Global Research Review in Business and Economics [GRRBE]
ISSN (Online) 2454-3217, ISSN (Print) 2395-4671
| Open-Access | Volume 10, Issue 01,
Pages 119-129 ||2024||

THE EFFECT OF BOARD COMPENSATION, MARKET CAPITALIZATION, AND CORPORATE SOCIAL RESPONSIBILITY ON FINANCIAL PERFORMANCE IN THE BANKING INDUSTRY

[1]Putri Kumala Dewi, [2]Bahtiar Usman
[1,2](Faculty of Economics and Business/Universitas Trisakti, Indonesia)

ABSTRACT

This research aims to examine the effect of board compensation, market capitalization, and corporate social responsibility on the financial performance. The control variables in this study consist of board gender diversity, leverage, and operational cash flow. Data collection utilized purposive sampling method, drawn from the annual reports of banking companies listed on the Indonesia Stock Exchange (IDX) that met specific criteria, resulting in 25 eligible banks with a sample size of 125. Analysis of the data used to test the hypothesis is the panel data regression method using the program Eviews 13. The findings indicate that board compensation has a significant impact on financial performance. Additionally, market capitalization and social responsibility do not have a significant effect on financial performance. Control variable results reveal that board gender diversity and leverage negatively and significantly affect financial performance, while operational cash flow shows a positive impact on financial performance. The implications of this research suggest that financial managers should possess a deep understanding of the company's financial situation and the business environment in which it operates. For investors, a comprehensive analysis of factors such as board compensation, board gender diversity, leverage, and cash flow from operating is crucial for assessing the potential profitability and investment risks of the considered companies.

KEYWORDS - Board Compensation, Board Gender Diversity, Cash Flow from Operating, Corporate Social Responsibility, Financial Performance, Leverage, Market Capitalization

1. INTRODUCTION

The economy of a country is heavily dependent on the financial sector, where financial institutions play a crucial role in financing modern trade and online transactions. The strength of financial institutions reflects the overall economic strength [1]. Despite global economic pressures, the banking industry in 2022 demonstrated stable performance, although risks such as the impact of the COVID-19 pandemic, increases in bond yields, Rupiah depreciation, and declining liquidity need to be monitored [2].

The performance of a bank is not only determined by financial aspects but also involves evaluating its performance in various operational areas [3],[4]. The assessment of financial performance is crucial for evaluating the financial management of the company, including liquidity, capital adequacy, and profitability. Leverage is an important method for assessing company performance, and cash flow from operating activities is also recognized as relevant information in investment decision-making [5], [6].

In the context of corporate leadership, gender diversity in the board of directors has a positive impact on company performance [7] Board gender diversity not only affects financial performance but can also enhance market value and competitiveness. The market capitalization of the company becomes a crucial factor in attracting investors, and the positive growth of the Indonesian capital market reflects economic stability and growth [8]

Corporate governance management also plays a role in gaining market confidence and supporting external sources of funding [9]. The board of directors has a direct influence on the company's value, and executive remuneration can be used as a tool to align stakeholder interests with corporate sustainability and responsibility ([10]. CEOs,

as company leaders, are under pressure to improve company performance and deliver value to shareholders [11].

Corporate Social Responsibility (CSR) practices are also crucial factors in the financial performance of banks post-global crisis [12] Increased investment by banks in CSR not only has a positive impact on reputation but also enhances relationships with stakeholders and cost efficiency [13]. Corporate sustainability and social responsibility are not only legal requirements but can also add value to financial performance and corporate reputation. This research contributes to a better understanding that banks with a strong board will have lower risks and better performance by considering the influence of Board Compensation, Market Capitalization, and Corporate Social Responsibility as internal governance mechanisms and their impact on risk-taking and banking performance.

2. LITERATURE REVIEWS

2.1 Finance Performance

The performance of a company is an evaluation of the extent to which a company can achieve its goals with good effectiveness and efficiency, especially in the context of financial success related to maximizing shareholder revenue and managing corporate assets [14]. According to [15], the operational performance of a company is also correlated with its sales and market value, influenced by work results as well as internal and external factors. The evaluation of financial performance, as a formal process, is designed to assess the efficiency and effectiveness of the company in generating profit and managing cash carefully. Financial performance measurement tools allow for a deep understanding of growth prospects, financial development, and the optimization of resource usage [16]. The financial performance of a company serves as a primary indicator of management performance, especially in the banking sector, which must demonstrate financial strength, profitability, asset quality, and managerial efficiency ([17]; [18]). Financial performance analysis involves aspects such as liquidity, solvency, profitability, and activity, with the aim of presenting relevant information to various stakeholders so that they can make informed decisions [19].

