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Financial Risk, Corporate Governance, And Financial Performance: An Empirical Study of Banks Indonesia

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Abstrak

Studi ini menggali hubungan antara risiko keuangan dan tata kelola perusahaan terhadap kinerja keuangan Bank di Indonesia. Data dari 19 bank di Indonesia yang sahamnya terdaftar di Bursa Efek Indonesia tahun 2021-2022 dianalisis melalui metode analisis variabel deskriptif dan partial least squares structural equation modeling (PLS-SEM). Ditemukan bahwa dampak risiko kredit terhadap kinerja keuangan Bank Indonesia rendah, sementara risiko pasar memiliki pengaruh signifikan terhadap kinerja keuangan. Selain itu, kepemilikan manajerial berpengaruh positif, sedangkan kepemilikan publik memiliki dampak yang besar. Oleh karena itu, pengungkapan tata kelola perusahaan memengaruhi kinerja bank. Penting untuk mengelola risiko pasar dan meningkatkan praktik kepemilikan. Temuan ini menyarankan perlunya meninjau ulang penilaian risiko kredit untuk peningkatan kinerja secara tidak langsung. Dengan memperbaiki tata kelola dan mengatasi risiko pasar, kinerja perbankan dapat ditingkatkan. Informasi dari studi ini memberikan panduan bagi sektor perbankan dalam meningkatkan faktor-faktor yang mempengaruhi kinerja keuangan.

Kata Kunci: *Resiko Keuangan;Tatakelolah Perusahaan ; Kinerja Keuangan*

Abstract

This study explores the interplay of financial risk and corporate governance on the financial performance of Banks in Indonesia's. Data from 19 Exchange-listed Indonesian banks' 2021-2022 reports were analyzed via variable and PLS-SEM methods. Credit risk impact was found minor, while market risk significantly influenced performance. Managerial ownership positively affected, while public ownership had substantial impact. Thus, governance disclosure affects bank performance. Managing market risks and enhancing ownership practices is crucial. Findings suggest revising credit risk assessment for indirect performance betterment. Improving governance and addressing market risk can elevate banking performance. Insights guide the sector in enhancing performance determinants, informed by this study.

Keywords*: Financial Risk, Corporate Governance, and Financial Performance.*

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1. Introduction

As a source of capital for financial intermediaries, the banking industry is crucial. Financial hazards and signs that banks are not paying enough attention to applying risk management guidelines to banking management. Undoubtedly, this banking would encounter both internal and external difficulties. Financial institutions are currently dealing with some very difficult problems. connected to the introduction of fresh rivals with competitiveness. Of course, every bank must implement corporate governance and risk management.

Thus, through this governance, risks may be diminished, and the company's value can be increased among both shareholders and the general public. Corporate governance's primary objective is to establish a system of checks and balances to stop resource abuse and maintain company growth [1]. Seeing banking financial performance can be measured by evaluating or analyzing financial reports. How the financial position, financial information, and previous company performance will be used as a basic reference for predicting future financial performance. According to [1] Risks that are not managed properly will cause losses and even companies can experience bankruptcy.

According to the world bank, corporate governance is a set of laws, rules, and requirements that must be followed to promote effective company performance and generate long-term, sustainable economic value for shareholders and society at large. [2]. Fraud by top management went undetected for a long time due to weak independent oversight by *corporate boards*. Corporate governance can be included in two categories, the first is more inclined to a series of corporate behavior patterns as measured by performance, growth, financing structure, and treatment of shareholders and stakeholders, second looks more at the normative framework, namely all good legal provisions that come from the legal system, justice system, financial markets, and so on that influence company behavior [2]. Based on an appropriate theoretical framework for bank governance, the significance of corporate governance and its advantages for risk-taking and bank performance are discussed. [3]. A shift in risk from creditors to shareholders, excessive profit sharing, or insufficient risk management efforts are all causes of agency problems. [3]. Risk analysis [4] discovers the risks that banks face, including credit risk, liquidity risk, operational risk, and risk capital as an independent variable. [4] conducted research His study's findings on the board of directors, board of commissioners, and company size all had a positive effect on banking, according to his research on the Effect of Corporate Governance Implementation on Banking Financial Performance. However, these results are in accordance with previous studies [5] and [6]. Risk management has an important role in overcoming financial risks in realizing corporate governance through efficient risk management so that companies can meet and minimize risks and can be careful to take opportunities.

