

# **DIRECTORS AND COMMISSIONERS REMUNERATION AND FIRM PERFORMANCE: INDONESIAN EVIDENCE**

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## **Abstract**

*The financial crisis in Asia in mid-1997 have an impact on the economic performance of countries in East Asian, including Indonesia. The lack of sound corporate governance has been argued to be a major cause of the 1997 financial and economic crisis experienced by countries in the East Asian region (D’Cruz, 1999). The Indonesian government through the relevant authorities such as the Ministry of Finance, Capital Market Supervisory Agency and Financial Institution (Bapepam-LK), Indonesia Stock Exchange, Bank Indonesia (Central Bank of the Republic of Indonesia), oversee the implementation of corporate governance practices in companies. Corporate governance principles require the disclosure of remuneration for directors and commissioners (“directors commissioners”).*

*The purpose of this study is to investigate the relationship between Indonesian directors’ remuneration and firm performance. From a sample of 100 listed companies throughout the period 2008-2009, it has been found that there has been positive relationship between current year directors and commissioners remuneration and lag effect analysis accounting performance indicator.*

**Keywords:** directors and commissioners remuneration, accounting measurement, firm performance.

## **1. Introduction**

The implementation of proper corporate governance that are not considered as a cause of financial and economic crisis in mid-1997. This raises the overall improvement of the Indonesian government to re-examine corporate governance principles and overseeing its implementation in the company. The Indonesian government through the relevant authorities such as the Ministry of Finance, Capital Market Supervisory Agency (Bapepam), Indonesia Stock Exchange, Bank Indonesia (Central Bank of the Republic of Indonesia), implementing corporate governance practices including remuneration of the entire board of directors and commissioners.

The principles of corporate governance requires directors remuneration associated with the assessment of corporate performance. The principles are convinced that the remuneration of directors and commissioners is an important aspect for the effective implementation of corporate governance.

Board of Commissioners on remuneration issues related to problems in the agency (agency problem). Agency theory states that there is a conflict of interest between principal and agent. As agents, managers are morally responsible to optimize benefits shareholders (principal). While the manager also has an interest to maximize their personal welfare (Jensen & Meckling, 1976).

To overcome the problem of differences of interest, agency theory suggests that the interests of managers and shareholders will be in line when the compensation for the managers associated with firm performance (Murphy, 1985).

Literature study shows that there are two main streams in examining compensation and company performance. British study examined the relationship of remuneration of directors and commissioners (in the one-tier system known as the board of directors, while according to two tier system, it means the board of directors and board of commissioners) and corporate performance, a study in the United States investigated the relationship between CEO compensation and firm performance . This happens because the majority of the directors in the UK is dominated by executive directors so that not too different between the directors and management. Unlike the structure of the board of directors in the United States that the majority is non-executive directors (Hassan et al., 2003). A recent study in Asia to embrace the mainstream United States is committed Unite et al. (2008). This study uses the remuneration of the board of directors and board of commissioners (hereinafter referred DCREM). The reason for using a total remuneration for directors and commissioners are very few companies which separate remuneration separately each for directors and commissioners in Indonesia. DCREM in Indonesia expressed in the form of total remuneration.

Several studies have shown that the remuneration of directors commissioner relating to company performance. Performance measurement is used to use accounting-based performance and market-based performance (Conyon, 1997; Hassan et al., 2003; Abdullah, 2006; Kato & Kubo, 2006; Unite et al., 2008).

The financial statements which is a form of corporate accounting information is one of information that can be used in assessing corporate performance. One form of accounting information that are important in the company's performance appraisal process is a form of corporate financial ratios for certain periods. With the financial ratios will be evident variety of financial indicators that can reveal a company's financial condition and performance of the company that has been achieved (Meriewaty and Setyani, 2005).

Several studies about the benefits of financial ratios have been conducted among others by Beaver (1966) who use 30 financial ratios to determine the level of corporate bankruptcies, Machfuedz (1994) using 13 financial ratios to predict changes in income, Meriewaty and Setyani (2005) conducted an analysis of financial ratios to changes in company performance.

It can be concluded that the accounting information in the form of financial ratios, can be used to measure company performance. From the company's performance, will be visible effect on remuneration.

The purpose of this study was to provide empirical evidence in Indonesia about the effect of the company's performance against the remuneration for directors and commissioners (DCREM) on companies listed in Indonesia Stock Exchange during the study period.

