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The Effects of Good Corporate Governance, Independent Boards, and Firm Size on Bank Financial Performance in the Digitalisation Era: A Capital Structure as a Mediation Variable

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Financial performance is important for banks. Determinant financial performance remains a concern for bank management. This study examined how good corporate governance, independent boards, and company size can improve financial performance. This study also examined capital structure in the relationship framework. A total of 30 banks reporting on the Indonesian Stock Exchange were a sample, observed between 2015-2018. Path analysis tested the hypothesis. The test results show that good corporate governance does not affect financial performance, while independent boards and company size have a positive effect on financial performance. The capital structure also mediates the influence of independent board and bank size on financial performance. Further, this study provides empirical evidence that capital structure is directly proportional to bank financial performance in this digitalization era. The implication is banks must pay more attention to the supervising, independent board structure, to improve the operational performance and financial performance of companies. An increase in the size of bank assets can increase financial performance, thereby increasing the bank's operational performance.

Key words: *Finance, bank, firm size, good corporate governance, independent board.*

Introduction

Financial performance in the form of profitability is important in corporate sustainability. In the Industrial Era 4.0 companies, especially banks, must practice good corporate governance, to not lose in the competition for customers' trust, especially in meeting corporate funding goals. Good corporate governance practices are important, to reduce investor risk and improve company performance. Companies need better financial and revenue resources to promote their goals. Factors affecting capital structure and profitability must be carefully considered. Due to an attention to the above factors, the profitability of banks on the Indonesia stock exchange tends to declined.

The relationship of capital structure, independent board, corporate governance, business size, and business performance has traced in various countries, with diverse empirical evidence (Chaudhry et al., 1995; Al-Omar and Al-Mutairi, 2008; Al-Jarrah et al., 2010; Ajanthan, 2013; Al-Kayed et al., 2014; Basuony et al., 2014; Anarfo, 2015; Dahmash, 2015; Samad, 2015; Azutoru et al., 2017; Siddik et al., 2017; Aktan et al., 2018; Anandasayanan and Velnampy, 2018; Rashid, 2018; Trofimov et al., 2018; Ayodeji and Okunade, 2019). The company must carry out corporate governance comprehensively (good corporate governance) to improve company performance (Connelly et al., 2012). An independent board is very important in corporate governance; it is an internal mechanism for supervision (Denis and McConnell, 2003). Research by Ahsan et al. (2015) revealed empirical evidence that matters such as independent boards and company size affect capital structure. Implementing corporate governance requires costs, so cost allocation for an implementation of corporate governance also depends on firm size. Given the importance of capital structure for companies in optimizing profitability, it is necessary to examine capital structure and good corporate governance in other sectors, especially the banking sector.

Literature Review and Hypotheses Development

The company's main goal is to prosper shareholders (Brigham and Davies, 2011). Shareholder prosperity can achieved if the bank's business performance is high. Profitability is important. It must be maximized in company operations, necessitating corporate governance. Company management has the potential to cause conflicts of interest, known in agency theory (Jensen, 1993). Management is also required to achieve company goals and reduce the potential for conflict between the management and company owners, by managing through the principles of corporate governance.

Basuony et al., (2014) sampled conventional and Islamic banks operating in seven Arabian Peninsula countries, such as Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates, and Yemen. They found that corporate governance mechanisms (concentration of ownership, audit committee, and meetings audit committee) significantly influences ROA. Azutoru et al., (2017) researched insurance finance companies in Nigeria between 2011-2015, and found that corporate governance mechanisms, such as board size and the remuneration of non-executive directors, had a negative and significant effect on ROA. However, an independent board and institutional ownership are positive and significant for financial performance as predicted by agency theory. Research at the Sri Lankan Colombo Stock Exchange found that corporate governance mechanisms improve corporate profitability, Anandasayanan and Velnampy (2018).

Research on the Bahrain Exchange between 2011-2016 found empirical evidence that corporate governance mechanisms, board size, ownership, concentration and auditor's reputation positively affect company performance (ROA). Whereas, independent boards and the frequency of board meetings have no effect on company performance (Aktan et al., 2018). An investigation of the Nigerian stock exchange between 2008-2017, specifically it is banking sector, founded that the presence of independent boards increased companies' performance proxied by ROA (Ayodeji and Okunade, 2019).

In contrast to the empirical evidence above, Ajanthan (2013) discussed research regarding the Colombo Stock Exchange (CSE) of Sri Lanka, between 2007-2012. Empirical factors such as independent boards, board size, and CEO duality had no effect on capital structure and corporate profitability (ROA). Likewise, Rashid's research (2018) in Bangladesh on 135 companies on the Dhaka Stock Exchange, for the period 2006-2011, produced empirical evidence that even though board independence is an important attribute in corporate governance, it remains an illusion in Bangladesh.