Analyzing the behavior of banks after the crisis these findings will represent an area of opportunity for banks wishing to improve their corporate governance frameworks and practices and for policymakers seeking policy measures that can contribute to achieving them, [3]. The level of success that performance, experienced in their operational activities is demonstrated by their financial performance, bank financial performance is the main factor and is very important for assessing the overall performance itself starting from assessing assets, debt, liquidity, profitability, and so on).

It was also revealed [7] Knowing the ability of the company's financial condition to reflect work performance over a specific period is crucial to make the best use of the resources owned. Company performance is a snapshot of the company's financial condition as measured by financial ratio analysis. Banking bankruptcy originates from the actions of managers or compensation contracts between shareholders who may be more intensively managed, namely managers who have no openness to shareholders or creditors [8]. This study attempts to examine the connection between corporate governance and bank financial risk in Indonesia. This study adds to the body of knowledge. Managerial ownership and the board of commissioners are two metrics used to assess the effectiveness of corporate governance. Market risk, liquidity risk, risk, and risk are the four risks that makeup bank risk and can all be quantified. Return on Assets and Return on Equity are metrics for measuring financing and financial performance.

With both of these indicators being important and commonly used metrics for evaluating a bank's financial performance. According to [9], Return on Assets (ROA) is a ratio that indicates the return on the amount of assets used in the company, while Return on Equity (ROE) is a measure to assess how efficiently total equity is utilized to generate a certain level of profit. Although there are many other financial ratios that can be employed, ROA and ROE often serve as the primary focus in studies pertaining to banking performance because they provide a strong insight into a bank's ability to generate profits and manage its capital. Furthermore, the use of these two ratios has become established within the banking industry, allowing for easier comparisons between different banks. However, it is important to remember that this research can also consider other financial ratios as additional variables if deemed relevant within the research context.

2. Literature Review

2.1.1 Corporate Governance

As reported by [10], corporate governance is a system for managing and directing a company's operations. Additionally, "the definition of corporate governance used by the Organization for Economic Development and Cooperation (OECD) defines it as: "The procedures and processes according to which the organization is directed and controlled. Corporate governance, as previously stated, refers to a group of procedures that control the interactions of the numerous parties that make up an organization. Because principals are frequently harmed by agents' bad behaviour, corporate governance can safeguard their interests. [11] defines corporate governance as a collection of safeguards for outside investors against insider takeovers. Takeovers can take a variety of shapes. The modern definition of CG is more expansive and multidisciplinary, and it combines several organizational functions like management, finance, accounting, business law, business ethics, and economics. It also covers other aspects of the business like responsibility, openness, disclosure, social responsibility, fairness, and the relationship between the board of directors, shareholders, and stakeholders. [12]. In addition, the phrase "Corporate Governance" didn't even exist until the middle of the 1970s. [13].

Therefore, the higher the public ownership of a company, the better the company's management will be in delivering the company's financial performance. Based on research conducted by [16]) it was stated that ownership does not have an influence on the financial performance of the company. Meanwhile, research conducted by [17] found that public ownership affects financial performance. The indicator used in this study to measure the public ownership of a company is by comparing the shares owned by the public with the total shares outstanding [18]. This hypothesis suggests that the higher the proportion of a company's shares owned by the public, the better the company's financial performance will be. This could be due to the fact that companies with high public ownership are subject to stricter supervision and accountability, which can lead to better management practices and improved financial performance.

H1. Public ownership has a positive effect on company performance.

From agency theory, the difference in interests between managers and shareholders results in a conflict known as an agency conflict.. This hypothesis suggests that the higher the proportion of a company's shares owned by its managers, the better the company's financial performance will be. This could be due to the fact that when managers have a stake in the company, their interests are more closely aligned with those of the shareholders, leading to better decision-making and improved financial performance.

H2. Managerial ownership has a positive effect on company performance.

