



The Effect of Profitability, Credit Quality and Covid-19 Pandemic on the Amount of Executive Compensation on Banking Companies in Indonesia

Wahyu Usmawati^(✉), Ratna Septiyanti, and Usep Syaipudin

Master of Accounting Science, Lampung University, Bandar Lampung, Lampung, Indonesia
wahyu.usmawati200276@gmail.com, ratna.septiyanti@feb.unila.ac.id

Abstract. Disclosure of executive compensation has not been widely carried out in Indonesia. There are many factors that affect executive compensation. This research analyzes profitability, credit quality, and the Covid-19 pandemic on executive compensation in banking companies in Indonesia. This study is a quantitative study using targeted sampling. The data collection method for this study is to document the Annual Report 2018–2020 by downloading it from the website www.idx.co.id and each company's website. The results of the study, in part, indicate that projected profitability as return on assets (ROA) has a significant impact on executive compensation. Credit quality as a proxy for Non-Performing Loans (NPL) has an insignificant negative effect on executive compensation. Meanwhile, Covid-19 has no significant effect on executive compensation at Indonesian banking companies.)

Keywords: profitability · credit quality · ROA · NPL · Covid-19 · executive compensation

1 Introduction

The Covid-19 pandemic has prevented the banking sector from freely distributing credit to businesses. This has been impacted by the increased risk of bad credit or default by debtors, as most debtors, both individuals and businesses, tend to have lower incomes during the Covid-19 virus pandemic. The future of banking challenges will not be easy.

The decline in the performance of the company will affect the company's profitability where the profits generated will have a negative effect and make shareholders very selective in terms of spending money either for investment or for company operational costs. Many things will be done by the principal to make efficiency related to all kinds of expenses, one component that can be reviewed is the amount of executive compensation. Analysts point out that it is appropriate for the incentive payment criteria to be changed in this extraordinary situation. But the board of directors must be able to answer questions from shareholders who may disagree if executive salaries remain high in times of crisis.

While in Indonesia itself, there has not been much research on the policy of providing executive compensation during this pandemic.

Several studies related to compensation include research [1] found that there is a positive and significant effect between firm performance and total executive compensation. Further research by [2], who found that there was a positive influence between company performance as a proxy for ROA and CEO compensation. Research findings [3], shows that the company's financial performance is an important determinant of CEO compensation. This is corroborated by research conducted by [4] by using different research objects, namely financial companies where the results show that the company's performance has a positive influence on executive compensation. The formatter will need to create these components, incorporating the applicable criteria that follow. Company's performance increases, the compensation received by the executive will also increase.

Different results presented by [5], who in his research found that financial performance had no effect on executive compensation. Likewise, research conducted by [6], found a negative effect of executive gross salary on stock market performance. Finding [7] shows that profitability has a negative effect on executive compensation. This finding explains research on agency theory that compensation for performance does not apply in Indonesia.

The difference in the results of various studies on executive compensation above causes the need for re-testing with different data settings and conditions, with the title "The Effect of Profitability, Credit Quality, and the Covid-19 Pandemic on the Amount of Executive Compensation in Banking Companies in Indonesia". This study aims to add empirical evidence on the effect of profitability, credit quality, and Covid-19 on the amount of executive compensation in banking companies in Indonesia.

2 Literature Review

2.1 Theoretical Base

2.1.1 Agency Theory

Agency theory is a theory that explains agency relationships and the problems they cause [8]. An agency relationship is a relationship between two parties in which the first party acts as principal/trustee and the second party, called the agent, acts as an agent to transact with third parties on behalf of the principal. According to [8], agency conflict occurs if management's share ownership is less than 100%. This situation will cause management to tend to act in its own interests, rather than based on the greatest prosperity for the principal. The relationship between executive compensation and performance can be explained in this agency theory. In this theory [8] describes the agency relationship as a set of contracts between owners of economic resources and managers who manage the use and control of resources in a company.

2.1.2 Profitability

According to [9], the rate of return is a ratio for evaluating a firm's ability to aim for profit. This ratio is also a measure of the effectiveness of corporate governance. This

is shown by profit on sales and return on investment. Accounting-based approaches are becoming more and more popular, and researchers tend to use this approach to measure performance.

2.1.3 Credit Quality

According to [9] Bank is a business entity that collects funds in the form of savings and distributes them to the public to improve the standard of living of the people. So, it can be concluded that funds from people who have excess funds (surplus spending units) are then placed back into people who need funds (deficit spending units). Therefore, banks must pay attention to the quality of their credit, to reduce the risk that will be borne by the bank itself if a risk occurs.

