The Bank Soundness in Indonesia: Risk and Corporate Governance

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Abstract: This study aims to provide the evidence associated with the growth of corporate governance in crisis. This research is a type of literature study with secondary data (ROA and LDR) period January 2015–December 2019. The analysis is by using descriptive research with the support of theories and the findings from previous studies. Return on Assets (ROA) has increased and decreased for several periods and Loan to Deposit Ratio (LDR). Profitability with ROA decreased by 0.35% from 2.82% in January 2015 to 2.47% in December 2019. As measured by ROA, banking performance declines to make banks vulnerable to a crisis. Banks that have a high LDR potentially have liquidity risk. This study provides descriptive statistics that describe the potential of high LDR in the future since there’s a sharp trend for the increasing value of LDR. LDR increased as much as 5.95% from 88.48% in January 2015 to 94.43% in December 2019. Liquidity risk continues to rise to make banks vulnerable to a crisis. This study provides several findings from previous research regarding standard corporate governance and risk governance in the financial crisis to mitigate those risks. Evaluating formal corporate management and risk governance can lead to optimal financial soundness.

Keywords: Board Independence, CEO’s Duality, Gender Diversity, Financial Governance, Bank Soundness.

JEL Classification Code: E6, F65, I22

1. INTRODUCTION

The first study about bank soundness has occurred in the 1980s by Zouari (2010). Much academic literature underlines a positive relationship between corporate governance and bank soundness (Levine, 2009; William, 2014). Stulz (2012) find companies with good corporate governance have the worst banking soundness during the crisis. Corporations need to grow to be able to attract funding from investors. These investors want to invest their money for a stable company and produce long-term profits (Minton, Taillard, and Williamson, 2014). Corporate governance is essential to achieve the performance of the firm. This is the process used for business management to produce welfare and accountability of shareholders (Mohamed, Ahmad, and Khai, 2016). Implementing good governance is a critical issue, especially after a crisis.

Many studies examine the developed and developing countries to correlate a company’s performance and corporate governance (Sami, 2011). Many researchers discover that corporate governance has a positive relationship to the soundness of companies (Ammann, 2011; Iqbal, 2019) study the association between management and soundness of microfinance firms. They discover the relationship between corporate governance and the soundness of the company. Abdallah & Ismail (2017) investigate the role of management in companies and the implication to the performance by concerning concentrated ownership. The results confirm the significant effect between the quality of governance to implementation of the company. It is more vital for the low concentrated ownership. Mongiardi & Plath (2010) emphasize the need for a devoted board-level risk committee, board independence, and Corporate Risk Officer (CRO). Generally, this study generates survey literature of risk governance and standard governance to the commercial banks’ financial soundness in Indonesia during the financial crisis.
2. Literature Review

Board independence defines as independent directors without any connection except for the board chair in the company (Aebi, Sabato & Schmid, 2012). A higher outside directors can decrease the agency conflict and increase shareholders’ wealth (Fama & Jensen, 1983a; Fama & Jensen, 1983b; Jensen & Meckling, 1976). Consequently, it is better to have more outside directors to strengthen the independence of directors (Bacon & Brown, 1975; Williams & Shapiro, 1979; Fama & Jensen, 1983b). Also support these findings, independent boards are more objective in monitoring the firm. Eng & Mak (2003) find that independence can increase the monitoring ability and generate better company information for all stakeholders. It aims to avoid the occurrence of information asymmetry and opportunistic managers. As in any corporation, the boards of large banks can influence the risk choices of executives utilizing their advisory and monitoring functions (see Adams et al., 2010). A significant role in shaping risk choices is usually assigned, indent directors. These directors are conventionally seen as better monitors than other directors as one of their key objectives is to maintain a good reputation in the directorship market (Fama & Jensen, 1983). Studies on non-financial firms show that career opportunities in the directorship market depend on independent directors achieving good past performance in the execution (Hoi 2003; Farrell & Whidbee 2000; Gilson, 1990; Harford 2003; Jiang et al., 2015). Good past performance has significant reputational effects that increase the chances to gain directors of gaining the labor market. In contrast, poorly performing directors see a decline in the demand for their services in the labor market and tend to hold fewer directorships (Fich & Shivdasani, 2007; Gilson, 1990; Harford, 2003). Furthermore, reputation concerns also affect the supply of director services in the labor market, with directors who are members of large corporations’ boards increasing their effort in performing their duties (See. Masulis & Mobbs, 2014; 2016).