2.1.2 Financial Risk

Financial Risk. In general, [21] financial risks are matters relating to finances, especially anything that has the potential to cause the loss of some or all of the money and wealth assets that you have. There will be many situations and unforeseen circumstances that can cause you to lose your money. Because of this, you need to understand it so that you can manage these risks and even avoid them. In this study, there are several financial risks, including:

a. Market Risk

Market risk exists when compared to the position of the balance sheet and administrative accounts, which include derivative contracts, which result from modifications in market circumstances, including the risk of fluctuating option prices. Stock prices are one of the factors, high and low bank interest rates, commodities, foreign currency values, and securities. Market risk illustrates how much interest income can be generated from assets owned by the bank. Market risk describes management's ability to manage a company's productive assets to earn net interest income. The greater the net interest income figure will result in the bank's financial performance tending to be higher. [22] found that market risk (NIM) has a significant effect and has a positive relationship with the profitability (ROA) of banks listed on LQ 45 for the 2012-2018 period. This means that market risk is an important risk in the profitability of a bank and with increasing market risk, so does the bank's financial performance. This hypothesis suggests that the higher the market risk faced by a company, the better the company’s financial performance will be.

H3. Market risk has a positive effect on company performance.

Every bank that extends credit to the public will face credit risk. Credit risk is a risk that arises due to the inability of the debtor and other parties to carry out their obligations to the bank [23]. This risk comes from the functional activities of the bank. Previous research found that credit risk (NPL) has a significant and negative relationship to profitability (ROA) for banks that are listed on LQ 45 for the 2012-2018 period. This means that the higher the value of credit risk, the lower the profitability of a bank, and credit risk is an important risk in the profitability of a bank. This hypothesis suggests that the higher the credit risk faced by a company, the better the company’s financial performance will be.

H4. Credit risk has a positive effect on company performance.

The researcher will consequently develop a conceptual framework that links the independent and dependent variables. The relationship among those concepts has to be depicted in a figure of a conceptual framework as in the example below.

2. Hypothesis Development

There have been several studies on the relationship between financial risk, corporate governance, and financial performance in the context of banks in Indonesia. One study examined the effect of Islamic corporate governance on financial performance using financing risk as mediation, focusing on Sharia Banks in Indonesia[24]. The researchers applied a multiple regression analysis on data collected from annual reports of the companies from 2013 to 2018. The results showed that Islamic corporate governance cannot increase financial performance, but Islamic corporate governance can reduce financing risk. The decrease in financing risk can improve the financial performance of Sharia Banks, so it can be said that the financing risk variable can mediate the effect of Islamic corporate governance on financial performance .

Another study aimed to examine the effect of corporate governance on financial performance on banks listed on the Indonesia Stock Exchange (IDX) period 2011-2015, either directly or indirectly through credit risk and operational risk [25]. The results showed that improving the implementation of corporate governance can reduce credit risk and operational risk and increase financial performance, whereas low credit risk and operational risk can increase financial performance. The results of mediation testing showed that credit risk and operational risk positively mediated the effect of corporate governance on financial performance [25].

Based on these studies, a possible hypothesis could be that good corporate governance practices can reduce financial risks and improve financial performance in banks in Indonesia. This relationship could be mediated by factors such as credit risk and operational risk. Further research could test this hypothesis using empirical data from banks in Indonesia.

3. Research Methods

The data used in this study came from banks audited annual financial reports for the fiscal years 2021 and 2022 that are traded on the Indonesia Stock Exchange. All Indonesian banking companies that are publicly traded on the Indonesia Stock Exchange make up the study's population. Purposive sampling was used to select the sample, and the criteria were:

Tabel 1. Bank Sample

No	Criteria	Total Banks	Persentase
1	Banking Companies listed on IDX in 2021-2022	107	100
2	Inconsistent Banking Companies and Incomplet Annual Reports	88	82.2
3	The Count of Banking Firms Encompassed within the Research Sample.	19	17,7

Data was obtained from the Indonesia Stock Exchange (IDX), specifically from 19 banks selected as samples out of a total of 107 banks in the 2021-2022 period. The researcher collected data spanning 2 years from these 19 IDX-listed banks, resulting in a total of 38 data observations. PLS, or partial least squares, is used in this data analysis method. With a variance approach or component-based structural equating Modeling, PLS is a structural equation model of equation modeling (SEM PLS, which does not require that the data be measured at a particular scale, is a soft modeling analytical technique, according to [26], that enables the use of few samples (under 100 samples). the application for Smart PLS 3.0. This type of research is quantitative with a descriptive approach. This method is a type of research that in particular is systematic, structured, and well- planned, and clear from the start to the creation of the research design [27]. Methods of data collection, obtained from annual reports of bank companies listed on the Indonesia Stock Exchange using secondary data with documentation methods www.idx.com

Financial performance as determined by return on equity and return on assets using the formula serves as the endogenous variable in this study.

$$Roe = \frac{\text{Net Income}}{\text{Shareholders equity}} x100$$

$$Roa = \frac{\text{Net Income}}{Total\ Asset} x100$$

Variables affect the emergence of endogenous variables. This study has two exogenous variables, namely financial risk and credit Market risk and credit risk are used to measure the respective indicators of financial risk while managerial ownership and public ownership are used to measure corporate governance. utilizing the formula given.