There are two statistics that are often used to measure credit risk in banks, namely (a) NPL and (b) Loan at Risk (LaR). NPL in the sense of Gross is the ratio of the number (nominal) of credit with collectibility of 3–5 to the total credit. LaR is the ratio of collectibility loans (3–5/NPL) plus collectibility loans 2 and 1 (but the result of restructuring) to total loans. LaR statistics have increased in popularity in recent years, as they are considered more comprehensive and anticipatory to credit risk. Based on OJK data, as of November 2019, banking NPL (gross) was at 2.77%, up 10 bps from the same period the previous year, while LaR was at 9.8%, down 0.7%. This statistic shows credit risk that can be managed well, the regulator's comfort zone is estimated at (respectively) 5% for gross NPL and 6–7% for LaR. Banks are estimated to have formed a reserve of 60%-70% of the total NPL.

2.1.4 Covid-19

Covid-19 has caused shocks in all sectors of the economy, education and society. Seeing the condition of the economic crisis, especially the MSME community, OJK provided a stimulus to debtors who were affected by the spread of Covid-19 in the banking system. Stimulus in the economic sector is very important as a driver for optimal banking performance, maintained financial system and increased economic growth. The issuance of stimulus policies by the government, especially in the banking sector which put in [10] Regarding National Economic Stimulus as a Countercyclical Policy The Impact of the 2019 Coronavirus Disease Spread brought fresh air to the industrial sector. POJK related to credit relaxation in the form of improving the quality of credit collectibility and credit restructuring for debtors affected by Covid-19.

2.1.5 Executive Compensation

Definition of compensation from [11] is everything that the employee receives in return for his contribution to the company or organization. Another purpose of the compensation package is to motivate management to maximize potential. The amount of executive compensation can be used as a tool to minimize the misalignment of goals between agents and principals and reduce agency problems.

According to [12] explained that the compensation package is divided into three parts, namely the first is the basic salary which is the basic compensation, where the main

honorarium will be paid permanently and is not determined by the original performance of the employee. The second is allowances, where allowances are income that will be given indirectly including post-employment benefits, health benefits and others. The third type of compensation is incentives, which are income or rewards that will be given by the principal to the agent used in relation to performance and the amount of compensation given is not fixed.

According to [13] In determining the compensation package, there are 3 primary problems, namely: the form of compensation, the amount of compensation and disclosure. The way to find out the problem of the form and amount of compensation is to choose what factors affect the compensation. Compensation is divided into 2, namely internal and external. Intrinsic rewards are rewards that are evaluated in and from employees, attached to the activity itself. An example of this reward could be pride in the success of his work. While extrinsic rewards are measurable rewards in the form of material and non-material. In this case, the researcher uses extrinsic rewards in the form of materially measurable compensation.

2.2 Hypothesis Development

2.2.1 The Effect of Company Profitability on Executive Compensation

According to [14] company performance is the company's ability to generate profits from sales, assets, and capital. According to [15] Return on Assets (ROA) is a measure of the rate of return (earnings) on all assets used by a company. Research was also conducted by [20] found that company performance has a positive effect on executive compensation. Based on the above statement, the first hypothesis can be drawn in this study, namely:

H₁: ROA has a positive effect on executive compensation.

2.2.2 Effect of Credit Quality on Executive Compensation

Credit quality can be measured by the ratio of NPL (Non-Performing Loan). The smaller the NPL value, the greater the credit that can be collected for each bank. The results of research conducted by [9] prove that there is a significant negative impact of the CEO's gross salary on the company's risk level. Poor credit quality will result in decreased profitability so that the company's performance will also decline. Based on the following thinking, the second hypothesis is:

H₂: NPL has a negative effect on executive compensation.

2.2.3 The Effect of the Covid-19 Pandemic on Executive Compensation

[17] stated that the COVID-19 pandemic caused the company to have to close and/or limit its operations for the sake of ensuring the health of its people. This will have an impact on the banking sector by increasing the number of bad loans (NPL). According to [18], the Covid-19 pandemic is detrimental to the company's financial and non-financial performance while [19] argued that the pandemic resulted in a collapse in demand, disruption of supply chains, reduced employee well-being, and increased uncertainty. Based on the foregoing, the third hypothesis can be drawn, namely:

H₃: The Covid-19 pandemic has a negative effect on executive compensation.

