The Influence of Independent Commissioner on the Indonesian Rural Bank's Credit Performance

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Abstract—**One of the main problems with BPRs with core capital below Rp6 billion is that the credit performances of those rural banks tend to deteriorate. From OJK's investigation, that worsening was caused by the lack of capital, the lack of management, the lack of governance, and the lack of IT system. This research is concentrated to the empirically analyze of the worsening caused by the lack of governance, especially the effects of the existence of independent commissioner and independent commissioner's expertise on the credit performance of BPRs with core capital below Rp50 billion. It is concentrated to that issue because according to OJK in POJK No.4/POJK.03/2015, the existence of independent commissioner - as one of internal governance mechanism - is only compulsory for BPRs with core capital Rp50 billion and above. This research result shows that independent commissioners' existence and independent commissioner's expertise have positive significant effects on the credit performance of BPRs with core capital below Rp50 billion.**

Keywords—credit performance; internal governance; independent commissioner; expertise; and rural bank

I. INTRODUCTION

In order to develop Micro, small and medium enterprises (MSMEs) in Indonesia, as stated by Armanto, Indonesian Rural Banks (Bank Perkreditan Rakyat/BPR) are expected to increase their role and contribution [1]. To achieve it, the government through Bank Indonesia has encouraged the banking industry in Indonesia by way of appointment of BPRs as executing agents or channeling agents from commercial banks to specifically extend credit to MSMEs [2]. Moreover, The Decree of the Minister of Finance No.1064/KMK.00/1988 on the Establishment and Enterprises of BPRs states that the duty of BPR is directed to support the growth and modernization of rural economy as well as to reduce the practices of debt bonds [3]. Bank Indonesia also issued Peraturan Bank Indonesia (PBI) no. 14/22/PBI/2012 requiring every commercial bank to distribute credit or UMKM financing in 2018 at least 20% of the total credit or financing discharged [4]. With the issuance of that PBI, for BPRs it is as challenge, opportunity, and potential to be as the partners of commercial banks in that mentioned linkage program.

According to Data from Direktorat Penelitian dan Pengaturan BPR Departemen Penelitian dan Pengaturan Perbankan of OJK, the total number of Conventional BPRs in Indonesia as of June 2016 is 1,634 [5]. The growth rate of BPR's assets in the period 2011 to 2015 increased 16%. In terms of loan disbursement, as of June 2016, BPR credit disbursement reached Rp79 billion [6].

OJK stated that the widespread of services accompanied by an increase in the volume of BPR business, the greater the risk of BPR (6). Although the BPR's growth rate is very good, most BPRs of 1,184 (68%) are BPRs with limited core capital (MI) less than Rp6 billion, even 16 BPRs have a core capital of less than Rp3 billion [5]. The main problem with BPRs with core capital below Rp6 billion is the financial performance of banks that tend to deteriorate. Referring to data from Bureau of Research and Conventional BPR Statistics, especially for BPRs' credit performance, it shows worsening evidence until June 2016 as the NPL of June 2016 is 6.20 compared with 2012 (4.75), 2013 (4.45), 2014 (4.76) and 2015 (5.40) [7].

From OJK's investigation, that worsening was caused by the lack of capital, the lack of management, the lack of governance, and the lack of IT system [8]. This research is concentrated to empirically analyze to the worsening cause of the lack of governance, especially the existence of independent commissioner. According to OJK in POJK No.4/POJK.03/2015, the existence of independent commissioner is only compulsory for BPRs with core capital of Rp50 billion or above [9]. In fact, contradictive with that, the worsening of financial performance precisely happened mostly in BPRs with limited core capital (CC) of even less than Rp6 billion [5]. Although indeed, some BPRs with core capital of Rp50 billion have their independent commissioners [6].

Results from the prior researches of the influence of independent commissioner on the credit performance were not consistent. Novia et al. gave no-positive result or even negative [10]. In contrast with them, Nisasmara et al., Manzaneque et al., and Nurim et al. found positive results [11-13].

Relating to those phenomena and gaps, the objectives of this research are to give new scientific evidences with new data by the examining the influences of independent commissioner's existence and independent commissioner's expertise on the credit performance of BPRs with core capital below Rp50 billion. So, this research questions are:

- Is the existence of BPR's independent commissioner as one of the mechanisms especially the supervision of BPR governance effectiveness affecting the credit performance of BPR?

- Is the BPR's independent commissioner's expertise as the independent supervisor of the effectiveness of BPR governance affecting the credit performance of BPR?