The term independent directors were used interchange with term non-executive directors and outside directors. However, not all non-executive directors are independent. The study on board independence and firm performance showed mixed results; either positive, negative or no relationship with firm performance. Few studies also look at the relationship between board independence and earning management. Firm performance is studied by using market-based measure or accounting based measures. The accounting based measure through Return on Assets (ROA), Return on Investment (ROI), earnings per share and profit measures. Meanwhile, market-based measure carried out in many studies by using Tobin’s q for market value. The study in India showed that by having board independence did not guarantee to improve firm performance due to poor monitoring roles of independent directors (Garg, 2007). One of the vital roles of independent directors is to monitor the company’s performance and operation. Effective monitoring mechanism in the firm could reduce agency problems. Thus, the company should appoint independent directors who could exercise proper oversight function in monitoring governance, internal control and risk management. Similarly, Hermalin and Weisbach (1991) found out no relation between firm performance and the proportion of outside directors. The study used the Tobin’s q to measure the firm performance by using mixes market-based and accounting based measures. That firms in United States with annually elected boards, small size boards, 100 percent independent nominating committees, and 100 percent independent compensation committees have more negative discretionary accruals. Similar with Cybinski and Windsor (2013), the independence remuneration committee may align CEO remuneration with firm performance in larger Australian Stock Exchange (ASX) as compared to smaller and medium ASX300 firms. It showed that independent directors were having a crucial function of the monitoring remuneration process of CEOs and executive directors for larger public companies, and later the remuneration paid to them commensurate with their performance.

This is similar to the results found on the association of the board independence and the earning management (Johari, Saleh, Jaafar & Hassan, 2008). It showed that the board’s independence was not associated with the earning management even though the proportion of independent directors on the board was one-third of the total majority. This means that even though the company had many independent directors on the board, it would not increase shareholders’ return. Abdul Rahman and Mohamed Ali (2006) concluded that Malaysian companies had insignificant relationship between other corporate governance mechanisms such as the independence of the board, and the audit committee with the earnings management. It relates to the ineffectiveness of the board directors in
their monitoring roles due to the dominant role of the manager and the executive directors in board matters. In Hong Kong firms, study on board committee independence and firm performance in family firm showed no association. However, there is a positive relationship between board independence and firm performance in nonfamily firms (Leung, Richardson & Jaggi, 2013). It is due to the minority of independent directors in family firms as compared to non-family firms. The recommendation by regulators on composition of independent directors on board is voluntary basis. If the company could not comply, they may explain for the non-compliance. From the results, the independent directors’ views would help companies to improve their corporate performance. In contrast, a research was carried out by Abdullah (2004) in the year 1996. The study measured the relationship between the percentages of independent directors at 412 Companies in the Main Board of KLCSE with the firm’s performance. It showed positive and significant correlation with returns on assets, profit margin and earnings per share. From that finding, it showed that the board’s independence might contribute to the effective performance of a firm. It showed evidence that the high number of independent directors on the board influenced the company’s financial performance.