The operational effort to generate profits cannot be separated from the firm size, proxied by the total assets used to get income. Chaudhry et al. (1995) stated that business size is one of the determinants of profitability for American commercial banks. Furthermore, Al-Omar and Al-Mutairi (2008) investigated the impact of special determinants on Kuwaiti banks, about profitability for the period 1993-2005. The results showed that the equity ratio, loan-asset ratio, operational expense ratio, and total assets explain about 67% of the variation in return on assets (ROA). Bank size positively impacts company efficiency and profit potential.

Samad (2015) provided empirical evidence about the impact of bank-specific characteristics and macroeconomic variables, in determining Bangladeshi banking profitability. Bank specific factors such as loan-deposit ratios, provision for loan-losses to total assets, equity capital to total assets ratios, and operating costs to total asset ratio, significantly affect profitability. Whereas, bank size and macroeconomic variables do not show an impact on profitability. Trofimov et al., (2018) examined commercial banks in Malaysia. Bank size related significantly, positively with the performance of commercial banks in Malaysia. Likewise, research on the Nigerian stock exchange in 2008-2017, as to the banking sector, revealed that company size affected company performance (Ayodeji and Okunade, 2019).

In contrast to the above, Dahmash (2015) founded that for bank companies, diversified financial companies, and real estate companies with firm size, did not significantly affect profitability. That study sampled 1538 companies listed on the Amman Security Exchange, Jordan, between 2005 and 2011. Likewise, empirical research into the Colombo Stock Exchange, Sri Lanka, revealed that capital structure and company size do not affect corporate profitability (ROA) (Anandasayanan and Velnampy, 2018). Firm size can play an important role in the producing profitability. The company that will be even greater with a continuous increase in profitability.

In some developed countries bank size affects the capital structure, because it will increase around a volume of transactions (Baker and Wurgler, 2002). Anarfo (2015) examined the determinants of bank capital structure in Sub-Saharan Africa. Asset returns, size, asset tangibility, bank growth rates and inflation rates were statistically significant in determining bank capital structure. Furthermore Ahsan et al. (2015) with an unbalanced panel data model for 39 years (1972-2010) from Pakistani non-financial companies, found that governance mechanisms influence capital structure. Poor corporate governance and weak legal systems make it difficult for companies to account for the management of creditors' companies.

Research on the determinants of bank profitability in Jordan during the 2006 period by Al-Jarrah et al. (2010) revealed bank profitability as paramount. It relates to the ratio of loans to total assets, operating expense ratios, capital structure, deposit ratios, and expenditure ratios. The profitability of Jordanian banks does not respond quickly to changes in explanatory variables, in the short run. The influence of capital structure on company performance was studied by Al-Kayed et al. (2014), for 85 Islamic banks in 19 countries. Bank performance (profitability) responded positively to an increase in equity (capital ratio). Sharia banks must carefully manage the right mix of debt and equity, such as the capital structure, to maximize bank value.

Capital structure decisions play an important role in a company's performance. Siddik et al. (2017) used panel data from 22 banks in Bangladesh, for the period 2005-2014. They empirically found that capital structure was inversely proportional to bank performance. Thus, bank management in Bangladesh really demands a concentration of bank management and policy makers, to reduce debt dependency, to optimize capital structure. Research at the Colombo Stock Exchange found that capital structure has no effect on corporate profitability (ROA) (Anandasayanan and Velnampy, 2018). Research on companies in Malaysia, between 1990 and 2010, found that capital structure mediates asset structure and financial performance (ROA) (Ramli et al., 2019).

This conceptual framework is formulated as follows:

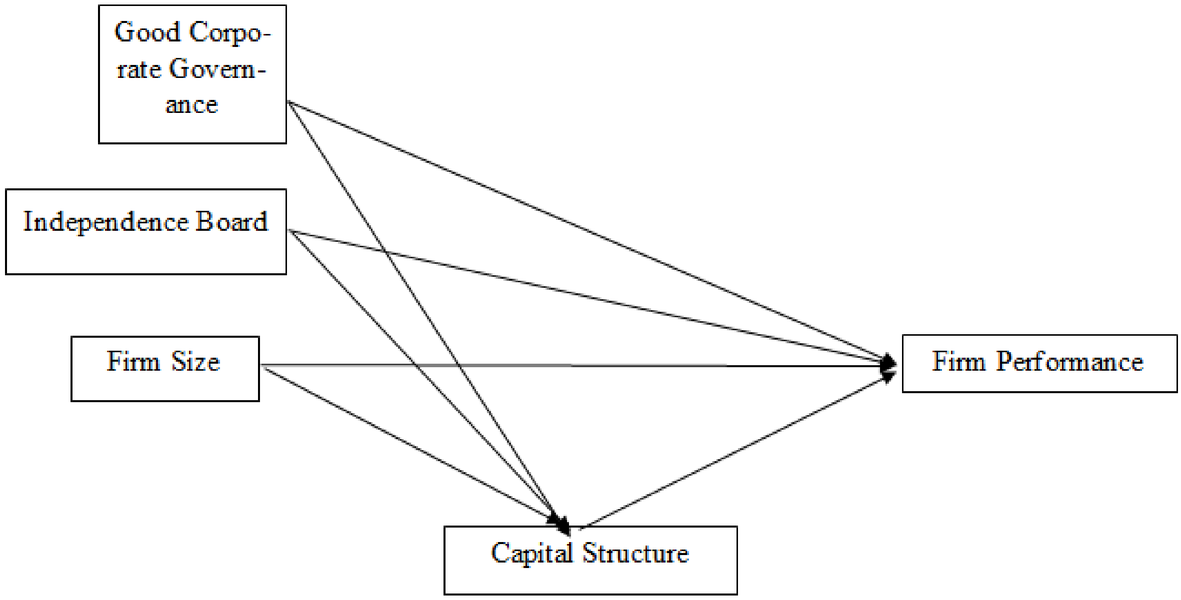

Figure 1. Research Model

Methods

Company performance was proxied by profitability as measured on return on assets (ROA). Good corporate governance scored by the bank assessing itself. An independent board also proxied by the percentage of an independent board. Company size is proxied by total assets. Capital structure is proxied by CAR. The research population includes all companies going public in the Indonesian Stock Exchange (IDX) bank sector, whose shares were actively traded in the 2015-2018 period. In this case, all populations met the criteria and were sampled in the research. Our sample, consisting of 30 companies, presents in Table 1.

Table 1: Sample selection

No.	**Criteria**	**Total**
1	The company goes public in the banking sector	45
2	The company goes public in the sharia banking sector	(3)
3	The company goes public the non-sharia banking sector listing after 2014	(4)
4	The company goes public in the non-sharia banking sector and did not post a loss for the 2015-2018 period	(8)
Total for Research Sample		**30**
Number of observations (2015-2018)		**120**

Results

Descriptive statistics of the research variables are presented in Table 2. It includes the maximum, minimum, average, and standard deviation values.

Table 2: Descriptive statistics

	N	Minimum	Maximum	Mean	Std. Deviation
GCG	120	1.00	3.00	1.9167	.33263
Independent Board	116	.62	1.11	.9814	.07308
TA	120	1.00	978.00	1.4086E2	230.26128
ROA	120	.09	4.19	1.7242	1.02356
CAR	120	10.52	66.43	21.6132	6.91122

The outer model testing presents in Table 3. This research used a formative indicator measurement model for all variables. This was used by met p-value and VIF less than 0.05 and 5, thus the formative construct measurement is considered feasible.

Table 3: Indicator Measurement Model Test Results

Variable	GCG (score)	GCG (Ind. Board)	TA	ROA	CAR	Type	P Value	VIF
GCG	1	0	0	0	0	Formative	<0.000	0.000
Independent Board	0	1	0	0	0	Formative	<0.000	0.000
TA	0	0	1	0	0	Formative	<0.000	0.000
ROA	0	0	0	1	0	Formative	<0.000	0.000
CAR	0	0	0	0	1	Formative	<0.000	0.000

Table 4: Structural Model Analysis

No	Model fit and quality indices	Criteria Fit	Analysis	Explanation
Panel A: Model's Goodness-of-Fit Test				
1	Average path coefficient (APC)	P<0.05	0.272; P<0.001	G o o d
2	Average R-squared (ARS)	P<0.05	0.429; P<0.001	G o o d
3	Average adjusted R-squares (AARS)	P<0.05	0.412; P<0.001	G o o d
4	Average block VIF (AVIF)	Acceptable if<=5, ideally <= 3.3	1.253	G o o d
5	Average full collinearity, VIF (AFVIF)	Acceptable if<=5, ideally <= 3.3	1.604	G o o d
6	Tenenhau Gof (GoF)	Small>=0.1 Medium >= 0.25 Large>= 0.36	0.655	G o o d
7	Sympson's paradox ratio (SPR)	Acceptable if >=0.7, ideally = 1	0.714	Ideal
8	R-squared contribution ratio (RSCR)	Acceptable if >=0.9, ideally = 1	0.959	Ideal
9	Statistical suppression ratio (SSR)	Acceptable if >=0.7	1.000	G o o d
10	Nonlinear bivariate causality direction ratio (NLBCDR)	Acceptable if >=0.7	1.000	G o o d
Panel B: Coefficient of Determination (R^2) Test				
ROA			0.47	feasible
CAR			0.38	Feasible

