

Board of Directors and Remuneration in Indonesian Banking

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Abstract—This research examines the effect of commissioner and remuneration committee characteristics on the remuneration in the banking sector of Indonesia. Using a sample of 18 banks for the fiscal year that ends on December 31 2006 through 2012, this study finds evidence of negative impact of gender and number of meeting on the remuneration. With respect of size as a control variable, this study proves a positive impact on the remuneration.

Keywords—Remuneration, Remuneration committee characteristics, Commissioner characteristics, Indonesia banking

I. INTRODUCTION

According to a survey of Indonesia Bank, Indonesia has the highest incentive fee among the directors of banks in ASEAN. Incentive fee of banking directors in Philippines is 1.1 million Rupiah per year, 5.6 million Rupiah in Malaysia, 2 million Rupiah in Thailand, and 12 million Rupiah in Indonesia [32]. Salaries of directors and commissioners of banks in Indonesia is the highest in Southeast Asia [32]. According to the state minister of economic, remuneration system should be based on performance [17].

Executive remuneration is important because proper remuneration could motivate human resources to work better and board director to take actions or policies that meet the interests of shareholders [18], key to attract and retain the best executive, as an incentive for managers to boost productivity of manager and show better financial performance [18].

Remuneration committee was set up in Indonesia banking in 2006 with the regulation of [29] and modified in [30]. Remuneration committee tasks are to generate remuneration policies and make recommendations to the board of commissioners and is expected to assist the commissioners in aligning the interests of managers and shareholders [19].

The purpose of this study is to examine the effect of the characteristics of the commissioners and remuneration committee to the remuneration of banking in Indonesia. Characteristics of the commissioners in this study are: gender proportion,

size of commissioners, proportion of independent members, the number of commissioners meeting, and frequency of attendance at the commissioner meeting. Characteristics of the remuneration committee are: the proportion of independent members and size of remuneration committees with control variables are firm size and firm performance.

The difference of this study with previous studies is this study does not use a stock ownership as monitoring instrument to company. Unlike previous research in Indonesia such as [27], this research correlated to remuneration committee.

In the next section, we will explain about literature review and hypotheses development in section two, research method in section three, result and discussion in section four, and research conclusion and implications in section five.

II. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Agency theory explained that the agency conflict occurred because of the separation between ownership and control of the company [18]. In these circumstances, managers had a tendency to make the consumption of excessive additional advantage. To minimize conflict between insider and external stakeholders, monitoring mechanism is needed to align them [9].

Compensation package as internal mechanism was developed to align the interests of managers with shareholders [18], [19], such as ESOP (Employee Stock Ownership Plan) or a stock option. With the ownership of shares, when any increase in the company's performance would have a direct impact on the welfare obtained [37].

According to references [11], [8], [28], [39] and [20] corporate governance influenced remuneration. Reference [1] examined the influence of gender on governance and performance of the 1939 companies in the US in the period of 1996-2003. They reported that greater gender diversity would encourage over monitoring because women were more active than men in the meeting attendance. When monitoring is increased, it became more rigorous in monitoring so that the total remuneration become lower. Women on the board effects executive compensation negatively

because women are more careful than men. Thus, the hypotheses can be stated as follows:

H₁: Proportion of gender on the boards negatively affects remuneration

According to reference [7] the greater size of commissioners, the easier and more effective in monitoring activities of management. This opinion was supported by [12] which stated that the greater size, the more complete in expertise is commissioner.

The board member required coordination and communication with each other in order to achieve the best performance. According to [23] greater size of commissioners affect remuneration positively especially on basic salary and bonuses. This happen because of the existence of potential inefficiency, rent-seeking, and free rider issues in the company. Reference [10] stated that CEO compensation correlated positively with the size of BOD. Reference [28] stated that when size of the board was getting bigger, it would provide greater compensation. Thus, the hypotheses could be stated as follows:

H₂: Size of commissioners positively affects remuneration

Reference [2] stated that the monitoring activities of the board could be viewed via the number of meeting. The same opinion was expressed by [11] which stated that the number of commissioners meeting was one way to create an effective board of directors. Thus, the hypothesis can be stated as follows:

H₃: The number of commissioners meeting positively affects remuneration

Reference [11] stated that the greater number of the commissioners who came to the meeting will increase the communication between the directors and the company's internal controls, so that the work of commissioners became more effective. Members of the board commissioners who attend the meeting show that they were serious in carrying out their duties [36].