The literature on non-financial firms typically links the notion of good performance by independent directors to the interests of shareholders (Coles et al., 2008; Fama & Jensen, 1983; Hermalin & Weisbach, 2003; Jensen & Meckling, 1976; Wagner, 2011). However, in large banks, what constitutes good performance by independent directors has been called into question by the global financial crisis. The crisis is a crucial example of how hazardous choices by large banks can impact a wide range of stakeholders, including taxpayers, and, more importantly, produce instability at the systemic level (Acharya et al., 2014; Becht et al., 2012). As a result, a growing number of studies (See. for instance, Adams, 2012; Kirkpatrick, 2009; Ringe, 2013) and the media blame independent directors for not having played an effective advising and monitoring role in the years leading to the crisis. At the root of this criticism, there is the view that the independent directors of banks should consider the interests of the comprehensive set of bank stakeholders that might be affected by bank business choices. Accordingly, they should favor a more prudent bank risk exposure even though this can go against the objective to maximize shareholder value (See. Pathan, 2009, for a related argument). Numerous regulators and policymakers express a similar view of independent directors post the crisis. See Dermine (2013) for a summary. While they respond to the problem by reaffirming the importance of maintaining highly separate boards in banks, they increasingly identify good board practices with actions safeguarding broader stakeholder objectives (See. the Basel Committee on Banking Supervision, 2010, 2015; European Union 2010; OECD, 2010). A good summary of this is contained in the 2010 report on how to enhance governance in banks, and in the following revisions, by the Basel Committee on Banking Supervision (2010), stating that “…board should take into account the legitimate interests of shareholders, depositors, and other relevant stakeholders. It should also ensure that the bank maintains an effective relationship with its supervisors”. CEO Duality has two positions at once, namely as Chairman of the Board (board of commissioners) and Chief Executive Officer (board of directors) in a company. The board of commissioners is tasked with conducting board of directors meetings and overseeing recruiting, firing, evaluating, and providing compensation to the board of directors. Meanwhile, the role of the board of directors is to develop strategic recommendations for the board of commissioners and ensure that the strategy is approved and reflected in the business. CEO Duality creates a concentration of power where the board of directors can dominate the board of commissioners and reduces the effectiveness of the board of commissioners in supervising and controlling management (Fama & Jensen, 1983). In addition to the formal authority that comes from being a CEO, by combining one’s position on the board of commissioners, that person can exert considerable influence on the board by controlling the flow of information at board meetings and intervening in the process of appointing new directors (Dayton, 1984). From an agency theory perspective, having one person in charge of both the implementation of management and control is inconsistent with the concept of check and balance. However, from organizational theory, CEO Duality can improve organizational efficiency in corporate leadership (Boyd, 1995). The fundamental question surrounding CEO Duality’s administration is whether the board of directors’ position should be filled by the CEO or by a different person. In Indonesia, a person cannot serve on the board of directors and commissioners but through the kinship system. This is due to the 1995 Company Law, which stipulates that all companies must adopt a two-tier
board system. Many companies in Indonesia were originally family companies which later developed and became public companies. This has resulted in many cases where parents are on the board of commissioners, and their children are on the board of directors, encouraging management discretion. CEO Duality (Dual) in this study uses dummy data where CEO Duality is coded as one if there is a family relationship between a person serving on the board of commissioners and the board of directors in a company and coded as 0 if there is no family relationship between a person acting on the board of directors. Commissioners and boards of directors in a company. According to Kouki and Guizani (2015), an influential manager who tends to dominate the boards of directors is the duality of the CEO. Sometimes they may still be chairs of the committee. Such CEOs may weaken the power of the board sometimes at the expense of the shareholders. They may maximize their interest in a firm since they enjoy the discretion to “rubber stamp” the board’s decisions.

Similarly, Bhagat & Bolton (2008) confirmed that the separation between CEO and chairman positively correlates significantly with the firm’s performance. The duality of CEO happens when CEO also have the chairman position (Al-Amarneh, 2014). CEO duality may interfere board in terms of management monitoring and increase the agency cost. Following agency theory, this separation will upgrade the soundness of the company. (Jensen, 1993) The implication of this duality is the poor performance of internal control systems because the board cannot evaluate the CEO’s performance. Gender diversity is an umbrella term used to describe gender identities that demonstrate a diversity of expression beyond the binary framework. For many gender-diverse people, the concept of binary gender – having to choose to express yourself as male or female – is constraining. Some people would prefer to have the freedom to change from one gender to another or not have a gender identity. Others want to be able to defy or challenge more normalized concepts of gender openly. For gender-diverse people, their identity is about presenting something more outwardly authentic to the world, whether they understand themselves differently gendered or have no gender at all. It is essential to recognize that many cultures throughout history have recognized gender diversity beyond masculine and feminine.