2.2 Board Compensation

Based on the research by [21], the agency theory of Jensen & Meckling found that conflicts of interest can arise within the corporate structure between shareholders and managers. This difficulty arises because managers have broader control and access to information, allowing them to pursue personal gains. Board compensation is designed to address this issue by providing incentives to the CEO, but shareholder concerns about overpayment and mismatch with company performance [22] have led to the introduction of shareholder voices. Board compensation is also considered a governance cost; however, the lack of research on this is surprising. In Indonesia, the National Governance Policy Committee has issued guidelines for implementing good corporate governance, particularly in the banking industry. Compensation in the financial sector is related to the principles of accountability, fairness, and equality. Studies indicate that board compensation can impact financial performance, with a positive effect on bank profitability [23]. Therefore, researching the influence of Board Compensation on financial performance provides valuable insights into understanding the factors that shape a company's financial success [24].

2.3 Market Capitalization

Market Capitalization is a fundamental parameter in investment management and ownership of a company's stock. To calculate the total value of outstanding shares, market capitalization is determined by multiplying the number of common shares by the market price per share at that time [24]. As a widely recognized measure of a company's value, market capitalization provides insights into the aggregate value of a company or its shares, playing a key role in the banking industry and signaling to investors about the future prospects of the company [25]. Although market capitalization and equity ownership are distinct, their fluctuations with stock prices reflect investment stability, where higher values indicate greater stability [26]. According to [27], market capitalization has a simultaneous influence with Return on Assets (ROA), reflecting market value and signaling effects on external stakeholders. Recent research by [28] highlights the role of market capitalization in describing a company's capacity to generate profit from its assets, indicating a complex relationship between company size and financial performance, especially in operational efficiency and financial results reflected in ROA. Therefore, market capitalization is not just an indicator of market value but also reflects a company's potential to optimize financial performance through efficient asset utilization.

2.4 Corporate Social Responsibility

The implementation of Corporate Social Responsibility (CSR) represents a company's effort to serve people, communities, and the environment beyond legal obligations. CSR strategies, as explained by ([29]; [30]), integrate financial factors with social and environmental values, creating long-term competitive advantages. CSR

investments can yield financial benefits by enhancing reputation, stakeholder engagement, risk reduction, and fostering innovation. CSR initiatives focus on long-term success and can improve reputation, brand attitude, consumer engagement, positive advertising, and customer trust [31]. Bank participation in CSR is seen as a win-win strategy for both business gains and societal well-being. CSR practices are linked to corporate financial performance [32] and can enhance company value and market reputation. Research highlights CSR's contribution to financial performance through improved reputation and customer satisfaction [33]). In the context of Return on Assets (ROA), CSR practices can enhance asset utilization efficiency and create added value from social, environmental, and financial performance perspectives [34]. Therefore, CSR implementation reflects a company's responsibility toward social and environmental impact, with the potential to create added value across various aspects, including ROA.

2.5 Board Gender Diversity

Board gender diversity has become a central essence in agency theory, mitigating agency problems through cultural dimensions. Agency theory emphasizes corporate legitimacy and the contract between managers and shareholders [35]. Gender diversity in the board brings a profound perspective, enhancing the performance of female employees, corporate reputation, creativity, and innovation. Diversity, broadly defined as significant differences [36], has been the focus of research and policy in the last two decades [37]. Advancing companies by promoting the presence of women on boards contributes to healthier financial performance, board compensation packages, and leadership skills [38]. Female directors have also been proven to reduce risks, enhance governance, and corporate social responsibility [39]. Women business leaders tend to pay attention to social values and studies show the positive impact of gender diversity on decision-making and risk management in the boardroom [40]. With the integration of diverse perspectives, board gender diversity supports innovation and operational efficiency, potentially enhancing the overall financial performance of the company.