3 Methodology and Data Analysis

The study uses secondary data in the form of annual reports published by the Indonesian Stock Exchange. The sampling method for this study was extracted by targeted sampling. The sampled population includes all banking companies listed on the Indonesian Stock Exchange (IDX). From 2018–2020 where there are 31 Indonesian banking companies on the IDX that will be sampled (Table 1).

3.1 Variables and Variable Operational Definitions

(See Table 2).

3.2 Research Model

The regression model developed in this study is as follows:

$$EC = \alpha + \beta_1ROA - \beta_2NPL - \beta_3COV + \varepsilon$$

Information:

EC: Executive Compensation

ROA: Return on Assets

Table 1. Details of the Research Sample

No	Information	Amount
1	Banking companies listed on the Indonesia Stock Exchange in 2018–2020	43
2	Banking companies that do not publish annual reports in 2018–2020	(12)
	Number of samples that meet the criteria	31

Source:www.idx.co.id

Table 2. Variables and Operational Definitions of Variables

Variable	Measurement
Executive Compensation	Ln (Total Income of Directors)
Profitability	ROA = (Profit Before Tax/Total Assets) × 100%
Credit Quality	NPL = (Non-performing Loans/Total Credit) × 100%
Covid-19	The Covid period uses a Dummy variable which gets a value of 0 for the period before Covid-19 and a value of 1 for the period during Covid-19

NPL: Non-Performing Loan

COV: Covid-19 period

α : Constant

β : Regression Coefficient

ϵ : error

4 Research Result and Discussion

4.1 Descriptive Statistics

The sample of this study is the banking sector companies listed on the Indonesia Stock Exchange. The data is taken from the 2018–2020 financial statements and annual reports of each company. The variables tested in this study were the amount of compensation for directors, financial performance, namely ROA, credit risk, namely NPL, and Covid-19. Descriptive statistical testing on 31 samples for 3 years of operation with a total of 93 observations. This research was conducted using Eviews 10 Authors and Affiliations.

Based on Table 3 on the executive compensation variable, the minimum value is 8.68 which is owned by PT Bank Jago Tbk, while the maximum value is 13.52 which is owned by PT. Bank Mandiri Tbk. The average executive compensation is 10.49, meaning that the average executive compensation for banking companies is 10.49. The company's performance variable is projected with ROA, the minimum value is -12.28 owned by PT. Bank Jago Tbk., while the maximum value of 3.27 is owned by PT. Bank Mega Tbk. The average ROA of the banking is 0.22.

In the projected credit quality variable with NPL value, the minimum value is 0.00 which is owned by PT. Bank Capital Tbk and PT. Bank Jago. Tbk, while the maximum value of 11.68 is owned by PT. Bank IBK Indonesia Tbk. The average NPL of the banking sector is 3.63.

Table 3. Descriptive Statistics Test Results

	COM	ROA	NPL	COV
mean	10.49364	0.228062	3.631075	0.333333
median	10.23753	0.569828	3,000000	0.000000
Maximum	13.52385	3.270783	11.68000	1.000000
Minimum	8.682538	-12.28423	0.000000	0.000000
Std. Dev.	1.181977	2.379243	2.134316	0.473960
Observs	93	93	93	93

Source: Data processed, 2022

4.2 Hypothesis Testing

Hypothesis	Coefficient	Probability	Result
H ₁ . ROA has a positive effect on executive compensation	0.19	0.00	Hypothesis supported
H ₂ . NPL has a negative effect on executive compensation	-0.06	0.29	Hypothesis supported
H ₃ The Covid-19 pandemic has a negative effect on executive compensation	0.06	0.79	Hypothesis not supported
R-squared	0.19		
prob(F-stat)	0.00		

The R-squared value is 0.188 or 18.8%, which means that the variation in the level of compensation can only be explained by performance, credit quality, and period of 18.8% while 81.2% of executive compensation disclosure is influenced by other factors outside observation or outside the research model.

Based on the F test, the prob value (F-stat) is 0.00 and the significance value is 0.05. Thus, it can be concluded that the simple linear regression model in this study consisting of performance, credit quality, and period together has an influence on executive compensation so that this model is fit so that it is feasible to carry out the next stage of testing.