The inner model test presents in Table 4. This ensures a structural model. Panel presents for the model's goodness-of-fit test. Thus, the model is good and can be used to both explain the phenomenon under study, and test the hypothesis. A good corporate governance, independent board, TA, and the CAR variables have predictive relevance on the ROA variable. Panel B shows that the R^2 of CAR is 0.47, while R^2 of the CAR is 0.38. This means that the values meet for requirements to be examined in the next process.

Table 5: Path Analysis

Path	Path Coefficient	P Value
GCG ROA	-0.07	P=0.21
Independent Board ROA	0.12*	P=0.09
TA ROA	0.57***	P<0.01
GCG CAR	-0.07	P=0.23
Independent board CAR	-0.47***	P<0.01
TA CAR	-0.32***	P<0.01
CAR ROA	0.28***	P<0.01
Independent board CAR ROA	-0.0336**	0.04
TA CAR ROA	-0.0896**	0.01

*sig 10%, **sig 5%, ***sig 1%

Next, to test the hypothesis, researchers used a path analysis with PLS, presented in Table 5. Hypothesis 1 stated that improvement on good corporate governance increases company performance. It is not supported by empirical evidence. This is because the standard of good corporate governance assessment used in the self-assessment has been standardised to be run by banks. These results are in line with research (Azutoru et al., 2017), but different from the results of Basuony et al., (2014), Anandasayanan and Velnampy (2018). Likewise, hypothesis 4 is not supported by empirical evidence; capital structure does not mediate the effect between good corporate governance and return on assets.

However, the second hypothesis as to independent boards is proven in this study. Independent boards can improve company performance, by increasing supervision in bank operations. This research result was also found by Azutoru et al. (2017) and Ayodeji and Okunade (2019). It was not the same as empirical evidence presented by Aktan et al. (2018), Ajanthan (2013), and Rashid (2018). The third hypothesis is also proven. Bank size still improves bank performance, in line with findings from Al-Omar and Al-Mutairi (2008), Trofimov et al.,(2018), Ayodeji and Okunade (2019), and Anandasayanan and Velnampy (2018). Bank size can improve bank operational performance, thereby increasing bank profitability. These results are not in line with research findings from Samad (2015) and Dahmash (2015).

The fifth and sixth hypotheses are supported by empirical evidence. Capital structure acts as a mediating variable in the relationship between independent boards and firm size, for bank performance. This is the same as the results of research from Ramli et al., (2019), who said that companies in Malaysia can increase an independent board and bank size, then reduce for bank capital structure and financial performance. The independent board and company firm size can increase confidence for bank customers, thereby reducing net capital which decreases the capital structure as indicated by the capital adequacy ratio. From other studies, a decrease in capital structure should increase profitability. Eventually, a decrease in capital structure has an impact on a decrease a bank profitability. These results are not in accordance with the research of Siddik et al., (2017) that there is an opposite relationship between capital structure and financial performance.

Conclusions

This study investigated determinants of financial performance in 30 banks on the Indonesian Stock Exchange in the 2015-2018 period. It researched the role of capital structure as a mediating variable in the relationship of good corporate governance, independent board, and company size on financial performance. This study showed that good corporate governance does not affect financial performance. However, it also demonstrated that independent board and company size affect financial performance. In this digital age, a firm size is still measured by investors that can be assessing banks. The capital structure is proven to mediate the relationship between independent board and company size, as to financial performance. Capital structure is still a concern of investors. In the relationship between good corporate governance and financial performance, capital structure is not proven as a mediating variable.

Good corporate governance has become a regulatory standard that must be upheld by banks in Indonesia. It has become a standard operating procedure within banks. Therefore, it is not associated with financial performance. Supervision by an independent board in the digital age can improve financial performance. A greater size of the bank, or greater amount of bank assets, can increase the ability of obtaining profitability, for good financial performance. A particularly interesting aspect of this study is that a decline in capital structure was shown to be directly proportional to financial performance as seen from profitability. It was shown that in the Industrial 4.0 era profit-making has not changed, such as the firm size and capital structure, although many banks have followed e-money or financial technology. This suggests for future research, such as assessing capital structure size more precisely, to measure capital structure.

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