This research contributes as the proposal to OJK to revise or add governance rules as stipulated in Regulation of the Financial Services Authority number 4/POJK.03/2015 which is mainly related to the compulsory of the existence of independent commissioner as a mechanism for internal governance of BPRs with core capital of less than Rp50 billion. That mechanism is very important for supervision of the effective implementation of BPR's governance. This research can also give education to public observers of governance that for the effective implementation of internal governance mechanism conducted by the board of commissioners needs independent supervision conducted by the independent commissioners and their existence must be supported with their eligibility in terms of their expertise.

II. LITERATURE REVIEW

The formulation of financial performance of banking is usually done by using Return on Assets (ROA), Return on Equity (ROE), Operating Expense compared to Operating Income Ratio (OEOI), Non-Performing Loans (NPL) and other financial ratio analysis [14,15]. In connection with the various measures of banking financial performance, the authors use measurement of credit performance of banking in accordance with the characteristics of BPR (micro finance) which is based on the ratio of credit performance of Non-Performing Loans (NPL); related to BPR credit risk because the loans provided usually have small guarantees [16]. Meanwhile, according to Wu et al. corporate governance/social responsibility have a negative effect against Non-Performing Loans (NPL) [15].

On the basis of the results of previous studies, the first hypothesis of this study are:

H1 = The existence of independent BPR commissioners has a positive significant effect on the credit performance of BPR

In previous studies (Agrawal et al., Yermack, Klein, Bhagat et al., and Drakos et al.) found that there was no significant relationship between the presence of independent commissioner and firm performance [17-21]. According to Basyith, some companies choose commissioners on the basis of good relations or friendship, so its existence does not cause a positive and significant impact on the performance or value of the company [22]. This is in the context of companies in Indonesia also supported by Novia et al. that there is a positive indication of increased corporate compliance in Indonesia in terms of improving board governance structures, but allegedly increased compliance is due to the company's obligation to comply with regulations and avoid sanctions [23]. The success of the mechanism for implementing the governance of the board of commissioners in relation to its duties ensures that good governance is carried out by the BPR board, it is necessary to have appropriate judgment in the assessment. In some studies, in the context of behavioral accounting has revealed the important role of knowledge on the accuracy of judgment, such as Bonner et al., Earley, and Nurim et al. [24-26]. Knowledge enhances cognitive appropriateness of the

judgment with assignments, so judgment is more accurate. It is also supported by Hirst et al. and Borthick et al. which states that the performance and accuracy of judgment is influenced by appropriate knowledge and is obtained formally at the appropriate level as well [27-28]. In terms of the board of commissioners' co-ordination as a mechanism for internal governance, it is important to note the background of experience and expertise possessed by the board of commissioners, the composition and the right combination will have a positive impact on the company's performance through optimizing the strategic role of the board of commissioners as stated by Lukviarman [23]. Thus, commissioner knowledge will have a positive effect on the company's financial performance. OJK also states that BPRs also experienced problems in the lack of human resources expertise of BPR including independent commissioner's expertise [8].

Therefore, the author attempts to consider the independent commissioner's expertise element that may affect the credit performance of the BPR, so the second hypothesis of the study is:

H2 = the appropriateness of independent BPR commissioner's expertise has positive effect on the credit performance of BPR

However, as stated by Coad et al., considering the financial performance of a BPR may also be influenced by the BPR's operational experience in accordance with the passage of time [29], then in this study the authors include the element of BPR's Age as a reflection of the operational experience of the BPR as a control variable. The selection of BPR's Age as a reflection of BPR operational experience in this study is in accordance with research has been done by Mersland et al. in measuring the effect of a governance mechanism on the financial performance of microfinance institutions [30].

III. RESEARCH METHOD

A. The Research Data and Sample

According to the objectives, the steps in this study are:

- Collect secondary data in the form of annual financial statements and information related to this research in 2016 from selected BPR samples in Central Java and DIY taken from BI website (www.bi.go.id) and / or OJK website (www.ojk.go.id) and the corresponding BPR website.

- The collected secondary data will be processed and analyzed by means of cross-sectional regression using statistic software and the results will also be described in depth.

Samples of this study are taken using a purposive sampling method of the BPR population in DIY and Central Java. Determination of the sample using purposive sampling method is done in order to obtain the sample that meets the criteria with special specifications in accordance with the problems that occur. The criteria are:

- BPRs with a core capital of less than Rp50 billion

- The BPR is still in operation until the end of June of 2016

- The BPR publishes its annual financial statements and / or other information in June of 2016 on the website of Bank Indonesia (BI) and the Financial Services Authority (OJK)

- The BPR published the information related to the data which is needed in this research on the respective BPR website.