Today the internet has provided a platform where people can explore everyday experiences with gender diversity, and a lot of the language used to describe these experiences is still evolving. There are often misunderstandings that report hundreds of genders, each with unique rules, terminology, and pronouns. Many of these claims are exaggerated, taking into account very niche and specialized terms or very personal explorations of gender. Umbrella terms such as non-binary, genderqueer, or X gender are adequately broad descriptors for gender-diverse people. Individuals, however, may use more specialized personal terms to describe themselves within their peer group and safe spaces. There is a lot of debate around what pronouns are acceptable or should be used to describe gender-diverse people. The singular ‘they’ (e.g., “they are taking their dog for a walk”) is widely recognized as an existing pronoun structure that is courteous of gender diversity, if not always considered ideal. People may use many other gender-neutral pronouns (such as fae and eir), but ultimately, it is best to use the pronoun the gender-diverse person asks for.

A change of name and pronoun can appear difficult for some people to accept and respect. However, socially, we learn to accept and respect changes people make to their terms all the time – think about people changing names when they marry. Many people, regardless of their gender identity, expect nicknames to be respected, and some cis-gender people (someone whose gender identity correlates to their birth sex) can be offended when they are misgendered (for example, if a woman is called "he"). The same principles apply to people who are gender diverse. While it is okay to make a mistake when someone has recently shared their new name and pronoun, it is essential to practice and work towards getting it right all the time. This diversity reflects the varied characteristics and creates the heterogeneity of the work environment. It can make the board heterogeneous and provide better solutions. Women are better at obeying legal aspects and generate better outcomes. Women are better at obeying legal aspects and generate better outcomes. They find this diversity upgrades the controlling activity for top management performance. The increasing number of female boards can upgrade the board independence of companies. Groysberg & Bell (2013) survey female and male directors and find that women can provide a fresh perspective on board. Women can give social sensitivity in problem-solving (Woolley et al., 2010). The female
board generates better performance within the workplace than men (Langston & Graesser, 1995). Gender diversity is about acknowledging and respecting that there are many ways to identify outside of the binary of male and female. Presenting as gender diverse is not about attention-seeking or receiving special treatment; it is about being authentic. There is not a need for people to know about every gender identity out there. What is more important is that people respect gender diverse and the choices they make about their lives. Using the correct names and pronouns for gender-diverse people and gender-neutral language are reasonable expectations for gender-diverse people. Inclusivity not only benefits gender, various people – it helps everyone!

3. Research Method and Materials

3.1. Sample Criteria

This research is a type of literature study. The analysis is by using descriptive research with the support of theories and the findings from previous studies. The recapitulated data comes from reports from financial services authorities related to the Loan to Deposit Ratio (LDR) and Return on Assets (ROA) variables starting from January 2015 – December 2019. Furthermore, the data is then analyzed in a flowchart to be interpreted at the analysis stage data and finally discussed in sub-sections, namely Board Independence, CEO’s duality, Gender diversity, Risk Governance, and Bank Soundness in Financial Crisis.

4. Results and Discussion

4.1. Standard Corporate Governance and Bank Soundness in Financial Crisis

Gitman (2002) stated that return on assets reflects the effectiveness of the company in generating profit from utilizing the support. Figure 1 shows the declining trend for conventional bank profitability in Indonesia from 2015-2019. Profitability with ROA decreased by 0.35% from 2.82% in January 2015 to 2.47% in December 2019. Banking performance continues to decline to make banks vulnerable to a crisis.

Source: Otoritas Jasa Keuangan, data processed, 2020

Figure 1: Trend of Return on Asset

According to table 1, Return on Asset for conventional banks from 2015 to 2019 fluctuate each year. Return on Assets (ROA) increased as much as 2.51% in January 2016 but decreased to 2.46% in January 2017. In January 2019, Return on Assets (ROA) was 0.09% higher than January 2018, but the growth in Return on Assets (ROA) in December 2019 decreased by 0.12% compared to January 2019.
Table 1: Return on Asset of Conventional Banks period 2015-2019

