

THE IMPACT OF THE BOARD OF DIRECTORS' EXPERIENCE, EDUCATION, AND COMPENSATION ON INDONESIAN BANKS' FINANCIAL PERFORMANCE

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ABSTRACT

The company's governance enables it to be regulated and overseen in order to adhere to the law, stakeholder expectations, and relevant business ethics and standards. For the firm to survive and prosper in the long run, the board of directors, which makes the majority of the decisions, chooses the company's strategic course. As a result, in order to motivate the board of directors to enhance financial performance, it is essential to secure their wellbeing by paying them. In addition to salary, the board of directors' expertise and education in business and finance are probably going to be a factor in enhancing Indonesian banks' financial performance. The aim of this study is to demonstrate empirically the relationship between the financial performance of Indonesian banks and the board of directors' experience, business and financial education, and salary. The research sample consists of banking businesses from 2019 to 2023, and the research methodology is quantitative description utilizing annual report data. The EvIEWS-12 software tool aids in this study by generating 155 observation data that can be processed. According to the study's findings, the bank's financial performance has been demonstrated to be improved by the board of directors' salary. The business and financial education of the board of directors cannot enhance or detract from the bank's financial performance. The same results have been shown by the board of directors' experience, which can enhance the bank's financial performance.

Keywords: *Compensation, Business and Finance Education, Experience of The Board Of Directors, Financial Performance*

1. INTRODUCTION

The implemented corporate governance explains the roles, duties and responsibilities of all stakeholders, which is key for the company to discipline management in running the business. The company's shareholder ownership is spread across the company, controlled by managers (Rahman et al., 2017). Because of this, the board of directors serves as an efficient corporate governance tool that unites the interests and worries of all parties involved, especially shareholders and managers. The board of directors makes the majority of the decisions and sets the company's strategic direction for long-term survival and success. It also plays a significant role in maximizing dividends for shareholders (Rehman et al., 2019). As a result, a number of studies have linked the board of directors' role in improving the company's financial performance in recent years (Rahman et al., 2018; Rehman et al., 2019). Prior research has mostly concentrated on the independence of the board, gender diversity, and other significant characteristics that are connected to financial performance (Rahman et al., 2020; Rehman et al., 2019). According to Rehman et al. (2018), some of them also focus on the directors' age, experience, compensation, and family relationships, all of which are connected to the business's financial performance. Nevertheless, the majority of these studies on the connection between board composition and business performance were carried out in developed nations, and the findings were mixed, showing both positive and negative effects on the company's financial performance (Rahman et al., 2017; Rahman et al., 2018). Furthermore, the findings of a study carried out in one nation might not be suitable or applicable in another due to contextual

reliance and variations in the social, financial, economic, and regulatory settings (Rahman & Zahid, 2019). Consequently, separate and independent studies are needed in different countries with different cultures to examine how rarely examined board characteristics affect financial performance, which is a major concern for companies, especially those operating in developing countries.

This study not only reviews the characteristics of the board of directors in companies in the banking industry, but also looks at the annual compensation of the board of directors as a factor that influences the company's financial performance.

Financial performance is defined as a picture of a company's financial condition that is studied using financial analysis techniques (Al-Ahdal et al., 2020). This allows someone to see the financial condition of a company, which shows the company's performance over a certain period of time. The company's financial performance can be optimized through the use of corporate governance that is founded on professional ethics and aims to create added value for all parties concerned. The education and experience gained as a board of directors serve as the governance used in this study.

The results of Fernandes et al. (2018) prove that board experience and business and financial education are determining factors that are positively correlated with bank performance. The same results were proven by Sidki et al. (2024), showed that the proportion of managers without experience on the board of directors has a significant negative effect on the financial performance of German state-owned enterprises. However, different results were proven by Usman and Kibiya (2021); Pereira and Felipe (2021) who had education in business and finance were shown to decrease company performance. The reason is because board directors who have business and finance education use their education for their personal interests, which, in many cases, is not beneficial to the bank's financial performance. Different results have been proven by Fernandes et al. (2017) where board directors who have education in business and finance cannot improve or reduce the company's financial performance.