Reference [1] stated that frequency of attendance at meetings was one way to get important information and performed their monitoring task. Higher level of attendance in meeting means better process of board governance and evaluation, therefore the hypotheses proposed in this study was:

H₄: The frequency of the board meeting attendance positively affects remuneration

According to [14], commissioners from outside can increase the effectiveness of the board in carrying out its primary function which is to oversee the management of the company. This primary function affect remuneration decisions of the company. The objective decision will increase the congruence between the interests of the agent and the owner.

This opinion was supported by [5] and [34] which stated that the greater number of independent members of board commissioner the better management and monitoring mechanism. Thus, the hypotheses can be stated as follows:

H₅: The proportion of independent members of the board of commissioners positively affects remuneration

Reference [9] find a positive effect of the proportion of outsider remuneration committee members on the level of remuneration. The results were supported by [33] who find that the greater proportion of independent members of remuneration committees would increase the level of remuneration at 416 companies in the Canadian Public Companies during the period of 2000-2005. The results were confirmed by [15] who examined the influence of the independent members of the compensation committee to the CEO compensation in US for the period of 2004-2005. Reference [15] find that the independent members of compensation committee increase CEO compensation. Thus, the hypotheses can be stated as follows:

H₆: The proportion of independent members of the remuneration committee positively affects remuneration

Reference [34] examined the effects of the compensation committee on CEO compensation at 812 companies in the US for the period of 2001. Reference [34] reports that growing size of the compensation committee was associated with higher pay-performance. The greater size of remuneration committee was expected to produce more qualified recommendation on the board. The same result was found by [34] at 474 companies in the US during the period of 2001-2004. Thus, the hypotheses can be stated as follows:

H₇: Size of the remuneration committee positively affects remuneration

III. RESEARCH METHOD

A. Population, Sample and Sampling Techniques

The population are all banks listed in Indonesia Stock Exchange in the period of 2006-2012, totaling 28 companies. The samples are 18 banking consists of 4 state-owned banks and 14 private banks with purposive sampling method.

B. Operational Definition and Measurement of Variables

Total remuneration includes: a) remuneration in the form of non-kind, including salaries and other fixed income, among other benefits, stock-based compensation, bonuses and other forms of remuneration, and b) other facilities in the form of natura/non- natura i.e., no other fixed income,

including allowances for housing, transportation, health insurance and other facilities, which cannot be owned or possessed [30] and [35]. The formula to calculate total remuneration of commissioners is

$$\text{Total remuneration of Commissioners (TR)} = \text{Non Natura Remuneration} + \text{Other Facilities in Kind/Non Natura} \quad (1)$$

This study uses the company's total assets as a measure of firm size [24], [38], [2] and [21] and firm performance which is measured by ROA as control variable [6], [13], [31], [38].

C. Hypotheses Testing

This study uses multiple regression analysis to determine the effect of independent variables on the dependent variable. The regression equation use in this study is as follows,

$$\text{TR} = a_0 + b_1\text{GEND} + b_2\text{SBC} + b_3\text{NMBC} + b_4\text{FABC} + b_5\text{IBC} + b_6\text{IRC} + b_7\text{SRC} + b_8\text{SIZE} + b_9\text{PERF} + e \quad (2)$$

Where:

- TR : Total Remuneration of BoC
- GEND : Proportion of Gender in BoC
- SBC : Size of BoC
- NMBC : Number of Meeting BoC
- FABC : Proportion Frequency of Attendance BoC Meeting
- IBC : Proportion of Independent member BoC
- IRC : Proportion of Independent Member RC
- SRC : Size of RC
- SIZE : Total Asset
- PERF : ROA
- BoC : Board of Commissioner
- RC : Remuneration Committee

IV. RESULTS AND DISCUSSION

The classic assumptions of the regression model are tested before regression statistics analysis is done. The assessment shows that the data are normally distributed and there is no problem with classic assumptions. The statistic descriptive is presented in Table 1. Based on Table 1, the sample can explain that the remuneration varies from 1.606 million to 336.37 million with a mean value of 53.2 million. According to a survey of Indonesia Bank, Indonesia has the highest incentive fee among the directors of banks in ASEAN countries.

Regression result is presented in table 2. Based on table 2, proportion of gender variable affects remuneration. This result shows negative (-1.162) and significant coefficient (p = 0.000). This result support H₁ and consistent with prior studies done by [1] which found that greater proportion of gender in Board of Commissioner encourage smaller remuneration.

Size of commissioner does not affect remuneration. This result shows insignificant coefficient (p = 0.318). This result does not support H₂ and does not consistent with [25], [28], and [23] which stated that greater size of commissioners will encourage higher compensation based equity.