<table>
<thead>
<tr>
<th>Month</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>2.82</td>
<td>2.51</td>
<td>2.46</td>
<td>2.50</td>
<td>2.59</td>
</tr>
<tr>
<td>February</td>
<td>2.51</td>
<td>2.29</td>
<td>2.35</td>
<td>2.36</td>
<td>2.45</td>
</tr>
<tr>
<td>March</td>
<td>2.69</td>
<td>2.44</td>
<td>2.50</td>
<td>2.55</td>
<td>2.60</td>
</tr>
<tr>
<td>April</td>
<td>2.53</td>
<td>2.38</td>
<td>2.48</td>
<td>2.40</td>
<td>2.42</td>
</tr>
<tr>
<td>May</td>
<td>2.45</td>
<td>2.34</td>
<td>2.46</td>
<td>2.38</td>
<td>2.41</td>
</tr>
<tr>
<td>June</td>
<td>2.29</td>
<td>2.31</td>
<td>2.47</td>
<td>2.43</td>
<td>2.51</td>
</tr>
<tr>
<td>July</td>
<td>2.27</td>
<td>2.35</td>
<td>2.49</td>
<td>2.46</td>
<td>2.50</td>
</tr>
<tr>
<td>August</td>
<td>2.30</td>
<td>2.36</td>
<td>2.47</td>
<td>2.47</td>
<td>2.49</td>
</tr>
<tr>
<td>September</td>
<td>2.31</td>
<td>2.38</td>
<td>2.47</td>
<td>2.50</td>
<td>2.48</td>
</tr>
<tr>
<td>October</td>
<td>2.30</td>
<td>2.41</td>
<td>2.49</td>
<td>2.52</td>
<td>2.48</td>
</tr>
<tr>
<td>November</td>
<td>2.33</td>
<td>2.37</td>
<td>2.48</td>
<td>2.52</td>
<td>2.47</td>
</tr>
<tr>
<td>December</td>
<td>2.32</td>
<td>2.23</td>
<td>2.45</td>
<td>2.50</td>
<td>2.47</td>
</tr>
</tbody>
</table>

Source: Otoritas Jasa Keuangan, data processed, 2020

Besides that, Return on Asset (ROA), liquidity also has a significant role in generating profitability in banks. Liquidity risk is one of the potential determinants for financial distress that will lead to bankruptcy. Liquid assets have an opportunity cost of high return, and there is a significant relationship between the liquidity of a banking company and profitability in a banking company (Bourke, 1989). Increasing the cash is suitable to manage the occurrence of instability. Bank with Loan to Deposit Ratio (LDR) more than 120% has the lowest ranking in financial soundness in terms of liquidity (Surat Edaran Bank Indonesia No.6/23/DPNP Tahun 2004). Banks that have high LDR potentially have liquidity risk. As we can see from Figure 2, there’s the potential of high LDR in the future since there’s a sharp trend for the increasing value of LDR. LDR increased as much as 5.95% from 88.48% in January 2015 to 94.43% in December 2019. Liquidity risk continues to rise to make banks vulnerable to a crisis.

Source: Otoritas Jasa Keuangan, data processed, 2020

Figure 2: Trend of Loan to Deposit Ratio

According to table 2, conventional banks’ Loan to Deposit Ratio (LDR) from 2015 to 2019 fluctuates each year. Loan to Deposit Ratio (LDR) increased as much as 90.95% in January 2016 but decreased to 89.59% in January 2017. In January 2019, Loan to Deposit Ratio (LDR) was worth 4.87% higher than January 2018, the growth in Loan to Deposit Ratio (LDR) in December 2019 increased by 0.49% compared to January 2019.
Table 2. Loan to Deposit Ratio of Conventional Banks period 2015-2019