B. Definition of Research Variables and Model for Hypothesis 1

Based on the previous studies and the development of research hypotheses, the authors derived dependent variables, independent variables, and control variables from this study. The dependent variable of this research is credit performance which is more specifically reflected by a proxy of BPR's Non-Performing Loans (NPLs).

The independent variable of hypothesis 1 of this study is the existence of independent BPR commissioners. The independent BPR commissioner's existence variable is indicated by the value 0 if there is no independent commissioner in the respective BPR, the value of 1 if there is 1 independent commissioner in the respective BPR, and the value 2 if there are 2 independent commissioners in the respective BPR.

The authors include the element of the Age of BPR as a reflection of the operational experience of the BPR as a control variable. The control variable of the age of the BPR is indicated by the number of years since the BPR is established.

Based on the research variables that have been determined, then the secondary data related to these research variables that have been collected will be processed and analyzed by cross-sectional regression using statistic software with a significance level of 5%. Data processing and analysis will be done in accordance with the model for hypothesis 1 as follows:

$NPL\_BPR = \alpha + \beta 1 N\_Ind\_Com\_BPR_{it} + \beta 2 Age\_BPR_{it} + \epsilon$

Note:

- Dependent Variables; NPL_BPR = Non-Performing Loans of BPR

- Independent Variables; N_Ind_Com_BPR = Existence of independent BPR commissioner

- Control Variables; Age_BPR = BPR's Age

C. Definition of Research Variables and Model for Hypothesis 2

The dependent variable of this hypothesis 2 research is credit performance same as the hypothesis 1 as BPR's Non-Performing Loans (NPLs). The independent variable of hypothesis 2 of this study is the appropriateness of the expertise of independent BPR commissioner. That independent variable is indicated by 1 if commissioner of the respective BPR has education level under S1; 2 if the commissioner in the respective BPR has a minimum education level of S1 from

non-economic or business majors; and 3 if the commissioner in the respective BPR has a minimum education level of S1 from majoring in economics or business.

As well as for hypothesis 1, based on the research variables that have been determined, then the secondary data related to these research variables that have been collected will be processed and analyzed by cross-sectional regression using statistic software with a significance level of 5%. Data processing and analysis will be done in accordance with the model for hypothesis 2 as follows:

$NPL\_BPR = \alpha + \beta 3 E\_Ind\_Com\_BPR_{it} + \beta 4 Age\_BPR_{it} + \epsilon$

Note:

- Dependent Variables; NPL_BPR = Non-Performing Loans of BPR

- Independent Variables; E_Ind_Com_BPR = Appropriateness of expertise of BPR independent commissioners

- Control Variables; Age_BPR = BPR's Age

IV. RESEARCH RESULTS

In this research, to test the research hypothesis, 59 samples of BPRs are tested. Those samples are the samples which are meet the purposive sampling criteria mention in the previous section.

A. Hypothesis 1 Testing Result

For hypothesis 1 testing, minimum Number of Independent Commissioner is 0, maximum is 3, with mean and standard deviation of 1.36 and 0.826. For Non-Performing Loans, the minimal number is 0 and the maximal number is 17 with mean of 4.50 and standard deviation of 3.191. The last, for Age, the minimum Age is 0.496 year and the maximum is 64.959 years with mean of 26.107 years and standard deviation of 16.345. Below is the table 1 of those descriptive statistics:

TABLE I. DESCRIPTIVE STATISTICS OF HYPOTHESIS 1

Variables	Min	Max	Mean	Std. Deviation
N_Ind_Com_BPR	0	3	1.36	0.826
NPL_BPR	0	17	4.50	3.191
Age_BPR	0.496	64.959	26.107	16.345

Note:

- N_Ind_Com_BPR = Number of Independent Commissioner of BPR

- NPL_BPR = Non-Performing Loans of BPR

- Age_BPR = BPR's Age

The results of the research hypothesis testing are shown in the table 2 below:

TABLE II. REGRESSION RESULT OF HYPOTHESIS 1

	Coefficient of Regression	Sig
(Constant)	6.631	0.000
N_Ind_Com_BPR	-1.460*	0.006
Age_BPR	-0.006	0.824
Adjusted R Square	0.121	

Note:

- Dependent Variable: NPL_BPR (Non-Performing Loans of BPR)

- * = significant at 1%

The coefficient of adjusted R square is 12.1%. It means that the variable of Number of Independent Commissioner as controlled by Age affects Non-Performing Loans by 12.1%. It also means that the other variables that do not included in the model affect Non-Performing Loans about 87.9%.

