performance and interfere with the board of directors' ability to govern(Putri & Devie, 2017). Furthermore, conflict-of-interest issues that influence decision-making for personal purposes will not be of concern to management.

Experience

In some research, the age of the board of directors is an asset to the board and is considered part of human capital, because age can reflect experience and risk taking (Irwansyah et al., 2020). In addition, younger boards will be more positively associated with strategic changes and more willing to participate in the monitoring process (Irwansyah et al., 2020). This will improve board performance and decision making. In other words, improved performance with a younger board will improve the quality of the company's earnings, so that corporate governance will be better.

Independence

The Board of Directors is in charge of managing the business for the company's goals and interests, as per the Limited Liability Company Law. To further the interests of shareholders, the board of directors needs a mix of executive and non-executive directors. If non-executive directors on the board are not unbiased in their business judgment and are not independent of management, they will not be able to carry out their obligations in an effective manner. According to(Shin & Kim, 2018) , independent directors are those who possess the trust of shareholders to act on their behalf and minimize agency conflicts, hence enhancing the caliber of reported profits.

Gender

Gender diversity has attracted the attention of various scholars where increased gender diversity in board members will result in better boards and governance as diversity allows boards to utilize a wider range of human resources to serve as directors (Haruna et al., 2018). According to a number of studies, the majority of female directors are outsiders who work in non-corporate fields (Yami et al., 2023). Additionally, when compared to men, they are more likely to have managerial skills in areas like marketing, human resources, legal, communications, and public relations as opposed to line operations(Zelechowski & Bilimoria, 2004). Women also have diverse perspectives, attitudes, and modes of speaking and expressing their viewpoints. Because of this, women are more inclined to challenge established practices and voice their concerns through more inquiries and candid conversations when they are unhappy with a particular issue or managerial choice (Huse & Grethe Solberg, 2006); (Haruna et al., 2018).

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Grand Theory

The research uses two grand theories, the Resource dependency theory and the Upper Echelons theory. Resource dependency theory states that board diversity increases the resources provided by board members, such as skills, information, legitimacy, and access to key stakeholder resources (e.g. suppliers, buyers, public policy makers, and social groups) (Irwansyah et al., 2020). Therefore, board diversification in terms of age, gender and ethnic origin can provide unique information for management to make better decisions (Ayuso & Argandoña, 2009). Resource dependence theory provides an important argument in favor of board diversity. This theory states that board diversity brings new ideas and perspectives to the firm, and increases creativity and innovation (Carter et al., 2008).

The Upper Echelons theory developed by (Hambrick & Mason, 1984) that companies choose their business strategies and these decisions can be influenced by the characteristics of their top management (TLM). In other words, a company's behaviour or way of doing things can be assessed by looking at the characteristics of top management. Superiority theory states that managerial characteristics influence decision-making and firm performance. Superiority theory also states that organizational outcomes such as firm performance, strategic direction, innovation, creativity, and diversification are influenced by the demographic diversity of directors, such as education level, nationality, and gender.

Hypotheses

H1: Board size has a positive effect on banking earnings quality
H2: Duality of the board of directors has a negative effect on banking earnings quality
H3: Experience as a board of directors has a positive effect on banking earnings quality
H4: Independence of the board of directors has a positive effect on banking earnings quality
H5: Gender on the board of directors has a positive effect on banking earnings quality

2. RESEARCH METHOD

Quantitative methods are used in this research to test theories: certain hypotheses are discussed, then data is collected to support or oppose those hypotheses. This research uses parametric statistical tests by regressing panel data in the form of annual reports.

The sample used is a banking company for the 2019-2022 period listed on the Indonesia Stock Exchange (IDX), which determines the sample using the purposive sampling method, with the aim of obtaining a sample in line with the predetermined criteria. The following are some of the criteria that will be used as research samples, namely: (a)Listed on the IDX continuously in the 2019-2022 period; (b)Did not experience losses in the 2019-2022 period; (c)Its financial statements use the rupiah currency (symbol: IDR); (d)Not conducting mergers in the 2019-2022 period; (e)Not conducting an IPO within the 2019-2022 period; (f)Not experiencing delisting from the IDX in the 2019-2022 period.

Based on the criteria mentioned above, the banking sample that can be processed becomes twenty-nine banks with a total of 116 observations.

The research model uses panel data regression analysis with the panel data regression equation as follows:

EQt = ait + bBSit + cDUALit + dEXPit + cINDit + +eGENDei*t* + e …..…(1)

Notes:
EQ = Earnings quality
BS = Board size
DUAL = Duality
EXP = Experience
IND = Independence
GEND = Gender
e = error

Table 1. Operationalization Variable

Variable	Measurement
1. Dependent	
Earnings Quality (Penman, 2013)	Operating Cash Flow / Net Income
2. Independent	
Board Size (Kurniawati & Setiawan, 2022)	Measured by assuming the board of directors owned
Duality (Wulandari & Apriada, 2022)	Measured by the dummy variable, where the duties of chairman of the board of directors and executive director are given to one person, the company is given the number one instead of the number zero.
Experience (Rawabdeh, 2016).	Measured by counting the average age of board members
Independence (Gharaibeh, 2016)	Measured by dividing the number of independent board members by the total number of board members
Gender (Kurniawati & Henny, 2021)	It is calculated by dividing the number of women in the board of directors by the total number of members of the board.