2.6 Leverage

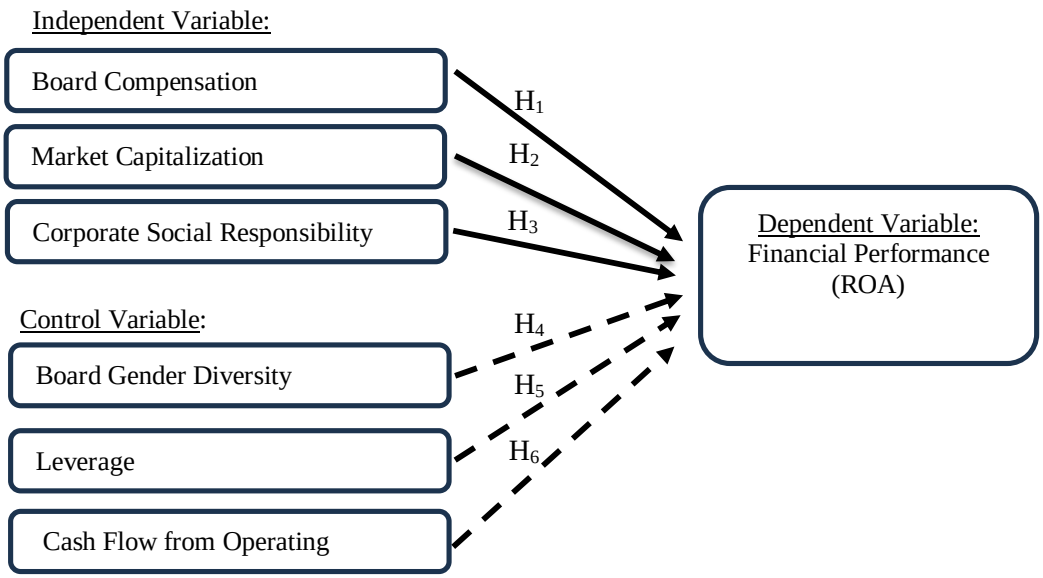
Leverage is a measure of how much money an organization borrows to fund its activities and capital structure [41]. Leverage reflects the level of debt of a company, and companies that increase their debt with ROA tend to have lower profits. The use of leverage in financing can increase profits for shareholders, but it also carries the risk of greater losses, especially when investments become worthless. Wise leverage management is crucial because the decision to take on significant debt can enhance the business value through tax reduction. Although leverage provides tax protection benefits, additional costs such as fixed interest, financial difficulties, and bankruptcy risks need to be considered ([42];[43]).

2.7 Cash flow from operating

The Cash Flow from Operating (CFO) in a company provides a more accurate representation of current cash ownership compared to net income, which can be artificially manipulated. CFO encompasses earnings adjusted for non-cash or accrual-based earnings, reflecting the excess of cash receipts over cash payments from operational activities [44]. CFO serves as a key indicator of financial health, demonstrating the company's ability to generate cash flow from its core business activities [45]. Analyzing CFO is crucial in understanding the financial dynamics of a company, especially in its operational context, reflecting the efficiency of the company in managing resources to generate positive cash flow [46] The positive influence of CFO on financial performance, such as Return on Assets (ROA), indicates managerial efficiency and the operational sustainability of the company [47]. Therefore, CFO provides a comprehensive insight into the financial health of the company and serves as a performance indicator for evaluating effective financial management [48].

Based on the background above, the following hypothesis can be drawn:

H_1: There is an effect of Board Compensation on financial performance.
H_2: There is an effect of Market Capitalization on financial performance.
H_3: There is an effect of Corporate Social Responsibility on financial performance.
H_4: There is an effect of Board Gender Diversity on financial performance.
H_5: There is an effect of Leverage on financial performance.
H_6: There is an effect of Cash Flow from Operating on financial performance.



The research model depicted in Figure 1

3. RESEARCH METHODS

This research using a secondary data collection method with data sourced from the Indonesia Stock Exchange (www.idx.co.id) and official websites of focused companies. The data analysis encompasses information on banking companies listed on the Indonesia Stock Exchange from 2018 to 2022, utilizing a quantitative approach with Return on Assets (ROA) as the dependent variable. The independent variables include Board Compensation, Market Capitalization, and Corporate Social Responsibility (CSR), while control variables involve Board Gender Diversity, Leverage, and Cash Flow from Operating. The sample is selected using purposive sampling technique based on relevant and essential criteria. Although there are 47 banks listed on the Indonesia Stock Exchange, 22 banks have incomplete data, resulting in 25 eligible banks with a sample size of 125.