From the results of the multiple regression test, the following mathematical model is obtained:

$$\text{Compensation} = 10.64 + 0.188 \text{ ROA} - 0.06 \text{ NPL} + 0.06 \text{ COV}$$

Based on the mathematical model, it is known that the constant value is 10.64, meaning that if the dependent variable is fixed, then the compensation value is 10.64 with the assumption of *ceteris paribus*. The Performance variable has a coefficient of 0.188, meaning that if the performance (ROA) increases by 1 point, the executive compensation will only increase by 0.188 million. The credit quality variable (NPL) has a coefficient of -0.06, meaning that if the credit quality (NPL) increases by 1 point, the executive compensation will decrease. The Covid variable (COV) has a coefficient of 0.06, which means it is suspected that the Covid pandemic will not reduce executive compensation.

4.3 Discussion

4.3.1 Company Performance Has a Positive Effect on Executive Compensation

The ROA coefficient from the test shows a value of 0.188 with a probability value of 0.0004 or less than 0.05 so that H₁ in this study is accepted. That is, ROA has a positive and significant effect on the amount of executive compensation. Companies with higher profitability will be able to generate high profits as well. This will affect the bonus that is assessed through the agent's performance where the higher the profit generated, the

bigger the bonus will be. With the acceptance of this first hypothesis, it can be said that the company's performance can be used as one of the factors or variables determining the amount of executive compensation. This conclusion is also in accordance with agency theory that financial performance is a measuring tool or determinant of the success of a company's operations.

4.3.2 Credit Quality Has a Negative Effect on Executive Compensation

The NPL coefficient from the test shows a value of -0.21 with a probability value of 0.2947 or greater than 0.05 so that H2 in this study is accepted because the expectation of the sign is fulfilled, which is marked ($-$) this means that npl has a negative effect on executive compensation. It can be interpreted that every increase in the value of NPL affect the health and profitability of banks. With the increase in the NPL value, interest income will decrease, which means the company's performance will decrease and have an impact on the income earned by executives, although it does not have a significant effect.

4.3.3 The Covid-19 Pandemic Has a Negative Effect on Executive Compensation

The period coefficient of the test shows a value of 0.06 with a probability value of 0.7964 or greater than 0.05 so that H3 in this study was rejected because the expectation of the sign was not met, which was marked ($+$), meaning that the Covid-19 pandemic had a positive effect on executive compensation. It can be interpreted that the COVID-19 pandemic does not make executive compensation experience a significant decrease. The Covid-19 pandemic did not make banking performance negative, although it did not experience a large enough increase. The government's role in its policies is sufficient to help the banking performance to return to stability so that it does not have a large impact on profitability.

5 Summary

Based on the analysis of research data, the conclusions are: (1) The projected company performance with ROA has a positive and significant effect on executive compensation, (2) Credit quality projected with NPL has a negative and insignificant effect on executive compensation, (3) The Covid-19 pandemic does not affect on executive compensation.

6 Implications/Limitations and Suggestions for Further Research

The limitation of this study is that the variables used in this study are only company performance that has a significant effect, while credit quality and the covid-19 pandemic have not been able to show as determinants of a good executive size. This is also since the year of sampling during the Covid period was only taken in 2020 so that it did not reflect the actual conditions during the Covid pandemic.

Based on the conclusions above, some suggestions that can be used for further research include: (1) For further research, it is recommended to use samples from various

types or sectors of companies affected by Covid-19, such as the property & real estate sector in order to gain influence from the impact covid-19 from the whole company; (2) In future research, it is recommended to add other factors as independent variables that can affect executive compensation, such as the growth of third party funds and credit growth.