Related market risk is dependent on volatility in the market meter, especially on changes in interest rates and exchange rates that affect market values. Market risk consists of several types of risk and in this study market risk is measured by liquidity risk with the following formula:

$$LDR = \frac{\text{Total Loans}}{\text{Total Deposit}} x100$$

Non-performing loans (NPL) reflect credit risk, which is measured by non-performing loans and total loans, the formula used to calculate NPL is as follows:

$$NPL = \frac{\text{Non Performing Loans}}{\text{Total Loans}} x100$$

Managerial ownership is the total amount of stock that the management owns in the business that they are managing. [28]. Which can be formulated in the following way :

$$KM = \frac{\text{Number of shares owned}}{\text{Number Of outstanding shares}} x100$$

The term "public ownership" refers to the total number of shares that the general public owns. A person outside of management who has no special connection to the company is considered to be in the public in this context. Indeed, this sample size is very small, but this is based on the theory that conveys, PLS-SEM can use a small sample size, with a requirement of 10 times the size of the most formative indicators to measure one latent variable . The analysis was performed using Partial Least Square (PLS), using Smart PLS 3.0 Software to evaluate measurement instruments and conceptual models. The data analysis method uses multiple regression analysis to test the direct effect of the variables in the model.

4. Result dan Discussion

This research was conducted to determine the connection between corporate governance and financial performance. An evaluation of the company's financial performance is done to determine how well it has used the regulations for financial implementation in accordance with the findings of the research discussion.

Tabel 2. Discrimination validity

Variable	**Item Measurement**	***Loading F***	**sig**	**Status**
FR	Market Ris	-0.090	0.05	Invalid
	Credit Risk	0.960	0.05	Valid
CG	M.ownership	0.837	0.05	Valid
			0.05	
	P.ownership	0.837		Valid
FP	ROE	0.856	0.05	Valid
	ROA	0.776		Valid

The table above shows each of the validity test results with 6 instruments showing valid results because each instrument has an ave value above 0.05 and one item shows an instrument value below = have value.

Table 3. Reliability Test

Variable	Cronbacth's Alpha	Composite Reliability	AVE	Status
FR	0.571	0.823	0.700	Reliable
CG	0.565	0.823	0.700	Reliable
FP	0.324	0.414	0.465	Not Reliable

Table 3 shows the results of the reliability test for 3 instruments showing 2 reliable results, and one because it is below a value of <0.7 Cronbach's alpha and composite reliability is more than 0.70 and AVE ismore than 0.5.

Table 4. The results of the Determination Coefficient Test

No	Variable	R.Square	R Square adjusted
.1	Financial performance	0.100	0.100

The coefficient of determination (R^2) by measuring how far the model's ability to illuminate the variation of the dependent variable. (R^2) is taken from the Coefficient of Determination Adjusted R square column. Based on the table above, the Adjusted Square is 10, this means that financial performance can be explained while the rest can be determined by other factorsoutside the model (100-10%) - 90%

