

Conference Paper

Determinants for Banking Governance in Indonesia

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Abstract

Objective: This study intends to conduct an empirical investigation to find the factors that determine good corporate governance on banking industry in Indonesia. **Methodology:** The method used in this article is partial least square regression.

Results: The findings show that the leadership variables strengthen the quality of GCG practice. Fit and proper variable is proven to strengthen the influence of leadership variables on the quality of GCG practice.

Implication: In the context of banking industry sustainability, concerns are paid to the potential and competitive strategy of bank. The performance of commercial bank requires structuring the quality of Good Corporate Governance (GCG) practices to be able to face and sustain in business risk. The greatest challenges arise from identifying determinants for banking governance to be sustained in Indonesian banking industry.

Keywords: leadership, good corporate governance, fit and proper.

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1. Introduction

Governance of financial institutions is a serious issue when the financial industry of the United States and Europe is hit by a crisis several years ago. Djokic & Duh (2016) argues that fraud cases, accounting scandals and business failures that occur throughout the world that usually lead to legal problems or bankruptcy make corporate governance a very important topic. Even Lenssen, et al. (2014) concluded that the 2008-2012 financial crisis showed a continuing global system failure and corporate responsibility due to weak / limited corporate governance in contributing to sustainable business in sustainable economy. However, even though there has been a lot of research relating to GCG practices, the study of GCG practices in the banking industry has never investigated the factors that determine the quality of GCG practices in banks, especially Indonesian

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banks. This research intends to study the determinants of GCG quality in banking practices, especially leadership and fit and proper test.

2. Literature Review

2.1. Leadership

Bass (1985) further states that there are 5 dimensions of transformational leadership, i) Vision, ii) Inspiring communication, iii) Supportive leadership, iv) Intellectual stimulation, and v) Personal recognition. The idea of Bass (1985) about transformational leadership is more than just giving a stimulus to get the desired performance through developing, intellectual stimulation and inspiring followers to achieve something beyond their personal interests into greater interests (interests, mission and shared vision). This behavior broadens the scope of leadership, more than just doing corrective or constructive activities. He placed transformational leadership as a construct consisting of three conceptual factors, namely charisma, intellectual stimulation, and individual consideration.

Leaders who are considered transformational are leaders who focus their efforts on long-term goals, place value and prioritize the development of vision. This type of leader inspires followers to pursue a vision and change or adjust the system to accommodate his vision rather than working within the existing system. They train their followers to take better responsibility for the development of themselves and others. Then, Van (2005), Nave (2006), Plowman et al., (2007) and Stahl (2007) concluded that leadership is the key to success in determining the quality of GCG practices. The leader is responsible for the vision and quality of the company's GCG practices and all efforts to move the organization. Plowman et al., (2007) and Stahl (2007) assert that all organizations need leadership to guide organizations and that leaders are problem solvers who are able to guide companies to face challenges and get of achievements through the employees they lead. Stahl (2007) adds that corporate leadership has the capacity to direct staff in the right direction to realize the quality of GCG practices that are consistent with the company's philosophy and values. According to Rossouw (2009), trust in leaders is one of the factors that contribute to the rise of interest in corporate governance. There is hope that compliance with the principles and practices of good corporate governance will increase the trust of stakeholders in the business. Meanwhile, the dimensions of leadership according to Stahl (2007) include i) intellectual stimulation, ii) vision and

philosophy and iii) directing ability. Comparison of Leadership Dimensions based on literature as in table 1. as follows:

TABLE 1: Comparison of Leadership Dimensions.

No	Researcher	Year	Dimention
1	Selznick	1984	- Vision and Quality of GCG Practices
2	Bass dan Avalio	1995	- Charisma - Inspiration as role model - Decision-making - Intellectual stimulation - Contingency award
3	Plowman <i>et al.</i> ,	2007	- Pattern of behavior - Ability to manage words - The use of language that is easy to understand (communicative)
4	Stahl	2007	- Vision and philosophy - Directing ability - Intellectual stimulation
5	Sotarduga Napitupulu	2018	- Vision - Use of language that is easy to understand (communicative) - Behavior as a role model - Intellectual stimulation

Source: Processed from various sources

2.2. Fit and proper test

Another factor that is considered influence on the quality of GCG is the process of obtaining a bank leader or Fit and Proper Test. Initial research on this issue was carried out by Khalid and Nadeem (2004), who found that in both developed and developing countries, the quality of GCG practices was determined by the key criteria used in the Fit and Proper Test. This substance is supported by the results of research by Singh (2004), Dewing, and Russell (2004) who conducted research in the UK, Hussain (2005) in Malaysia, Jayasuria (2006) in Sri Lanka, Nam and Lum (2006) in several Asian and Sanusi countries (2010) in Nigeria. Similar research was also conducted on Islamic banks, such as by Wardhany and Arshad (2012) in Indonesia, Malaysia and Brunei. Broadly speaking, the results of Hopt's (2013) research published in the Journal of Corporate Law Studies (2013) concluded that previous researches proved the effect

of Fit and Proper Test on the GCG quality implementation and that GCG practices in banks were very different than in other industries. One of the drivers of effective GCG implementation is the process that ensures that bank leaders lead and run the GCG process correctly is through a fit and proper test. Here are the opinions of experts regarding the definition of fit and proper test.