Research using panel data regression techniques which according to (Hsiao, 2003) has several advantages, namely: a) Panel data can solve the problem of a larger spectrum and unbiased, which cannot be solved using cross-sectional or time series data alone; b) It generates more degrees of freedom and reduces the level of collinearity between explanatory variables, resulting in increased estimation efficiency. So, with these virtues, the classical. assumption test on the panel data model does not have to be done (Gujarati & Porter, 2015); (Ekananda, 2016).

Pooled OLS, within-group fixed effects, random effects, and fixed effects least square dummy variable (LSDV) models are the four models utilized in panel data regression (Gujarati & Porter, 2015). The selection of the model to be used is selected by the model specification test. There are two specification tests, namely fixed effects or random effects.

Furthermore, after the research model has been determined, followed by a significance test, namely the F test and the t test. The F test and t test are carried out using the probability of t count, when the prob < 10% sig level. concluded Ho is rejected and Ha is accepted.
After the significance test, it is continued to determine the extent to which the research model is able to explain the variation of the dependent variable, called the coefficient of determination (R^2). The value of R^2 is usually in the range 0-1, so it is said that the closer to 1, the better the research model, and vice versa.

3. RESULTS AND DISCUSSIONS

Panel Data Model Analysis Technique

Chow Test. The aim is to understand which fixed effect or common effect model is best applied in this study.

H0: Common Effect
Ha: Fixed Effect

A zero hypothesis (H0) is a hypothèse that says that there is no relationship between the independent variable (X) and the dependent variable (Y). In other words, in the hypotheses formula, what is tested is whether the variable actually affects (X). An alterative hypothesis (H1) suggests that there is a relationship between the independent variable (X) and the dependent variables (Y) studied. The calculation of H1 will be used as a basis for compiling the research data.
If the chi-square probability shows a result < 5%, then H0 is not accepted. So, it can be concluded that the study uses a fixed effect model.

Table 2. Redundant Fixed Effect-Likelihood Ratio Model Test Results
Source: output Eviews 12

Effect Test	Prob.
Cross-section F	0.0461
Cross-section Chi-square	0.0045

From the table above, it is concluded that the right model is fixed effect, because the probability value is <5%. Then the Hausman test is carried out with the criteria:

H0: Random Effect
Ha: Fixed Effect

A zero hypothesis (H0) is a hypothèse that says that there is no relationship between the independent variable (X) and the dependent variable (Y). In other words, in the hypotheses formula, what is tested is whether the variable actually affects (X). An alterative hypothesis (H1) suggests that there is a relationship between the independent variable (X) and the dependent variables (Y) studied. The calculation of H1 will be used as a basis for compiling the research data.
If the chi-square random probability shows a result <5%, then H0 is not accepted. So it can be concluded that the research uses a fixed effect model.

Table 3. Hausman test results Model
Source: output Eviews 12

Test Summary	Chi-Sq.Statistic	Prob.
Cross-section random	3.925707	0.5602

From the table above, it is concluded that the right research model is random effect compared to fixed effect, because the random cross-section value has Prob> 5%.

Furthermore, the Lagrange Multiplier test is conducted to test the best model whether random effect or common effect. If the Breusch-Pagan probability < 5%, it means that H0 is not accepted and the model chosen is Random Effect.

H0: Common Effect
Ha: Random Effect

A zero hypothesis (H0) is a hypothèse that says that there is no relationship between the independent variable (X) and the dependent variable (Y). In other words, in the hypotheses formula, what is tested is whether the variable actually affects (X). An alterative hypothesis (H1) suggests that there is a relationship between the independent variable (X) and the dependent variables (Y) studied. The calculation of H1 will be used as a basis for compiling the research data.

Table 4. Lagrange Multiplier test result
Source: output Eviews 12

	Test Hypothesis		
	Cross-section	**Time**	**Both**
Breusch-pagan	1.948299	7.742603	9.690902
	(0.1628)	(0.0054)	(0.0019)

The results of the Lagrange Multiplier test show the Breusch-Pagan probability > 5% of 16.28%, this indicates that the best research model is common effect compared to random effect.

