



EFFECT OF COMPANY PERFORMANCE ON SHARIA COMMERCIAL BANK EXECUTIVE COMPENSATION IN INDONESIA

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ABSTRACT

After the disclosure of data from companies, research on executive compensation began to develop. Several studies on executive compensation in banking found that the determination of compensation is positively related to company performance. This research aims to determine the relationship between company performance and executive compensation of Islamic Commercial Bank's in Indonesia. Company performance is proxied by Return on Assets (ROA). This study uses a sample of Islamic Commercial Banks because they have very good performance growth and currently only have a market share of 6.18% compared to the national financial market so they still have the potential to experience growth. Furthermore, sample used 14 Islamic commercial banks registered with the OJK during 2014-2019. The research method used panel data regression analysis. The results showed that the performance of Islamic Commercial Bank's has an effect on executive compensation. Islamic Commercial Bank Executives have an obligation to improve company performance (ROA) because it affects the compensation received by the executive.

Keywords: Company Performance, Executive Compensation, Indonesia Sharia Commercial Bank.

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INTRODUCTION

There is very little research on executive compensation in Asia due to limited company data (Kato et al., 2007). Companies in Asia generally keep data about the compensation given to their employees secret. In 2006, Bank Indonesia issued regulation Number 8 of 2006 concerning the implementation of Good Corporate Governance (GCG) which supports the principle of transparency. This regulation requires banking institutions to disclose remuneration data and all facilities received by directors and commissioners in the Good Corporate Governance report (Bank Indonesia, 2006)

After the disclosure of data from companies, research on executive compensation began to develop. Several studies on executive compensation in banking found that the determination of compensation is positively related to company performance (Mardiyati et al., 2013; Sari & Harto, 2014). This research supports early research on executive compensation and firm performance (Buigut et al., 2014; Jensen & Meckling, 1976; Murphy, 1999). Company performance is an indicator of the success that the company has achieved. To assess company performance, financial and non-financial performance can be used (Gimbert et al., 2010). The growth in the company's financial performance indicates that the company is experiencing growth and can increase owner's profits.

Sharia banking in Indonesia itself has shown positive developments, especially after obtaining legal certainty from the government with the issuance of Law 21 of 2008 concerning Islamic banking. Based on OJK's Islamic banking statistics, as of December 2019 there are currently 14 Islamic Commercial Banks, 20 Sharia Business Units and 167 Sharia Rural Banks. Islamic banking assets always increase every year. In 2018 Islamic banking has total assets of Rp. 489.69 trillion or grew 12.57% from 2017, then in 2019 experienced a growth of 9.93% or Rp.538.32 trillion. Islamic banking in Indonesia has always experienced an increase in profitability every year. In 2018 Islamic banking was able to make a profit of Rp. 3.1 trillion or growing 107% from 2017 even though in 2019 it only increased by 47% or Rp. 3.3 trillion (Otoritas Jasa Keuangan, 2020).

Increasing the performance of banks in Indonesia has prompted shareholders to reward them with high and increasing compensation. The compensation received by bank executives in Indonesia is an average of Rp. 12 billion a year is the highest compensation in ASEAN. Compared to Malaysia only Rp. 5.6 billion or the Philippines for Rp. 1.1 billion or one twelfth of the bank executives in Indonesia. Compensation received by bank directors and commissioners during 2007-2010 increased by 65% or an average of 21% per year. ("Infobank: Analisis Strategi & Keuangan," 2012).

Compensation is a return on contributions made by employees to the company (Milkovich et al., 2013). The components in executive compensation can be short-term remuneration, long-term remuneration and other benefits

(Goergen & Renneboog, 2011). Based on OJK regulation number 59 of 2017, sharia banking executives in Indonesia get fixed and variable rewards in cash or in cash in accordance with their duties, powers and responsibilities. Compensation is formulated by the remuneration and nomination committee then determined by the shareholders through the General Meeting of Shareholders (Otoritas Jasa Keuangan, 2017)

Executive compensation can be used by company owners to solve agency problems. Agency problems are a possible conflict of interest between shareholders and company management (Gill et al., 2008). Agency problems arise because management does not act in the interests of shareholders but prioritizes its own interests (Jensen & Meckling, 1976). The provision of high compensation encourages agent performance to be better and this also makes the company's performance better (Ruparelia & Njuguna, 2016).