TABLE 2: Recapitulation Definitions of Fit and Proper Test.

No	Researcher	Year	Definitions
1	Barnard	1986	F & P is the feasibility test of the capability and quality needed to guarantee the ability of candidates to carry out banking management tasks in a proper and reasonable manner.
2	Khalid dan Nadeem	2004	F & P is a process that connects the quality of candidate bank managers with bank management requirements that are appropriate and appropriate according to applicable regulations
3	Pawana	2014	F & P is an admissible and feasible test for Candidate's Supreme Court Candidate by virtue of the authority granted by Law No. 3 Year 2009 About the Supreme Court, especially in Article 8 paragraph (2)
4	SE DK OJK NO. 7 /SEDK.03/2016	2016	The fit and proper assessment is a means for the OJK to provide approval or rejection of the party that will own or manage the bank
5	Sotarduga	2018	F & P or PKK is the process of evaluating the integrity and ability of prospective management and prospective bank shareholders carried out by the Authority in accordance with applicable regulations

Based on the exposure of the experts above, this study wants to synthesize that Fit and Proper Test is a process of evaluating the integrity and ability of prospective management and prospective bank shareholders carried out by the Authority in accordance with applicable regulations.

In this study, examining leadership variables and fit and proper variables as moderating variables on GCG practices in the banking industry in Indonesia. Based on the forming literature study determines the quality of GCG practices:

1. Leadership (Auh and Shih, 2007; Van, 2005; Nave, 2006; Plowman *et al*, 2007; Stahl, 2007)
2. *Fit and Proper Test* (Khalid and Nadeem,2004; Singh Dewing, 2004; Russell, 2004; Hussain, 2005; Jayasuria, 2006; Nam and Lum, 2006; Sanusi, 2010; Wardhany and Arshad, 2012 and Hopt, 2013).

Overall, clarify the following theoretical frameworks:

TABLE 3: Comparison of Fit and Proper Test Dimensions.

No	Researcher	Year	Dimention	
1	Barnard	1986	- Test material	-Banking regulations
			- Test vision	- Healthy banking philosophy
			- Response test	
2	Khalid dan Nadeem	2004	- GCG	- Banking philosophy
			- Effective and prudential management	
3	Pawana	2014	- Test of compliance (integrity)	
			- Feasibility test (competency)	
4	SE DK OJK NO. 7 /SEDK.03/	2016	- Manage	
			- ability	
			- Obedience	
5	Sotarduga Napitupulu	2018	- integrity	
			-Competence	