Table 1. Identification and Measurement Variable

Variable Type	Variable symbol	Definition	Source
Variable Dependent			
Return on Asset	ROA	Net income/Total assets	(E-Vahdati et.al.,2022)
Variable Independent			
Board compensation	LnCOMP	Total compensation of the board members (in natural logarithm)	(E-Vahdati et.al.,2022)
Market capitalization	Marketcap	The number of shares multiplied by the closing price (in natural logarithm)	(E-Vahdati et.al.,2022)
Corporate Social Responsibility	CSR	Log (Social Cost + Welfare Cost)	(Al Maeeni et al., 2022)
Variable control			
Board gender diversity	GENDER	Percentage of women on the board	(E-Vahdati et.al.,2022)
Leverage	LEV	Total debt/Total assets	(E-Vahdati et.al.,2022)
Cash Flow from Operating	CFO	Net cash flow from operating activities/Cash equivalents	(Rahman & Sharma, 2020).

There are stages in testing the regression model in this study, outlined as follows:

3.1 Chow Test

The outcomes of dietary examinations present two alternatives necessitating determination: a collective impact or a steadfast impact. Within this investigation, the Chow test serves to ascertain the superior and more fitting model. The Chow test hinges on the null hypothesis positing an absence of individual heterogeneity, counterbalanced by the alternative hypothesis asserting cross-sectional heterogeneity. Decisive criteria are applied in the decision-making process, whereby the acceptance of *H*0 is contingent upon the chi-square cross-sectional probability being < 0.05. The findings of the Chow test reveal that the chi-square cross-sectional probability values were 0.0000. Consequently, as the probability falls below 0.05, the decision negates *H*0, indicating the adoption of a fixed-effects model. If the model chosen is a fixed-effects model, further scrutiny is warranted through the Hausman test to discern whether a fixed-effects or random-effects model is more appropriate.

3.2 Hausman Test

The outcomes of the Hausman test present two alternatives requiring determination: random effects or fixed effects. Within the context of this investigation, the Hausman test serves the purpose of ascertaining the superior and more suitable model. Should the probability associated with the cross-sectional area exceed 0.05, the null hypothesis (*H*0) is upheld. As indicated by the findings of the Hausman test, the probability associated with cross-sectional randomness is revealed to be 0.0000, which is less than the critical threshold of 0.05. Consequently, the decision is made to reject *H*0, thereby favoring the utilization of a Fixed Effects model

Table 2. Chow Test dan Hausman Test Result

Test Summary	Statistic	Prob	Result
Cross-section Chi-square	102.1740	0.0000	H0 Rejected, Fixed Effect
Cross-section random	38.0496	0.0000	H0 Rejected, Fixed Effect

3.3 Method of Goodness of Fit Data Analysis (*R2*)

This test aims to assess the extent of the influence of independent and control variables in explaining its dependent variable. This analysis employs the adjusted *R*2 value since there is more than one independent variable. If the adjusted *R*2 value approaches 1, it indicates that the independent and control variables are capable of explaining the dependent variable. Based on the goodness of fit test results, the obtained adjusted r-square value is 0.7156. This means that all independent variables can explain the dependent variable measured by ROA by 71.56%, and the remaining 28.44% is explained by other variables outside of this research model.

3.4 Simultaneous Test (F-test)

This test is conducted to examine whether independent variables collectively have a significant impact on the dependent variable. Based on the simultaneous test results, it is observed that the F-statistical probability yields a value of 0.0000 < 0.05. Thus, the analysis results in this study indicate that independent variables collectively have a significant impact on the dependent variable.

4. RESULTS AND DISCUSSION

4.1 Descriptive Statistics

Descriptive statistics serves as a data processing method employed to provide an overview or description of data, encompassing measures such as minimum, maximum, mean, and standard deviation. The maximum and minimum values are utilized to ascertain the highest and lowest values within each variable. The mean value is employed to identify the central tendency of each variable, while the standard deviation is utilized to assess the homogeneity of each variable. Descriptive statistics delineate data by employing a statistical approach for each variable, namely LnComp, Marketcap, CSR, Gender, CFO, and LEV. In this study, the dependent variable is ROA, and the independent variables include LnComp, Marketcap, and Gender, with control variables comprising Gender, CFO, and LEV. The findings of the descriptive statistical analysis are presented in Table 3.