This study uses a sample of Islamic Commercial Banks because they have very good performance growth and currently only have a market share of 6.18% compared to the national financial market so they still have the potential to experience growth. This study aims to analyze the relationship between company performance as proxied by the ratio of Return on Assets (ROA), whether it has an influence on the compensation given to executives or not in accordance with previous research. This research data uses compensation data provided by the company to the Board of Commissioners and Directors which is available in the annual reports of 14 Islamic Commercial Banks registered with the OJK during the period 2014-2019.

LITERATURE REVIEW

Agency Relationships

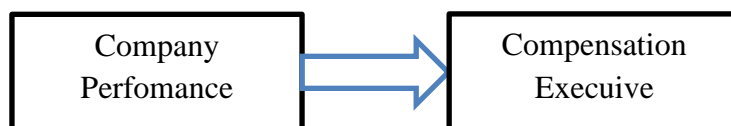
An agency relationship is an agreement between one or several people (the principal) and the agent to carry out work on behalf of the principal and authorizes the agent to make decisions (Jensen & Meckling, 1976). The relationship between the principal and the agent can lead to a condition of information imbalance because the agent has more information about the company than the principal, which can cause agency problems.

Agency problems are a potential conflict of interest between shareholders and company management (Gill et al., 2008). Agency problems arise because agents running a company do not act in the interests of shareholders but prioritize their own interests. Agents have more information and with their authority can withhold some information that will benefit the agent in order to get higher compensation for contributions made to the company (Jensen & Meckling, 1976).

Executive Compensation

One form that may reduce agency problems is by providing compensation for executives. Compensation is one way to reconcile the differences in interests between shareholders and management (Pepper, 2018). Compensation is a return on contributions made by employees to the company (Milkovich et al., 2013). Based on research, giving high compensation encourages agent performance to be better and this also makes company performance better (Ruparelia & Njuguna, 2016). The components in executive compensation can be short-term remuneration, long-term remuneration and other benefits (Goergen & Renneboog, 2011).

Research Framework



Effect of Company Performance on Executive Compensation

The issue of executive compensation will always be related to agency theory. This theory assumes that executives act in their own interests, so there must be a mechanism for executives to pay attention to the interests of shareholders. Effective monitoring will result in the ability to manage the company so that it can improve the company's performance, thus the company value will increase, and the principal's welfare will also increase.

One form that may reduce agency problems is by providing compensation for executives. Compensation is one way to reconcile the differences in interests between shareholders and management (Pepper, 2018). Company performance is one of the bases that can be used to measure the performance of a company in a certain period after being measured by several measurements.

Several findings (Gill et al., 2008; Rau, 2015) state that ROA, NPM, and EPS as measures of company performance always have a positive impact on executive compensation. In order to maximize company profit, measurement using ROA can explain significantly its effect on the payment of the Chief Executive Officer (CEO) in the company (Boschen & Smith, 1995). Likewise, research conducted by (Ramaswamy et al., 2000) and (Ghosh, 2006) where this year's ROA is stated as a significant factor in determining the total CEO compensation. The hypotheses in this study are:

H1: Company performance has a positive effect on executive compensation

METHODOLOGY

This study uses a sample from Islamic banking. A total of 14 Islamic Commercial Banks were registered with the OJK during 2014-2019. The analysis in this study used a balanced panel data regression analysis (balance panel data). Compensation data is obtained from the annual report published by each Islamic banking, while the performance data for Islamic banking, which is proxied by ROA, is obtained from the OJK. The method in this research is using Pooled Least Square (PLS) panel data regression. Data is processed using eviews 10 (Widarjono, 2018). The equation model tested in this study is as follows:

$$COMP_{it} = \beta_0 + \beta_1 ROA_{it} + e_{it}$$

Information :

- COMP* : Executive Cash Compensation
- ROA* : Return On Asset
- i* : type of banking
- t* : time

Table 2.
Variables Description, Hypothesis and Source of Data

Variables	Description	Hyphotesis	Source
Dependent Variables			
Cash Compensation	Salary + Bonus + Allowance		OJK
Independent Variables			
Firm Perfomance	Return On Asset (ROA)	+	OJK

Source: Data processed (2020)

In Table 2, executive cash compensation (COMP) consists of salaries, bonuses and allowances. Company performance is measured by measuring profitability, namely Return on Assets (ROA). The ROA ratio can be calculated by dividing net income with total assets (Alexander, 2018). In addition, in this study a regression of several other equations was also carried out, in which each of these equations would still relate to proxies in measuring company performance.