Hypothesis testing

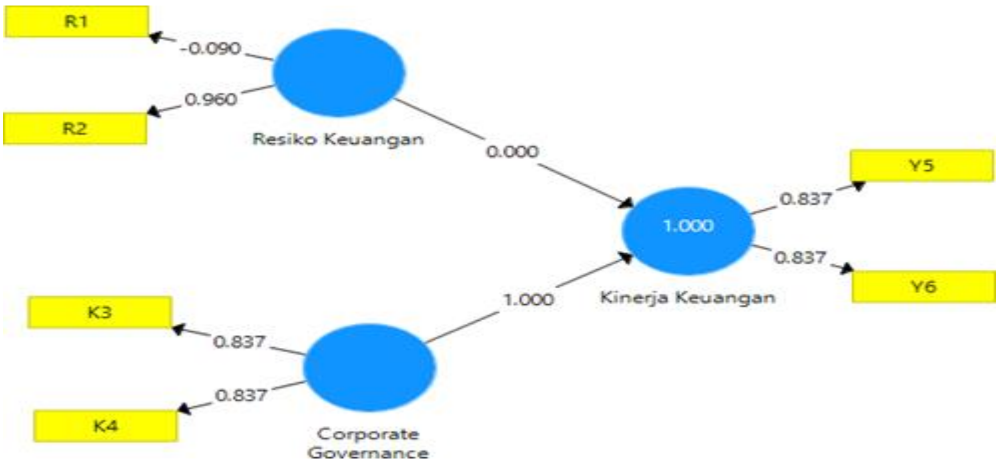

Figure 2. Loading Factor Test

Table 5 Variable Descriptive Analysis

Variabel	T.Statistik	P_Value
R1 <- Financial Risk	0.224	0.823
R2 <- Financial Risk	2,323	0.021
K3 <- Corporate Governance	36,300	0.000
K4 <- Corporate Governance	36,300	0.000
Y5 <- Financial Performance	36,300	0.000
Y6 <- Financial Performance	36,300	0.000

In the table above the results of Factor Loading meet the requirements if the overall value of the Original Sample is > 0.4 and there is one indicator that has the lowest score with the original sample <0.4, so there are several indicators in one variable that are well positioned in explaining each variable. This is reinforced by the value of all P values <0.5 so that each indicator in each variable is worthy of explaining/or measuring the constructed variable.

The processing results above show that credit risk has a significant negative effect on financial performance, presented at a beta coefficient of -0.090 or 9% with T.Value 0.224 <1.96 P.Value 0.823 > 0.5. Credit risk does not influence financial performance. seen from the beta coefficient of 0.960 or 96% with a T.Value of 2.323 > 1.96 and a P. Value of 0.021 <0.05, meaning that market risk has a significant influence on financial performance. The coefficient value is 0.837 or 83.7% with a T-Value of 36.30 > 1.96 and a P.Value of 0.000

Managerial Ownership has influence and is significant. Then the beta coefficient of 0.837 or 83.7 with T.Value 36.30> 0.000 and P_Value 0.0 00 <0.5 means that Public Ownership has a significant influence on financial performance. And in financial performance instruments, there is a beta coefficient of 0.837 or 83 .7 % and T. Value 36.30 > 1.97 with P. Value 0.000 <0.5. Financial Risks do impact financial, However, credit risk not significant The processing of the data indicates that credit risk does not have a significant influence on financial performance. In other words, credit risk does not have a substantial impact on financial performance. The obtained coefficient of -0.090 or 9%, with a P-value of 0.823 > 0.5, suggests that there is T no significant relationship between credit risk and financial performance. This finding explains that the occurrence of potential defaults by borrowers or customers that could result in financial losses for the bank.Therefore, company management needs to pay attention to various types of financial risks that exist and manage them effectively to ensure good financial performance. This aligns with a study conducted by [29], which found that financial risks, including credit risk, market risk, and operational risk, have a significant negative impact on the financial performance of banks in Indonesia. This illustrates that financial risks can indeed affect a company's financial performance and must be well-managed by the company's management

Another study conducted by [30] showed that banking risks, including credit risk, market risk, liquidity risk, and operational risk, also have an impact on the financial performance of banks listed on the Indonesia Stock Exchange. However, this study found that credit risk does not have a significant influence on financial performance. Research by [31] discovered that capital risk and operational risk significantly affect the financial performance of Islamic banks in Indonesia. Research by [32] indicates that financial development plays a crucial role in the sustainability performance of banks in developing countries, including Indonesia.

5. Conclusions and Implications

The purpose of this study is to ascertain its impact. According to the results of research on financial risk, good corporate governance will help banks perform financially in the years 2021–2022. Financial risk illustrates the amount of interest income that can be generated from assets, and management demonstrates that it is possible to manage financial risk while managing productive assets. Corporate governance Managerial Ownership has an influence on financial performance, which is shown to mean that Managerial Ownership has a significant influence on company performance, which is shown to be a smaller probability value, meaning that the more manageria.

This study still has limitations as it only considers the impact of financial risk, corporate governance, and financial performance. Subsequent research is expected to incorporate global influence factors, such as changes in the international financial markets, to assess the impact of financial risk and corporate governance on the financial performance of banks in Indonesia. We recommend that future research also considers observations over a longer period and employs a sample or population that is more representative to determine whether the findings from this study remain applicable. Furthermore, it is suggested to tailor the research sample to match the characteristics of the companies for more accurate research results.

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