Table 5. Model Estimation Result (Common Effect Model)
Source: output Eviews 12

Variable	Coefficient	t-stat.	Prob.
C	-131.4119	-1.416230	0.1595
BS	-3.451135	-2,144343	0.0342
DUAL	4.678273	0.463844	0.6437
EXP	2.784582	1.868133	0.0644
IND	10.22178	0.493847	0.6224
GEND	33.23219	1.315370	0.1911
R^2	0.096035	DW stat.	1.551039
Adjusted R^2	0.054946		
F-stats.	2.337231		
Prob. F-stats.	0.046543		

The research trial with the application of panel data analysis aims to gain an understanding of the effect of the characteristics of the Board of Directors consisting of size/number, duality, experience, independence, and gender on the quality of earnings generated. The research model used is the commo effect model with panel data regression as follows:

$$\mathbf{EQ = -131.4119 - 3.4511*BS + 2.7845*EXP + 10.2117*IND + 33.2321*GEND}$$

Based on the regression equation, the constant coefficient value is -131.4119. The independent variables in the model that have an impact on firm value are defined as:

Table 6. Hypothesis Result
Source: output eviews12

Hypothesis	Hypothesis Explanation	Prob. Value	Conclusion
H1	Board size has a positive effect on banking earnings quality	0.0342	Accepted
H2	Duality of the board of directors has a negative effect on banking earnings quality	0.6437	Rejected
H3	Experience as a board of directors has a positive effect on banking earnings quality	0.0644	Accepted
H4	Independence of the board of directors has a positive effect on banking earnings quality	0.6224	Rejected
H5	Gender on the board of directors has a positive effect on banking earning's quality	0.1911	Rejected

H1: The size of the board of director has a negative effect on the quality of banking earnings.

Based on table 5 it is evidenced that the size/number of the Board of Directors can reduce earnings quality with a coefficient value of 3.4511 and a probability of 0.0342. These results are not in accordance with the proposed hypothesis, because according to Agency theory argues that a larger board size increases agency costs and monitors the company inappropriately (Kao et al., 2019). And also, Jensen (1993) states that when the size of the board of directors increases beyond a certain point, this affects the performance of the company in the opposite direction, and causes free rider problems among many boards of directors.

H2: Duality of the board of director does not affect the quality of banking earnings.

The panel data regression results shown in table 6 reject the hypothesis with a probability> 10%, which supports the research results of (Bataineh et al., 2018)on the grounds that it is very small for the Board of Directors in the Company to do two job desc at once, because at the beginning they already know that doing two job desc will lead to fraud in the company's operations, so the Board of Directors prevents this from happening by not accepting two job desc in running the company. In addition, in reality in Indonesian banking, there are only 24% of the Board of Directors doing duality.

H3: Experience as a board of director has a positive effect on the quality of banking earnings.

Based on the results of the panel data regression table 6, the results accept H3, namely the experience of the board of directors can improve earnings quality. These research results support the research results of (Al-Othman & Al-Zoubi, 2019) in public companies in Jordan. This is because the average age of the Board of Directors is above 54 years old so it can be concluded that they have had a lot of previous experience to become the Board of Directors.

H4: Independence of the board of director does not affect the quality of banking earnings.

Based on the results of the panel data test (table 6), it is found that it rejects hypothesis 4, namely the probability value> 5%. The research results support the research results of (Tulung & Ramdani, 2018) with a sample of public companies on the Athens Stock Exchange with the findings that companies that have more independent board members have poor performance. The reason is that boards of directors with more independent members are more likely to form audit committees, which shows that the boards of directors of Greek companies take a more active role in providing advice than working. In addition, the results of Rashid's research (Rashid, 2018) which took a sample of Bangladeshi public companies proved that the independent board of directors did not affect the company's performance because the board of directors appointed in the company were mostly from insiders so they had more information about the company than outsiders / independent and thus the independent board of directors had to rely on them to make decisions on the company's operations.

H5: Gender on the board of director does not affect the quality of banking earnings.

Furthermore, based on table 6 proves that it rejects hypothesis 5 with a probability value of less than <5%. The results of this research support (Na & Hong, 2017) which proves that the female Board of Directors cannot improve or reduce earnings quality / earnings management for French public companies. This is because the sample companies are small and do not even have a female board of directors in their ranks so that the company cannot take advantage of the basic feminism possessed by women. In addition, this is in accordance with the International Financial Corporation (IFC) in 2019 that Indonesia is still behind Thailand and

Vietnam in the number of women who occupy the board of directors in public companies, which is 14.9% (Razak & Helmy, 2020)..

4. CONCLUSIONS AND SUGGESTIONS

Financial information (net income) contained in financial statements is becoming increasingly important for investment decision-making, especially when there is uncertainty that impacts the business. Quality net income is an important measure of the reliability of financial information used by interested parties such as investors, lenders, creditors, and others. Where the quality of net income is very helpful for decision makers to support the increasing quality of net income, the diversity of the board of directors is needed in order to maximize its duties so that the achievement of goals can attract the trust of potential investors. Diversity of the board of directors, namely size, independence, duality, experience, and gender of board members.

The panel data regression results demonstrate that the number and size of the board of directors can have an impact on the quality of the earnings; the duality of the board can neither increase nor decrease the quality of the earnings; the board's experience can enhance the quality of the earnings; the board's independence has no bearing on the quality of the earnings in the banking industry; and the gender composition of the board of directors has no bearing on the quality of the earnings. Further investigation into factors like nationality, experience, and other characteristics that might improve the quality of banking earnings can broaden the diversity of the board of directors.

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