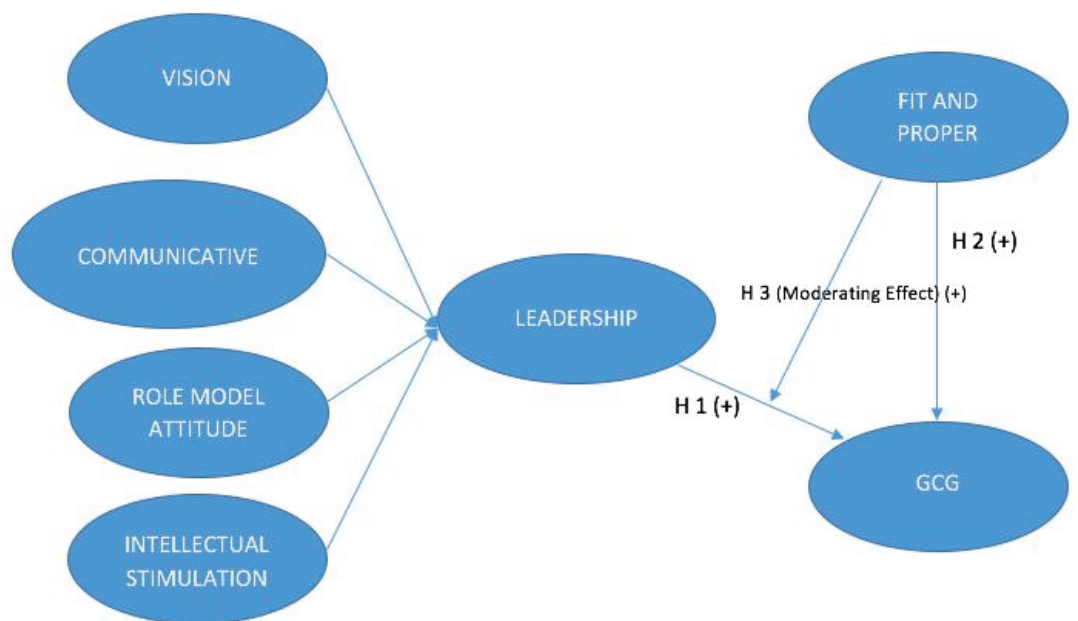


Figure 1: Theoretical Framework.

3. Methodology

The method used in this study is verificative research where research is carried out on the basis of a number of theories. From these theories developed hypotheses

or temporary answers to research questions as outlined in the formulation of the problem. The step in testing these hypotheses is through an inferential approach to give conclusions at the end of the study. The analysis method starts from the presentation of descriptive statistics and continues with factor analysis and calculation based on Structural Equation Model (SEM).

H1: **Leadership** influences the quality of GCG practices of national commercial banks in Indonesia

H2: **Fit and proper test** influences the quality of GCG practices of national commercial banks in Indonesia

H3: **Fit and proper test** is able to moderate the leadership variable that affect the quality of GCG practices of national commercial banks in Indonesia.

4. Result and Discussion

TABLE 4: Psychometric Properties for First Order Construct.

Constructs	Items	Loadings	Alpha	CR	AVE
Vision	The Bank has established clear responsibilities from each of the ranks that are aligned with the bank's vision, mission, business objectives and strategies.	0.952	0.943	0.959	0.855
	The BoD has made GCG as part of the company's vision and mission	0.959			
	The BoC has made GCG as part of the company's vision and mission	0.891			
Communicative (Language that is easy to understand)	Duties, responsibilities and objectives of the Steering Committee are defined and evaluated regularly	0.852	0.870	0.911	0.720
	All banks operate the principles of Good Corporate Governance (GCG) in every business activity of the bank	0.854			
	The BoD provides the opportunity for all stakeholders to provide inputs and convey their views to the interests of the bank and to have access to information in accordance with the principles of openness	0.895			
Role Model Behavior	BoD provides an example in building quality work	0.950	0.933	0.953	0.837
	BoD delivers the Bank's advantages and achievements in every forum	0.951			
	BoD conveys market potential that can be worked on by the Bank in each forum	0.940			

Constructs	Items	Loadings	Alpha	CR	AVE
Intellectual stimulation	The Bank has a measure of performance from all levels of the bank based on agreed measures consistent with corporate values, business objectives and bank strategies and has a reward and punishment system.	0.943	0.934	0.953	0.837
	There are external professionals on the Board of Directors / Advisory Board	0.896			
	The company considers new employees more in carrying out their duties	0.962			
Fit and Proper	Reports are provided systematically and regularly, for example: daily reports, weekly reports, monthly reports, semester reports, and annual reports	0.923	0.933	0.952	0.832
	Every employee is able to work according to the company's target	0.917			
	Every employee is willing to be given an additional quantity of work outside working hours if needed	0.945			
GCG	Transparency	0.946	0.945	0.964	0.901
	Akuntability	0.946			
	Resposibility	0.956			
	Independency	0.932			
	Fairness	0.864			

Abbreviation: BoD: Board of Director

TABLE 5: Mean, Standar Deviation, Intercorrelations of the latent variables for the first order construct.

Construct	Mean	SD	Visi	Commu- nicative	Role Model	Intell- ectual Stimula- tion	Fit and Proper	GCG
Vision	5.476	1.182	0.928*					
Communicative	5.755	1.048	0.722	0.861*				
Role Model	5.082	1.321	0.688	0.689	0.923*			
Intellectual Stimulation	5.601	1.193	0.685	0.615	0.671	0.917*		
Fit and proper	5.382	1.271	0.775	0.688	0.672	0.683	0.913*	
GCG	5.279	1.611	0.763	0.697	0.634	0.676	0.788	0.950*