From several studies that have been conducted, there is an inconsistency in the business and financial education and experience of the board of directors, which is due to several factors. Thus, by including the variable of the board of directors' compensation, this study reexamines the board of directors' attributes (experience, education in business and finance), where the compensation should be used as motivation to work harder to achieve the company's goals, namely improving financial performance. As proven in several studies that show a positive and significant relationship between board of directors compensation and financial performance, including research conducted in American companies (Aguinis et al., 2018). And also the results of research in South Africa by Ntim et al., (2018) and Razali et al., (2018) in Malaysia found a positive and significant relationship between director remuneration and financial performance. However, the findings of the study by Runkat & Ismiyanti (2024) show that, from 2014 to 2018, CEO compensation had no discernible effect on the value of publicly traded financial firms. This is caused by a number of things, including the pay structure's poor design, which hinders the board of directors' ability to work at its best.

The following research questions are posed in light of the above description of the research problem: 1) Does the board of directors' compensation boost banking financial performance? 2) Does the board of directors' business and financial education boost banking financial performance? 3) Does the board of directors' experience boost banking financial performance?

This study proposes a limitation on the sample used in the study, namely banking companies that have gone public (IPO) listed on the Indonesia Stock Exchange between 2019 and 2023. Our Contribution

This research provides benefits, namely providing insight to investors that providing high compensation to the board of directors can motivate the board of directors to maximize their potential in order to maximize banking profits.

Bank Financial Performance

For stakeholders, investors, and a nation's economy, a company's financial performance is crucial. For investors, one form of return on investment is financial performance. A company with strong financial performance offers a high rate of dividend return on investment, and since the investment is long-term, it is obviously a very valuable form of profit (Mohamed et al. 2020). Isbanah (2015) asserts that a company's financial performance serves as a gauge of how well its management are managing the business. Parties with an interest in the business are asked for financial performance data.

According to the description given above, a company's financial performance serves as a gauge for achieving its objectives and gaining a competitive edge. Return on Assets (ROA) is a fundamental metric used to evaluate a company's financial performance (Yanikkaya et al., 2018; Qayyum & Noreen, 2019). Arquisola et al. (2018) claim that ROA is a helpful indicator of a bank's profitability, which can subsequently be used to predict future profit levels and guarantee the sustainability of the business. ROA calculates the overall efficiency of asset-based profit generation. The ability to reap the rewards or profits from money invested is another way to think of ROA. The return on assets (ROA) is determined by dividing net income by total assets after interest and tax costs have been subtracted (Tangsingalu et al., 2020).

Compensation of Board of Directors Members

Board compensation in the literature on board characteristics related to corporate governance has become one of the most debated issues in recent years. This is especially true when trying to find a compensation system that aligns the principal's and agent's interests while distributing risk between the two parties. This is especially true when attempting to understand a compensation system that distributes risk among the two parties while also emphasizing the importance of agents and principles. Compensation plans need to be created in a way that motivates board members to decide and act in a way that will enhance the business's total worth and performance. According to Pucheta-Martinez and Gallego-Alvarez (2020), board salary should be sufficiently high to entice the company to hire skilled and experienced directors. Nonetheless, board compensation needs to be decided openly and impartially, taking into account the directors' qualifications and the corporate governance ethos. Because it may conflict with the organization's long-term objectives, it shouldn't be founded on short-term objectives (Pucheta-Martinez and Gallego-Alvarez, 2020).

Several academics have examined board remuneration, including Saidu et al. (2017), Ataay (2018), and Kurniawati and Setiawan (2022). Their findings demonstrate that board compensation can enhance a company's financial success. This is because paying board members allows them to maximize their potential to boost company profits through improved financial performance. However, research by Sitompul and Muslih (2020) and Pucheta-Martinez and Gallego-Alvarez (2020) demonstrates that the salary of the board of directors has no bearing on the company's performance, either positively or negatively. This is because the provision of compensation/remuneration to members of the board of directors needs to consider

many things other than their performance, namely based on the level of knowledge and expertise that members of the board of directors must have. Therefore, receiving this payment does not ensure that directors will perform their jobs more effectively and efficiently, which would enhance the success of the company. The log total board compensation received is used in this study to calculate the board of directors' compensation (Pucheta-Martínez, & Gallego-Álvarez, 2020).

Business and Finance Education

The focus of business legislation on the expertise and professionalism of directors can be used to gauge the significance of the board of directors' education. Based on its importance, the educational qualifications of the nominated directors are a major concern. Therefore, it is advisable not to hand over the affairs of the board of directors to people who are unqualified or have low qualifications, in the fields of business and finance. This is because it can not only damage the company's performance but also endanger the company's survival to compete in the market.