Table 3. Descriptive Statistics Result

Variabel	N	Minimum	Maximum	Mean	Std. Dev.
ROA	125	- 14.7500	4.2200	1.0110	1.9847
LNCOMP	125	8.6039	13.4072	10.8999	1.2871
MARKETCAP	125	13.4581	20.8013	16.4288	1.8486
CSR	125	0.1959	5.2421	3.4519	1.1162
GENDER	125	0.0272	0.6665	0.2234	0.1238
LEV	125	0.6552	1.0710	0.8265	0.0556
CFO	125	- 1.5713	2.0614	0.1041	0.5958

Source: Data processed using EViews 13

4.2. Hypothesis Testing Result

The t-test is employed to ascertain the extent to which the independent variable influences the explanation of the dependent variable. Hypothesis testing is conducted by examining the probability values in the analysis results using EViews 13. Hypothesis testing can also be based on a significance level of 0.05 ($\alpha = 5\%$). Acceptance or rejection of the hypothesis is determined by the criteria that if the probability value is > 0.05, then the hypothesis is rejected (the regression coefficient is not significant). This implies that, partially, the independent variable does not have a significant effect on the dependent variable. If the probability value is ≤ 0.05, then the hypothesis is accepted (the regression coefficient is significant). This signifies that, partially, the independent variable has a significant effect on the dependent variable.

Table 4. Hypothesis Test Result

Variable	Coefficient	Prob.	Result
C	17.8539	0.0004	-
LNCOMP	0.9465	0.0024	Positive significant
MARKETCAP	- 0.3901	0.0693	No significant
CSR	- 0.0912	0.7644	No significant
GENDER	- 6.7725	0.0004	Negative significant
LEV	- 22.9440	0.0000	Negative significant
CFO	0.3958	0.0387	Positive significant

Source: Data processed using EViews 13

4.2.1 The effect of Board Compensation on Financial Performance.

Based on the research revealed in Table 4, a significant relationship was found between board compensation and return on assets (ROA) with a low probability value, indicating a significant influence. Further analysis confirms a positive correlation between board compensation and the financial performance of the company through ROA. These results support previous findings, including research by [23] which indicates that board compensation has a positive and significant impact on ROA. This finding reinforces the view that board compensation significantly affects the financial performance of the company, highlighting the importance of compensation design that supports sustainable growth and efficiency, consistent with other research as indicated by previous studies ([49]; [50]).

4.2.2 The effect of Market Capitalization on Financial Performance.

Based on the analysis in Table 4, testing the variable market capitalization on Return on Assets (ROA) shows a large probability value, indicating its lack of significant influence. This finding contrasts with previous research, such as [27], which states that market capitalization has a positive influence on ROA. These results are also inconsistent with [51], which indicates that market capitalization is influenced by large investors, especially related to higher returns. Although controversial, this research is supported by [52], which found that market capitalization does not consistently have a positive or negative impact on ROA, and by the research of [53], which indicates that the relationship between market capitalization and ROA is neutral. Therefore, it can be concluded that market capitalization does not have a significant influence on ROA, while other factors such as asset management and business strategy may be more dominant in influencing ROA.

4.2.3 The effect of Corporate Social Responsibility on Financial Performance.
Based on the analysis in Table 4, this research indicates that the test of the Corporate Social Responsibility (CSR) variable on return on assets (ROA) shows a large probability, indicating its lack of significant influence. This result contrasts with the findings of [34], stating a positive influence of CSR on company performance, but aligns with [54], which found a negative influence of CSR on financial performance. This research highlights that in the banking sector, where CSR is not the main focus, social and environmental activities do not always directly reflect in financial performance, in line with the views of [55]. The implications emphasize the complexity of the relationship between corporate social actions and financial performance, reminding that CSR is not only about direct financial impact but also about core values that can provide long-term non-financial benefits.

4.2.4 The effect of Board Gender Diversity on Financial Performance.
Based on the analysis of testing the Board Gender Diversity variable on Return on Assets (ROA), the findings show a significant influence of the GENDER variable on ROA. This result is inconsistent with previous research by [56], which found a positive relationship between gender diversity on the board and financial outcomes in financial institutions. In this context, the research of [40], supports that board gender has a negative influence on the financial performance of the company. Analysis of the proportion of female board directors shows a tendency that an increase in the number of women may decrease financial performance because women's cautious decision-making can avoid higher risks. Although considered an advantage, this caution may lead to missing business opportunities, and company management needs to carefully consider gender composition in the board to achieve an optimal balance without sacrificing financial performance.