Number of meeting in Board of Commissioner affects remuneration. The result shows negative (-0.010) and significant coefficient (p = 0.000). This result does not support H₃ and consistent with [21] which found that the more frequent meeting was done, the more detail agenda to be discussed. Reference [21] stated that mechanism through Corporate Governance meeting negatively affected the amount of remuneration.

Table 1 Statistic Descriptive

Variables	Min	Max	Mean	Std Dev
Total Remuneration board of commissioner (million)	1.606	336.370	53.200	61.207
Proportion of gender in board of commissioner (%)	0.00	67.00	8.78	14.967
Size of board commissioner	2	10	5.528	1.769
Number of meeting board of commissioner	3	123	22.61	21.964
Proportion frequency of attendance in BoC meeting (%)	27.83	100.00	85.266	14.343
Proportion of independent member of board commissioner (%)	30.00	100.00	56.16	12.03
Proportion of independent member of RC (%)	20.00	100.00	44.90	14.867
Size of remuneration committee	2	9	4.21	1.638
Total asset (billion)	2.052	635.618	103.389	137.256
ROA (%)	-0.016	0.09	0.018	0.0134

Table 2 Hypotheses Testing Used Enter Method

Variable	Coefficient	t-Statistic	Prob.
C	8.863	7.659	0.000
Proportion of Gender in BoC	-1.162	-4.544	0.000***)
Size of BoC	0.040	1.002	0.318
Number of Meeting in BoC	-0.010	-3.597	0.000***)
Proportion Frequency of Attendance in BoC meeting	0.080	0.640	0.523
Proportion of Independence member in BoC	-0.309	-0.668	0.505
Proportion of Independence Member in RC	-0.458	-1.339	0.183
Size of Remuneration Committee	0.025	0.664	0.508
Firm Size (Total Asset)	0.638	11.656	0.000***)
Firm performance (ROA)	1.082	0.236	0.814
Adjusted R-squared	0.784		
F-statistic	51.547***)		
DW stat	1.664		

***) : significance at $\alpha = 1\%$
 **) : significance at $\alpha = 5\%$
 *) : significance at $\alpha = 10\%$

Frequency in attendance of meeting does not affect remuneration. This result shows the coefficient ($p = 0.523$) and does not support H_4 . Frequency of attendance of meetings was one way to get important information and performed their duties in monitoring [1]. Higher level of attendance in meeting means better process of board governance and evaluation

Proportion of independent members on the board variable does not affect remuneration. This result does not support H_5 . This result is indicated by coefficient ($p = 0.505$) and confirm the research which was done by [3], [4], [8].

Proportion of independent members in remuneration committee variable does not affect remuneration, so does not support H_6 . This result is indicated by coefficient ($p = 0.183$). This condition might happen because remuneration committee only make recommendations and does not make decision about how much the remuneration based on the regulation in Indonesia banking. The result supported by [9], [22], [26], and [38].

Size of remuneration committee variable does not affect remuneration. The result shows positive (0.025) and insignificance coefficient ($p = 0.508$). The result does not support H_7 and does not consistent with the study of [34] which stated that the bigger size the remuneration committee bigger remuneration. It might be caused of inefficient due to decisions making.

Firm size positively affects remuneration as was indicated by coefficient (0.638) and probability of significance was 0.000. This means that the larger the size the higher the remuneration. This result was supported by previous research which were done by

[24], [38] and [39]. Because larger companies had complex tasks to be carried out, greater responsibility and effort were required to run the company, so remuneration was getting bigger [36].

Firm performance does not affect remuneration as is indicated by coefficient 1.082 and probability significance is 0.814. This result does not confirm research was done by [16] and [23].

V. RESEARCH CONCLUSIONS AND IMPLICATIONS

Based on the descriptive data, remuneration was highest in Southeast Asia, so the implication was that Bank of Indonesia reviewed the rules on remuneration in Indonesia banking, so remuneration gap became smaller. According to these results, two proxies of CG influence remuneration. The implication was that BI should revise the rules on the number of meetings and evaluate gender proportion in board of commissioner.

Reference [30] stated that there were no regulations governing the gender proportions in the BoC, so still a bit of banking in Indonesia which provided the opportunity for women to have positions in the BoC. Besides that reference [30] has been set on the number of BoC meetings in general, but there are no clear rules regarding the minimum number of meetings to determine remuneration. Therefore, Bank of Indonesia may review the regulations pertaining to the gender proportions in the BoC and BoC meeting number especially in determining remuneration.

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