The results of several studies, the board of directors who have education in business and finance such as the results of the study by Fernandes et al. (2018) emphasized that the experience of the board of directors and expertise related to the industry (finance) were found to be determinants that were positively correlated with bank performance. Although the board of directors of companies with less overall experience may not trigger a crisis directly, the practices of the company's board of directors appear to have influenced the extent to which the company is vulnerable to the economic crisis. According to Jin and Mamatzakis' (2018) research on banking in China, there is a negative correlation between the educational background of board members and the performance of Chinese banks. Different results were also proven by Lubis et al., (2022) who took the object of a manufacturing company that the business and financial education possessed by the board of directors was not able to increase/decrease the financial performance of the manufacturer. The reason for this is that not every member of the board of directors has experience with business and finance, but have knowledge in the field of economics and business from non-formal education (attending business and financial seminars) and also obtained from the experience they had previously gained (Lubis et al., 2022).

Board of Directors Members Experience

Previous literature often uses the age and experience of directors that are associated with company performance. Most people believe that older or senior people have a lot of experience that cannot be replaced in making better decisions made by those who understand the industry and market better. Compared to their younger counterparts, senior board directors make better Decision choices and make fewer mistakes in implementing decision results. Additionally, the board of directors' experience enhances the operation of the organization because it helps them manage risks and other organizational problems (Tulung & Ramdani, 2016).

Tulung and Ramdani's results are supported by research by Al-Matari (2019) and Henry (2019) with different research objects, where the results are that a more experienced board of directors is needed in decision making and identifying errors that must be solved for the smooth operation of the company. However, in some studies, young directors are preferred because they do not have knowledge of the latest technology and lack physical stamina (Abdullah & Ismail, 2013). The effectiveness of senior directors is also influenced by issues such as avoiding risk, protecting careers, and needing funds. Therefore, many studies show that the level of director leadership decreases business performance (Ismail & Manaf, 2016). In addition, this

study found that young directors who are responsive and dare to take risks can enhance the financial performance of the business (Muravyev, 2017). The experience of the board of directors in this study was measured by how long a board of directors served as a director in the current period and in the previous period (in the same company) (Al-Matari, 2019).

Hypothesis

According to the findings of the explanation of the research variables, the board of directors' compensation, their own business and financial education, and their experience can all be empirically demonstrated to enhance the financial performance of the company. So, the hypothesis proposed in this study are:

H1: Board of director's compensation has a positive effect on financial performance

H2: Board of director's business and financial education has a positive effect on financial performance

H3: Board of director's experience has a positive effect on financial performance

2. RESEARCH METHOD

Companies in the banking industry that are listed on the Indonesia Stock Exchange (IDX) between 2019 and 2023 serve as the study's population. Not all businesses can be used as research samples in this study; only businesses that fit the predetermined requirements can be used. The research sample is viewed from the website www.sahamok.com, and the company data is obtainable from www.idx.co.id. This research uses banking samples listed on the IDX with 2019–2023, with Sampling carried out using the purposive sampling method as the sampling technique by collecting samples that meet the predetermined criteria that are included as research samples.

A number of criteria, such as the following, will be used as research samples: The rupiah (IDR) is used in its financial reporting, and it was consistently listed on the IDX between 2019 and 2023; it did not incur losses during that time; it did not conduct a merger during that time; it did not conduct an initial public offering (IPO) during that time; and it did not experience delisting from the IDX during that time.

It was determined that 155 observations from 31 Bank annual reports across a five-year research period could be processed based on the previously mentioned criteria.

Panel data regression analysis is used in the study model, and the panel data regression equation is as follows:

$$ROA_t = a_{it} + bKD_{zt} + cPEND_{it} + dPENG_{it} + eBS_{it} + e \dots\dots\dots(1)$$

ROA = Bank financial performance

KD = Board of director's compensation

PEND = Board of director's business and financial education

PENG = Board of director's experience

BS = Board size

e = error

Table 1. Operationalization of Variables
 Source: Research Articles

Variables	Measurement
1. Dependent Variable	
Bank's financial performance (Tangsingah, et al, 2020).	ROA = net income / total assets
2. Independent Variables	
Directors Compensation Pucheta-Martinez, M.C., Gallego-Álvarez, I. (2020)	Measured by log total board compensation
Business and Finance Education	Proportion of the number of Board of Directors who have education in business and finance. Compared to the total number of Board of Directors
Experience Al-Matari (2019)	Measured by how long a board of directors has served as a board of directors in the current and previous periods.
3. Control Variable	
Board Size	Number of board of directors

Research using panel data regression techniques which according to Hsiao (2003) has several advantages, namely: a) In contrast to cross-sectional or time series data alone, panel data can provide an unbiased solution to the problem of a wider spectrum; b) This provides more degrees of freedom and a lower level of collinearity between the explanatory variables, thereby increasing the efficiency of estimation. So, with these virtues, It is not necessary to perform the traditional assumption test on the panel data model (Gujarati & Porter, 2015; Ekananda, 2016).