References

1. K. J. Sigler, "CEO Compensation and Company Performance," 2011. [Online]. Available: <http://astonjournals.com/bej>
2. M. Raithatha and S. Komera, "Executive compensation and firm performance: Evidence from Indian firms," *IIMB Management Review*, vol. 28, no. 3, pp. 160–169, Sep. 2016, doi: <https://doi.org/10.1016/j.iimb.2016.07.002>.
3. M. F. Sheikh, S. Z. A. Shah, and S. Akbar, "Firm performance, corporate governance and executive compensation in Pakistan," *Appl Econ*, vol. 50, no. 18, pp. 2012–2027, Apr. 2018, doi: <https://doi.org/10.1080/00036846.2017.1386277>.
4. M. F. Sheikh, A. I. Bhutta, and J. Sultan, "CEO compensation and unobserved firm performance in Pakistan," *Journal of Asian Finance, Economics and Business*, vol. 6, no. 3, pp. 305–313, Aug. 2019, doi: <https://doi.org/10.13106/jafeb.2019.vol6.no3.305>.
5. Wardoyo D, Pertiwi I, and Maulid R, "Pengaruh Nilai Perusahaan Dan Kinerja Keuangan Terhadap Kompensasi Eksekutif (Studi Kasus Pada Sektor Keuangan Yang Terdaftar Di Bursa Efek Indonesia Tahun 2018-2020)," *Jurnal Ilmiah Akuntansi dan Keuangan*, vol. 4, no. 2 2021, 2021.
6. F. Zoghalmi and A. Allouchi, "CEO compensation, firm profitability and risk-taking: Evidence from selected non-financial listed Tunisian companies," ~ 51 ~ *International Journal of Financial Management and Economics*, vol. 4, no. 2, pp. 51–58, 2021, [Online]. Available: <http://www.theeconomicsjournal.com>
7. A. S. Al'azhary and A. Dharmawan Buchdadi, "Determinants of Executive Compensation," *Jambura Science of Management*, vol. 4 no 1, 2022, doi: 10.37479.
8. M. C. Jensen and W. H. Meckling, "Also published in Foundations of Organizational Strategy," Harvard University Press, 1976. [Online]. Available: <http://ssrn.com/abstract=94043>, <http://hupress.harvard.edu/catalog/JENTHF.html>
9. Undang-Undang Republik Indonesia No 10 Tahun 2018, "UU No 10 Tahun 2018," 2018. [Online]. Available: www.bphn.go.id
10. POJK Nomor 11/POJK.03/2020, "POJK Nomor 11/POJK.03/2020," *Otoritas Jasa Keuangan Republik Indonesia*, 2020.
11. Ardana, *Manajemen Sumber Daya Manusia*. Yogyakarta: Graha Ilmu, 2012.
12. N. R. Anthony and Govindarajan, *Sistem Pengendalian Manajemen*. . Tangerang: Karisma Publishing Group, 2011.
13. H. Simamora, *Manajemen Sumber Daya Manusia*, 2nd ed. Yogyakarta: STIE YKPN, 1999.
14. L. J. Gitman and C. J. Zutter, *Global edition • Principles of Managerial Finance Fourteenth edition*, vol. 14. 2014. [Online]. Available: www.pearsonmylab.com.
15. Kasmir, *Analisis Laporan Keuangan*. Jakarta: PT. Raja Grafindo Persada, 2012.
16. Z. Fadli, N. Fadilah, and A. Kholis, "Pengaruh Kinerja Keuangan, Struktur Kepemilikan, Dan Nilai Perusahaan Terhadap Kompensasi Eksekutif Pada Perusahaan Perbankan Di BEI Tahun 2016–2018," *Prosiding Webinar Fakultas Ekonomi Universitas Negeri Medan*, 2020, [Online]. Available: www.idx.co.id
17. F. Zheng, Z. Zhao, Y. Sun, and Y. A. Khan, "Financial performance of China's listed firms in presence of coronavirus: Evidence from corporate culture and corporate social responsibility," *Current Psychology*, 2021, doi: <https://doi.org/10.1007/s12144-021-02200-w>.

18. H. O. Aifuwa, S. Musa, and S. A. Aifuwa, "Management and Human Resource Research Journal Official Publication of Center for International Research Development Double Blind Peer and Editorial Review International Referred Journal; Globally index Corona Virus Pandemic Outbreak and Firms Performance In Nigeria," 2020.
19. T. A. Hassan, S. Hollander, L. van Lent, M. Schwedeler, and A. Tahoun, "Firm-Level Exposure to Epidemic Diseases: COVID-19, SARS, and H1N1," *National Bureau of Economic Research*, 2021, [Online]. Available: www.firmlevelrisk.com

Open Access This chapter is licensed under the terms of the Creative Commons Attribution-NonCommercial 4.0 International License (<http://creativecommons.org/licenses/by-nc/4.0/>), which permits any noncommercial use, sharing, adaptation, distribution and reproduction in any medium or format, as long as you give appropriate credit to the original author(s) and the source, provide a link to the Creative Commons license and indicate if changes were made.

The images or other third party material in this chapter are included in the chapter's Creative Commons license, unless indicated otherwise in a credit line to the material. If material is not included in the chapter's Creative Commons license and your intended use is not permitted by statutory regulation or exceeds the permitted use, you will need to obtain permission directly from the copyright holder.