<table>
<thead>
<tr>
<th>Month</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>88.48</td>
<td>90.95</td>
<td>89.59</td>
<td>89.10</td>
<td>93.97</td>
</tr>
<tr>
<td>February</td>
<td>88.26</td>
<td>89.50</td>
<td>89.12</td>
<td>89.21</td>
<td>94.12</td>
</tr>
<tr>
<td>March</td>
<td>87.58</td>
<td>89.60</td>
<td>89.12</td>
<td>90.19</td>
<td>94.00</td>
</tr>
<tr>
<td>April</td>
<td>87.94</td>
<td>89.52</td>
<td>89.50</td>
<td>90.43</td>
<td>94.25</td>
</tr>
<tr>
<td>May</td>
<td>88.72</td>
<td>90.32</td>
<td>88.57</td>
<td>91.99</td>
<td>96.19</td>
</tr>
<tr>
<td>June</td>
<td>88.46</td>
<td>91.19</td>
<td>89.31</td>
<td>92.76</td>
<td>94.98</td>
</tr>
<tr>
<td>July</td>
<td>88.50</td>
<td>90.18</td>
<td>89.20</td>
<td>93.11</td>
<td>94.48</td>
</tr>
<tr>
<td>August</td>
<td>88.81</td>
<td>90.04</td>
<td>89.17</td>
<td>93.79</td>
<td>94.66</td>
</tr>
<tr>
<td>September</td>
<td>88.54</td>
<td>91.71</td>
<td>88.74</td>
<td>94.09</td>
<td>94.34</td>
</tr>
<tr>
<td>October</td>
<td>89.74</td>
<td>90.77</td>
<td>88.68</td>
<td>93.71</td>
<td>93.96</td>
</tr>
<tr>
<td>November</td>
<td>90.47</td>
<td>90.70</td>
<td>88.97</td>
<td>93.19</td>
<td>93.50</td>
</tr>
<tr>
<td>December</td>
<td>92.11</td>
<td>90.70</td>
<td>90.04</td>
<td>94.78</td>
<td>94.43</td>
</tr>
</tbody>
</table>

Source: Otoritas Jasa Keuangan, data processed, 2020

This study provides several findings from previous research regarding standard corporate governance and risk governance in the financial crisis to mitigate those risks.

4.2. Board Independence

Independency is essential in running corporate governance that has been explored for an extended period. Many studies aim to find the positive effect between independence to the value of companies (Weisbach, 1988; Mehran, 1995; Agrawal & Knoeber, 1996; John & Senbet, 1998). The manager has effective monitoring the company, reducing opportunistic managers and confiscating of resources of the company. Pathan & Faff (2013) discover a positive effect between the board’s independence and banking companies’ performance. The excellent performance of banks can be seen from better intellectual capital (Mavridis, 2004, Kamath, 2007, El-Bannany, 2008). The independent commissioners will prioritize the interests of the company that will lead to the intellectual capital performance.

Furthermore, Francis, Hasan, & Wu (2012) investigate the board’s performance in meeting attendance in the financial crisis. Firms with low board attendance at meetings have poor performance than boards with high meeting attendance. Campello, Graham, & Harvey (2010); Ivashina & Scharfstein, 2010) investigate the difference in crisis and noncrisis periods for the relationship between board independence and efficiency with the legal system as the moderating variable. This moderating variable is significant during the crisis.

4.3. CEO’s duality

Chief Executive Officer’s duality has a negative relationship to the soundness of companies (Brickley et al., 1997; Palmon & Wald, 2002). This duality could decrease the ability to monitor investments effectively (Tsui et al., 2001; Jermias, 2008; Leung & Horwitz, 2010). However, there’s also different finding, where CEO’s duality could increase the performance (Faley, 2007). According to Kouki and Guizani (2015), an influential manager who tends to dominate the boards of directors is the dual CEO. Sometimes they may still be chairs of the committee. Such CEOs may weaken the power of the board sometimes at the expense of the shareholders. They may maximize their interest in a firm since they enjoy the discretion to “rubber stamp” the board’s decisions.

Similarly, Bhagat and Bolton (2008) discover the significant effect between CEO and board chairman segregation with the company’s soundness. They use risk metrics databases with director information for U.S. companies. Mollah & Zaman (2015) study the relationship between duality and banking soundness. They examine 86 Islamic banks and 86 conventional banks during 2005-2011 from 25 countries. They find dual CEOs hurt the Islamic bank’s performance. Judge et al. (2003) surveyed a small sample size of Russian firms and found that duality negatively affects performance.
Furthermore, Boyd (1995); Al-Matari et al. (2012) and Bansal & Sharma (2016) find positive effects between company performance and duality of CEO. (Dechow, Sloan, and Sweeney, 1996) also support the importance of duality in board. Otherwise, Ujunwa (2012) and Azeez (2015) find a negative relationship between duality and companies' soundness. Separating CEO and chairman will increase the performance of companies. Jensen (1993) finds duality will lead to poor performance of internal control 1993. Pi & Timme (1993) emphasize that differentiate tasks of CEO and chairman will generate better performance of banking companies. The lack of independence makes the board have difficulty getting rid of managers who have poor performance (Goyal and Park, 2002). Therefore, it is rational to expect better performance by separating the CEO and chairman. More focused on the crisis period, Grove et al. (2011) investigate the US bank’s performance for 2005-2008. They find that duality of CEO has a negative effect on Return on Asset in pre-global crisis but no significant relationship in trouble.