The four models used in panel data regression are the pooled OLS model, the least square dummy variable (LSDV) fixed effects model, the within-group fixed effects model, and the chance effects model (Gujarati & Porter, 2015). Model specification tests are used to select the model to be used. Fixed effects or random effects are two options for specification testing.

Furthermore, after the research model has been determined, followed by a significance test, namely the F test and the t test. The F and t tests are carried out with a calculated t probability with a significance level of less than 10%, then H_0 is rejected and H_a is accepted. After the significance test is completed, it is necessary to find out how well the selected research model can explain the variation of the dependent variable called the coefficient of determination (R^2). The R^2 value that makes the research model the best is if the R^2 value is close to 1, and vice versa, because the R^2 value is between 0 - 1.

3. RESULT AND DISCUSSIONS

A classical assumption test on the data is the next step. This includes normality, multicollinearity, heteroscedasticity, and autocorrelation tests. The traditional assumption test on the panel data model does not need to be performed, though, because panel data regression techniques have the following benefits: (1) they can solve larger and unbiased spectrum problems that cannot be solved with cross-sectional or time series data alone; (2) they can generate more degrees of freedom and reduce the level of collinearity between explanatory variables, resulting in increased estimation efficiency; and (3) they can generate more degrees

of freedom (Hsiao, 2003; Gujarati & Porter, 2015; Ekananda, 2016). So, the next sequence is to conduct a panel data model analysis.

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

Table 2. Redundant Fixed Effect-Likelihood Ratio Model Test Results

Source: Output Eviews 12

Effect Test	Probabilitas
Cross-section F	0,0000
Cross-section Chi-square	0,0000

Based on the results of the Redundant Fixed Effect-Likelihood Ratio Model test, it is clear that the fixed effect model is the most suitable for this study. This is due to the fact that the chi-square cross-section probability value is 0.0000, which indicates that the chi-square cross-section probability value is smaller than the 5% significance value, or less than 5%. The Hausman model test was also conducted to show that the fixed and random effect models are the best for this study, according to the following criteria:

H0: Random Effect

Ha: Fixed Effect

It can be concluded that this study uses a fixed effect model if the random cross-section probability shows a result of <5%, then H0 is not accepted and Ha is accepted.

Table 3. Hausman Test Results Model

Source: Output Eviews 12

Test Summary	Chi-Sq.Statistic	Probabilitas
Cross-section random	14,6342	0,0055

The random cross-section probability, as determined by the Hausman model test, was 0.0055 (0.55%). This indicates that the fixed effect model, in which the random cross-section probability value is less than the significance value of 5% (<5%), is the most effective study model.

Table 4. Model Estimation Results (Fixed Effect Model)

Source: Output Eviews 12

Variable	Coef.	t-stats	Prob.
C	0,2487	1,8996	0,0599
KD	0,0338	0,9530	0,0342
PEND	.00,0066	0,3170	0,7517
PENG	0,0173	0,7388	0,0461
BS	-0,0062	-1,2829	0,4856

Table 5. Model Estimation Results (Fixed Effect Model)
 Source: Output Eviews 12

R ²	0,6344	Durbin-Watson stat.	2,1071
Adjusted R ²	0,5308		
F-stats.	6,1258		
Prob. F-stats.	0,0000		

Significance Test Results

F test. Based on table 4, the F-count value obtained is 6.12580 and the F probability is 0.0000. In this study, the level of significance used is 10%, so it can be concluded that the F test is proven to be significant. Therefore, it can be concluded that the compensation of directors, business and financial education owned by the board of directors, experience owned by the board of directors, and bank size can affect the bank's financial performance.

t test. The results of the t-test analysis in table 4 show that: (1) the amount of compensation received by the board of directors of Banks in Indonesia can improve financial performance with a probability of 0.0342, where the value is smaller than the significance level of 10%; (2) The variable of business and financial education owned by the board of directors is proven to be unable to improve the bank's financial performance, as evidenced by a probability value of 0.7517 where the value exceeds the significance level of 10%; (3) Different results are proven by the length of experience of the board of directors serving as directors at the Bank, can improve the financial performance of the bank where they work, with a probability value of 0.0461 where the value is smaller than the significance level of 10%; (4) And the size of the bank in this study is proven to be unable to improve the bank's financial performance.