RESULT

Table 3 shows descriptive statistics for all variables. The standard deviation of the compensation received by company executives in the study period has a value far above the average for the observed company. This indicates that the

compensation received by company executives has fluctuated and varied greatly. Compensation with a maximum value during the study period is Rp. 136,715 million and the minimum value is Rp. 4.4 million with an average value during the observation period of Rp. 22,490 million.

Table 3
Descriptive Statistics

	<i>COMP</i> (Million rupiah)	<i>ROA</i>
Mean	22.490	0,97
Median	15.519	0,80
Maximum	136.715	13,60
Minimum	4.400	-20,13
Std. Dev.	21.410.160	7,61

Source: Data processed by researchers

Table 3 shows the average value of return on assets (ROA) of 0.97%. The maximum value of ROA is 13.60% and the minimum value is -20.13%.

Chow Test

To determine the appropriate model in this study, Common Effect or Fixed Effect, a Chow Test was conducted. If the Chi-square probability is more than 0.05 then the correct model is the Common Effect, and if it is less than 0.05 then it must be tested again with the Hausman Test. The results of the Chow Test are as follows:

Table 4
Chow Test

Effects Test	Statistic	d.f.	Prob.
Cross-section F	186.999246	(12,1078)	0.0000
Cross-section Chi-square	1228.998840	12	0.0000

Source: Data processed (2020)

Based on Table 4, the Chi-Square probability value is 0.0000 which indicates that it must be retested with the Hausman Test.

Hausman Test

To determine which model is appropriate, Fixed Effect or Random Effect, a Hausman Test is performed. If the Chi-Square probability is less than 0.05 then Ho is rejected. Here is the hypothesis:

Ho: Random Effect

H1: Fixed Effect

The results of the Hausman Test are as follows:

Table 5
Hausman Test

Correlated Random Effects - Hausman Test			
Pool: POOL03			
Test cross-section random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	12.483638	1	0.0004

Source: Data processed (2020)

Based on the results from Table 5, the Chi-Square probability value is 0.0004 which indicates that Ho is rejected. Thus, this study uses the Fixed Effect model to investigate the effect of company performance on executive compensation.

Tabel 6
Fixed Effect Regression Results

Variabel	Equation I
<i>Intercept</i>	65,17 (22611,85)*** 0,0000
ROA	6,79 (644,7674)*** 0,0000
<i>Adjusted R-squared</i>	0,75
<i>Observation</i>	84

Note ***, **, * are stationer at $\alpha=1\%$, 5% , 10% respectively.

Source: Data processed (2020)

CONCLUSIONS

The empirical results of the whole equation can be seen in table 5 which is the result of panel data regression analysis using the Fixed Effect Model. ROA in Equation I has a positive coefficient and the probability of the t-test is significant at the 1% level. ROA also shows positive and significant at the 1% level. This shows that ROA has a positive and significant effect on executive compensation. The executives of the company is obliged to improve the level of company profitability (ROA) because this will provide an assessment of the performance of a company. Therefore, executive compensation is based on the rate of return on assets (Sari & Harto, 2014). This result is also supported by (Khasanah, 2015) which establishes that ROA has a positive and significant effect on the compensation received by executives.

By looking at the general correlation of the overall equation, the results show that the company's performance as measured by ROA has a significant positive effect on executive compensation. These results cannot be generalized to all financial companies in Indonesia because there is still a lot of data on compensation that is not available. Future research is expected to add other factors that appear to affect executive compensation, such as company performance using firm value and price changes or stock returns. Other variables that can also be added include company specific characteristics which can be seen from the number of business segments of each Islamic banking.

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