4.4. Gender diversity

Starting in 2001 with the Enron case, the board of directors becomes a topic of discussion for academics (Williams, 2003; Singh, 2007; Werhane, 2007). They find low board heterogeneity. Furthermore, senior leaders positively correlate to reported earnings quality, unlike female board (Shawver, Bancroft & Senneti, 2006). Board diversity is very crucial for achieving superior corporate earnings and income (Herring, 2009). Gender diversity could generate higher returns, a higher customer base, and higher profits. This is because diverse groups could develop simplified solutions. (Hoogendoorn, Oosterbeck, & Praag, 2013) Also find that teamwork with the proportion of men and women in it shows better of the soundness of companies (Smith, Smith, & Verner, 2006) found the positive association between women on top positions to the performance even after considering numerous characteristics. This effect depends on the board proportion of women. Companies with a female board have higher profitability (Izgi and Akkas, 2012). Haniffa & Hudaib (2006) discover that females in top positions taking more risks which leads to better performance. However, Yasser (2012) finds no considerable effect between gender diversity and companies’ soundness in Pakistan. Solakoglu and Demir (2016) investigate the emerging market about the relationship of gender diversity on performance. They have firm-level financial data from the companies listed in Borsa Istanbul for 2002-2006 with different performance measurements, accounting, and market-based. They find a significant effect between gender diversity and the soundness of companies. Research about the existence of women on board in crisis is scarce. Gyapong, Monem, & Hu (2015) show a positive effect between gender and ethnicity diversity inboard to company value. Companies tend to increase women and non-white directors in a period of crisis. Encountering a problem will decrease the likelihood of a firm reducing the proportion of women directors. Palvia, Vähämäa, & Vähämää (2015) also discover gender diversity is prominent when a company is dealing with financial distress or crisis because smaller banks with females boards are less likely to fail.

4.5. Risk Governance and Bank Soundness in Financial Crisis

Financial crisis generates several debates when examining corporate governance. Aebi, Sabato, & Schmid (2012) Investigate the existence of risk governance in banking companies. They discuss the role of a Chief Risk Officer (CRO), whether the CRO needs to report to the CEO or just directly to the board. Performance measurements are bought and held returns and Return on Equity. They control board size, CEO ownership, and board independence as the standard corporate governance. They find that banks in which the CRO directly reports to the board of directors have higher returns during a crisis. Otherwise, the board size, CEO ownership, and board independence have no significant relationship to the banking soundness during the crisis. Mongiardino & Plath (2010) emphasize the need for a board-level risk committee, board independence, and CRO. In the banking literature, recent studies find conflicting evidence concerning board independence and shares performance in global crisis (2008 to 2009). For example, Minton, Taillard, & Williamson (2014) discover a negative effect between board independence to performance for U.S. banks in the global crisis. Erkens, Hung, & Matos (2012) Also report that banks with higher board independence
experienced poor performance in the worldwide situation. Also, Pathan & Faff (2013) discover a negative effect between freedom of board and banking soundness in the global crisis. Eventually, this research emphasizes the significance of risk governance in banking companies. Banking companies need to prepare good risk governance for dealing with problems. Companies have to improve the risk management quality and match the appropriate CEO and CRO at the same level; they report the activity directly to the board.

5. Conclusion

This study provides shreds of evidence about the development of corporate governance in crisis, which is the value of this study. CEO’s duality, board independence, and gender diversity have a significant effect on the soundness of companies with the survey literature described before. Several findings generate evidence of the association of crisis periods in understanding the impact between corporate governance and financial soundness. Evaluating standard corporate management and risk governance can lead to the financial soundness of banking companies, especially in terms of the financial crisis.

References


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