Coefficient of Determination (Adjusted R²). Adjusted R² or model suitability based on statistical test results is 0.53088. This value indicates that the independent variables used in the research model contribute 53.08% in explaining the dependent variable. Meanwhile, 46.92% indicates that there are other factors outside the research model that also have an effect in explaining the dependent variable.

The research model used is a fixed effect model with panel data multiple regression:

$$\text{ROA} = 0,2487 + 0,0338 \cdot \text{KD} + 0,0066 \cdot \text{PEND} + 0,0173 \cdot \text{PENG} - 0,0062 \cdot \text{BS}$$

Based on the panel regression equation, the constant coefficient value is 0.2487. The independent variables in the model that have an impact on tax avoidance actions taken are defined as:

H1: Board of director's compensation has a positive effect on financial performance

The findings support hypothesis 1, which states that the board of directors' compensation can enhance the bank's financial performance. The findings of this study corroborate those of Saidu et al. (2017), Ataay (2018), and Kurniawati and Setiawan (2022), who documented that board of directors' compensation can enhance the financial performance of the organization. The reason is that by providing compensation to board members, they can maximize their ability to increase bank profits by improving their financial performance. These findings also lend credence to agency theory, which holds that director pay or compensation is a crucial tool for addressing or resolving persistent agency issues in businesses by balancing the interests of managers and shareholders. When owners (shareholders) or principals desire to increase earnings but haven't decided how much to pay managers based on their education and experience to accomplish this goal (Haron, 2018). Furthermore, this study's findings are

consistent with stewardship theory, which holds that raising executive compensation and rewards can boost company performance. Additionally, a number of empirical research demonstrate a beneficial relationship between director salary and business performance (Razali et al., 2018; Sheikh et al., 2018).

H2: Board of director's business and financial education has a positive effect on financial performance

This study shows that bank financial performance cannot be improved by a board of directors with a business and finance educational background. These findings corroborate the study conducted by Lubis et al. (2022) on a sample of manufacturing companies. The study posits that not all board members possess a formal education in business and finance, such as a bachelor's or master's degree, but that they may possess business and finance expertise through non-formal education (attending seminars on business and finance) and prior experience. These findings are also consistent with the fact that, on average, the Bank's board of directors regularly attends seminars or professional training in business and finance to gain experience in these areas. As a result, the organization must establish a policy for hiring board members who have completed at least a Bachelor of Business and Finance degree and have a formal education in these fields. The rationale is that a board of directors with a background in business and finance will be better able to improve financial performance outcomes and steer clear of management's earnings management tactics. For further reasons, they can perform better financially and create financial reporting techniques more efficiently (Saerang et al., 2018; Kendrila, et al., 2022).

H3: Board of director's experience has a positive effect on financial performance

The conclusion drawn from Hypothesis 3 is that the expertise of the board of directors improves the bank's financial performance. These findings corroborate the findings of Al-Matari (2019), Henry (2019), and Fernandes et al. (2018), who found that a bank's financial performance can be enhanced by the length of time its board of directors serves. Since senior or older boards of directors have a wealth of expertise that cannot be replaced, not even by higher education, these results are consistent with the fact that the average board of directors of non-BUMN banks has more than 10 years of experience. According to the study's findings, senior directors also make better decisions and commit fewer errors than their younger counterparts. Additionally, the board of directors' experience aids businesses in managing risks and other significant organizational concerns, which enhances performance (Demeke, 2016; Tulung & Ramdani, 2016).

4. CONCLUSIONS AND SUGGESTIONS

This study found that board of directors' education in business and finance can improve a bank's financial performance, but compensation for the board of directors does not. However, the bank's financial performance can benefit from the board of directors' experience. Despite several restrictions, it is anticipated that this research will offer future scholars' insights or recommendations. Among the limitations of this study are as follows: 1. This study only uses two attributes of the board of directors related to the bank's financial performance: education (business and finance) and board of directors' experience. 2. The sample used in this study is limited to companies included in the banking sector.

Additional variables, such as the qualities of the audit committee, the board of commissioners, and the caliber of auditors the bank chooses, can be used in future studies to help banks in Indonesia enhance their financial performance.

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