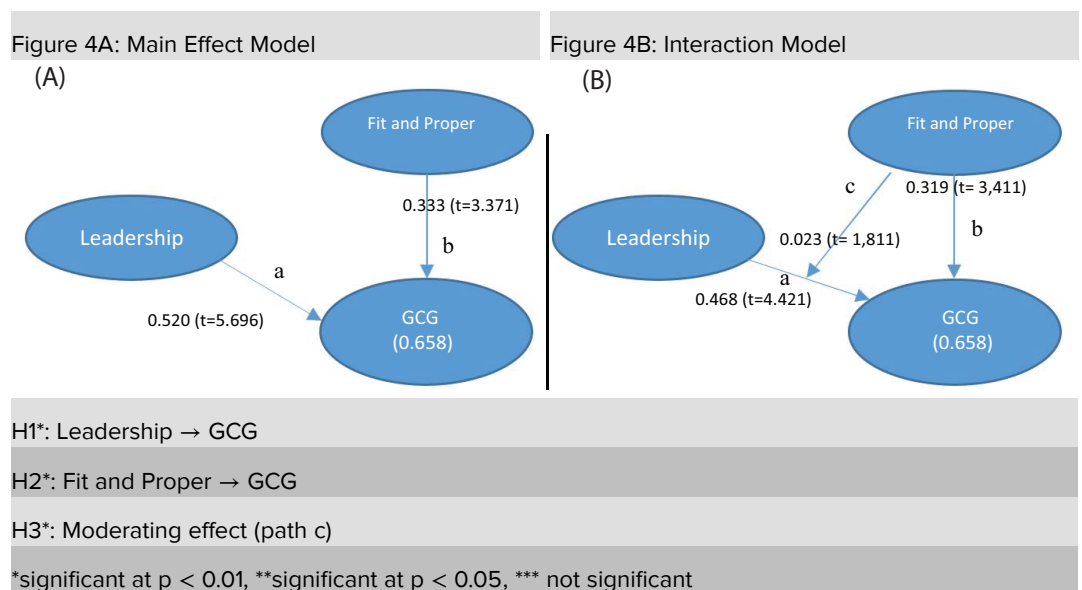
*square root of the AVE on the diagonal

TABLE 6: Leadership (CR = 0.962, AVE = 0.614).

Vision	Communicative	Role Model Behavior	Intellectual Stimulation
R2 = 0.801	R2 = 0.727	R2 = 0.775	R2 = 0.730
β = 0.894	β = 0.861	β = 0.872	β = 0.864
P < 0.01	P < 0.01	P < 0.01	P < 0.01

In Figure 4A, the results give a standardized beta of 0.333 from fit and proper to the quality of GCG practices and 0.520 leadership to the quality of GCG practices. Thus, we find support for H1 and H2.

TABLE 7



In Figure 4B, we present the moderation analysis applying PLS product-indicator approach (Chin et al. 2003) to detect the moderating effect of leadership on the relationship between fit and proper test and the quality of GCG practices. To test the possibility of such effect, leadership (predictor) and fit and proper test (moderator) were multiplied to create an interaction construct (fit and proper test × leadership) to predict the quality of GCG practices. In this case, leadership is a hierarchical construct which consists of 4 items and fit and proper test is a simple latent construct consists of 2 items, thus, the interaction construct represents 8 items (4*2). The AVE and CR of this interaction variable are respectively 0.768 and 0.995, which exceed the minimum cut off value.

To test the moderating effect, we have estimated the influence of predictor on criterion variable (b), the direct impact of the moderating variable on the criterion variable (c) and the influence of interaction variable on criterion variable (d) (see Fig.

4B). The significance of a moderator can be confirmed if the interaction effect (path c) is meaningful, independently of the size of the path coefficients a and b (Hopt's, 2013). In this case, we have estimated a standardized path coefficient of 0.023 for the interaction construct (path c), which is significant at $p < 0.05$ ($t = 1.811$). In estimating the significance of the interaction effect, we used two tailed test because there is a paucity of theoretical support whether leadership enhances or diminishes the association between fit and proper test and the quality of GCG practices. The effect size is calculated as follows:

$$f^2 = \frac{R_i^2 - R_m^2}{1 - R_i^2} = \frac{0.664 - 0.659}{1 - 0.664} = 0.015$$

Here, $i =$ interaction model, $m =$ main effect model

The results show that the size of the moderating effect is small ($f^2 = 0.02$) as well as the resulting beta changes are insignificant ($\beta = 0.023$, $t = 1.811$). Consequently, we confirm that fit and proper does moderate relationship between leadership and the quality of GCG practice, and we accept H3 (see Fig. 4B).

5. Conclusion

This study shows the leadership variables strengthen the quality of GCG practice. Fit and proper variable is proven to strengthen the influence of leadership variables on the quality of GCG practice. This research is useful for observers and researchers and can develop this research using different methodologies, variables, data, proxies because the topic of this research has not been conducted in Indonesia even though this topic is a problem in all countries in the world. This research is useful for mental banks, financial service authorities, banking practitioners to monitor GCG, especially the banking sector.

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