The linear regression of Number of Independent Commissioner as independent variable and Non-Performing Loans as dependent variable has significant level of 0.006 with coefficient of regression of – 1.460. Meanwhile, the linear regression testing result of Age as control variable and Non-Performing Loans as dependent variable has no-significant level of 0.824.

B. *Hypothesis 2 Testing Result*

For hypothesis 2 testing, here, minimum Total Appropriateness of Expertise of Independent Commissioner is 0, maximum is 8, with mean and standard deviation of 3.00 and 2.244. For Non-Performing Loans, the minimal number is 0 and the maximal number is 17 with mean of 4.50 and standard deviation of 3.191. The descriptive statistics for BPR's Age are same as the hypothesis 1. Below is the table 3 of those descriptive statistics:

TABLE III. DESCRIPTIVE STATISTICS OF HYPOTHESIS

Variables	Min	Max	Mean	Std. Deviation
E_Ind_Com_BPR	0	8	3.00	2.244
NPL_BPR	0	17	4.50	3.191
Age_BPR	0.496	64.959	26.107	16.345

Note:

- E_Ind_Com_BPR = Appropriateness of Expertise of Independent Commissioner of BPR

- NPL_BPR = Non-Performing Loans of BPR

- Age_BPR = BPR's Age

The results of the research hypothesis testing are shown in the table 4 below:

TABLE IV. REGRESSION RESULT OF HYPOTHESIS 2

	Coefficient of Regression	Sig
(Constant)	6.164	0.000
E_Ind_Com_BPR	-0.563*	0.005
Age_BPR	0.001	0.969
Adjusted R Square	0.125	

Note:

- Dependent Variable: NPL_BPR (Non-Performing Loans of BPR)

- * = significant at 1%

The coefficient of adjusted R square is 12.5%. It means that the variable of the Appropriateness of Expertise of Independent Commissioner of BPR as controlled by Age affects Non-Performing Loans by 12.5%. It also means that the other variables that do not included in the model affect Non-Performing Loans about 87.5%.

The linear regression the Appropriateness of Expertise of Independent Commissioner of BPR as independent variable and Non-Performing Loans as dependent variable has significant level of 0.005 or it is < 0.05 with coefficient of regression of – 0.563 meanwhile, the linear regression testing result of Age as control variable and Non-Performing Loans as dependent variable has no-significant level of 0.969.

IV. DISCUSSION

From the testing results of *H1 = the existence of independent BPR commissioners has positive significant effect on the credit performance of BPR*; show that the H1 is accepted. From the linear regression, as shown by the table the significant level of 0.006 or it is < 0.05 with coefficient of regression of – 1.460. It means that the Number of Independent Commissioner of BPR has negative impact on Non-Performing Loans of BPR (positive for credit performance). Every additional Number of Independent Commissioner will effect to the lower in Non-Performing Loans by 1.460. This result supports the previous research of Nisasmara et al., Manzaneque et al., and Nurim et al. found positive results also [11-13].

The regression testing result of Age as control variable shows no significant impact on Non-Performing Loans with significant level of 0.824. This result is contradicting with previous research conducted by Mersland et al. about the positive effect of company's age in measuring the effect of a governance mechanism on the financial performance of microfinance institutions [30].

From the testing results of *H2 = the appropriateness of independent BPR commissioner's expertise has positive effect on the credit performance of BPR*; show that the H2 is accepted. From the linear regression, as shown by the table the significant level of 0.005 or it is < 0.05 with coefficient of regression of – 0.563. It means that the Appropriateness of Expertise of Independent Commissioner of BPR has negative impact on Non-Performing Loans of BPR (positive for credit performance). Every additional level of The Appropriateness of Expertise of Independent Commissioner will effect to the lower in Non-Performing Loans by 0.563. This result supports the

previous research of Bonner et al., Earley, Nurim et al., Hirst et al., Borthick et al. [24 – 28], and Lukviarman [23]. As well as in hypothesis 1 testing, regression testing result of Age as control variable for hypothesis 2 also shows no significant impact on Non-Performing Loans with significant level of 0.969.

V. CONCLUSION

Base on the hypothesis 1 and hypothesis 2 testing, the authors conclude that the existence of independent BPR commissioner and the appropriateness of independent BPR commissioner's expertise have positive significant effect on the credit performance of BPR. It shown by the regression results that every addition in the number of independent BPR commissioners and level of the appropriateness of independent BPR commissioner's expertise cause the lower Non-Performing Loans (better credit performance) of BPR significantly.

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