4.2.5 The effect of Leverage on Financial Performance.
This research highlights the impact of the Leverage variable on the financial performance of the company, especially return on assets (ROA). Statistical analysis reveals a significant influence between the debt level and ROA, with a negative coefficient indicating that an increase in debt can reduce the financial performance of the company. This finding aligns with the study of [41] which found a negative relationship between the level of debt and company performance. Although leverage can increase profit potential, significant financial risks may arise, as supported by the research of [57]. This research provides an important contribution to financial management understanding in managing the financial structure to optimize the company's value and reduce unwanted financial risks.

4.2.6 The effect of Cash Flow from Operating Activities on Financial Performance.
Based on the analysis of the testing variable CFO on the variable ROA, a low probability value was found, indicating a significant influence between cash flow from operating activities (CFO) and return on assets (ROA). This finding aligns with previous research by [46], stating that CFO has a direct and significant relationship with the financial performance of the company. Cash flow from operating activities is considered crucial in predicting the asset return rate, with its positive influence on ROA. This finding supports the concept that managing operational cash flow can play a crucial role in determining the long-term performance of a financial institution [58], [46].

4.3 Multiple Regression Models
Based on the panel data regression results in the table 4, the relationship between the independent variables namely board compensation, market capitalization and corporate social responsibility and control variables consisting of board gender diversity, leverage and cash flow from operating, to the variables dependent, namely ROA, the panel data regression model can be written as follows:

ROA = 17.8539 + 0.9465*LNCOMP - 0.3901*MARKETCAP - 0.0912*CSR - 6.7725*GENDER - 22.9440*LEV + 0.3958*CFO

term:

ROA	= Return on Asset
LnCOMP	= Board compensation
β	= konstanta
MARKETCAP	= Market capitalization
CSR	= Corporate Social Responsibility
LEV	= Leverage
Gender	= Board gender diversity
CFO	= Cash Flow from Operating
εit	= error

5. CONCLUSION

5.1 Conclusion

Based on the results of the conducted tests, the following conclusions were drawn:
1. Board Compensation has a significant effect on financial performance.
2. Market Capitalization does not have an effect on financial performance.
3. Corporate Social Responsibility does not have an effect on financial performance.
4. Board Gender Diversity has a negative and significant effect on financial performance.
5. Leverage has a negative and significant effect on financial performance.
6. Cash Flow from Operating has a positive and significant effect on financial performance.

5.2 Implications

5.2.1 Implications for the Company

a. The effective design of board compensation can provide incentives for board members to enhance efficiency, transparency, and policies beneficial to the company.
b. Improved understanding of factors influencing financial performance, especially in the context of board compensation, supports strategic decision-making, risk management, and sustainable growth.
c. The negative impact of board gender diversity needs to be considered in recruitment policies to avoid adverse effects on financial performance.
d. Balancing caution and risk-taking reflects the need to find the optimal balance between risk mitigation and business opportunity pursuit.
e. Prudent financial structure management is necessary to avoid adverse financial risks, with particular attention to the use of leverage that can have negative impacts.
f. Risk management for the decline of CFO is crucial to address factors such as operational revenue decline or inefficient cash management policies to maintain and enhance financial performance.

5.2.2 Implications for Investors

a. The careful consideration of board compensation is essential for investors as it significantly impacts the company's financial performance.
b. Investors are advised to conduct comprehensive analyses of board compensation policies to make informed and long-term investment decisions.
c. Focus on transparency and efficiency in company management related to board compensation is also emphasized, with a positive correlation between compensation and financial performance as an indicator of management effectiveness.
d. Investment decisions also need to account for the potential impact of gender diversity policies on stock value and financial results.
e. Understanding investment risks, especially related to debt levels and return on assets (ROA), is considered crucial, while monitoring cash flow from operations is identified as a signal of investment risk.
f. Wise investment decisions are also emphasized by considering the company's financial structure and optimizing investment value, while assessing the company's financial health can be done through the positive relationship between cash flow from operations and ROA, reflecting the company's ability to generate good operational cash flow.

5.3 Limitations and Recommendations

5.3.1 Research Limitations

The use of variables in this study is limited to the dependent variable profitability, using only the ROA ratio. Independent variables are limited to Board Compensation, Market Capitalization, and CSR, with control variables of Board Gender Diversity, Leverage, and Cash Flow from Operating.

5.3.2 Recommendations

Based on the research findings, discussions, and limitations presented by the researcher, recommendations for future researchers include incorporating additional measurement methods that influence company financial performance, such as Tobin's Q and return on investment (ROI) (Ali et al., 2016; Qurashi & Zahoor, 2016).

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