## **2. Literature Review and Hypothesis Development**

### **2.1. Remuneration**

Remuneration is every form of salaries, allowances and bonuses received by the employee. Here is a form of compensation received by management (Murphy, 1986): (1) Salary: The compensation received by fixed and adjusted with the old work, performance, cost of living, and other considerations, (2) Bonus: Compensation received under the policy directors of the company and tailored to the company's performance, (3) Stock Options (Stock Option): compensation in which the CEO can buy shares over a period of time, (4) (Restricted) Stock Award: given or sold shares to the CEO at a discount. Often the ability of CEOs to sell stock is limited, at least samapai a particular condition (eg achieving a certain growth targets or target retirement income or to the CEO). The number of shares awarded depending on the performance of performance plans, (5) Phantom Stock Plans: As in common stock but has no ownership claims. CEO will be entitled to share price appreciation and dividends as well as the actual stock, (6) Stock Appreciation Rights: The right to collect a number of shares at a specified price at a certain time.

Broadly speaking remuneration obtained consists of cash remuneration and remuneration based on shares that are associated with short-term performance and long term (Milgrom and Robert, 1992). But not many companies in Indonesia that provides stock as remuneration linked to the performance of directors and commissioners.

### **2.2. Disclosure of Remuneration of Board of Directors in the Context of Good Corporate Governance (GCG)**

System of corporate governance (corporate governance) is triggered by the emergence of agency conflict in firms. The failure of international companies, financial scandals and economic crises in various countries, also focused the importance of good corporate governance (corporate governance). It also happens with countries in Asia.

One of the basic mechanisms of good corporate governance (corporate governance) is the Board of Directors. Sutojo and Aldrige (2005) states there are two systems of preparation of the Board of Directors of the Continental System and Anglo-Saxon system: (1) Continental System, among others, applied in Indonesia, the Netherlands, Belgium, Luxemburg. The Continental System: Board of Directors are separated into two layers (two tiers) consists of the supervisory board or the Board of Trustees and the management board or management. In Indonesia, the supervisory board called the Board of Commissioners and the management board called the Board of Directors, (2) Anglo-Saxon system: Board of Directors consists of one layer (one tier). The Board consists of Chairman, Non Executive Directors and Executive Directors. Board of Directors chaired by the Chairman. Anglo Saxon countries that apply include the United States, Britain, Australia, China, Korea, Philippines.

Board of Directors as a mechanism of corporate governance, internal control function (Jensen, 1993). This is in accordance with the statement that good corporate governance can be facilitated if the Board of Directors carrying out the primary responsibility for monitoring the implementation of long-term strategy, making the selection, performance evaluation and determination of management compensation effectively, the better the system Board of Directors is one-tier or two tiers (OECD, 2004; Sutojo and Aldrige, 2005).

The issue of remuneration of board of directors closely associated with corporate governance. Prof. Stephen Y.I. Cheung in 2006 to compare the remuneration disclosures related to corporate governance board of directors in Asian countries like Hong Kong, Japan, Malaysia, Singapore, South Korea and Thailand (Ulupui, 2009). Table disclosure of remuneration of board of directors are as follows:

**Table 2.1. Remuneration Disclosure Board of Directors in Asia**

<b>Country Name</b>	<b>Required Disclosures</b>
<b>Hongkong</b>	- Disclosed in full (Disclosed in full)
<b>Japan</b>	- It was decided by the board of commissioners (board) - revealed as a statement of business (business statement), and evaluated by the shareholders
<b>Malaysia</b>	- Disclose the policy is transparent and formal - remuneration report in detail.
<b>Singapore</b>	- Reveal a clear policy (clear) - Disclose the remuneration of all commissioners and directors (the board of directors) and income in detail the top five executives.
<b>South Korea</b>	- Disclose in full - Assessment of reasonable
<b>Thailand</b>	- Disclose in full

Source: Department of Economics and Finance, City University of Hong Kong, 2006

From the table above, it appears that different from the disclosure of management remuneration in the United States who have expressed individual remuneration. Governments in Asian countries have started to disclose the remuneration in full even though most directors only disclose the total remuneration of commissioners jointly (the boards of directors).

### **1.3. Effect of Corporate Performance of Remuneration for Directors Commissioners (DCREM)**

Several studies in England examined the relationship of remuneration and corporate performance as the focus of research (Gregg et al., 1993; Conyon and Leech, 1994; Conyon and Gregg, 1994; Conyon et al., 1995; Conyon 1997). The results showed that the company's growth is an important measure for the remuneration of directors. Main et al. (1996) showed positive and significant correlation between the total remuneration linked with the board of commissioners (board Total Remuneration). Conyon and Peck (1998) states that positive results and the associated significant correlation between performance and remuneration. It also shows the associated positive significant correlation between company size and remuneration of directors.

In Malaysia, Hassan et al. (2003) in Abdullah (2006) examined the relationship between the remuneration of directors and corporate performance in the period before and after the Asian financial crisis (1996-1998) and found positive results but has a weak relationship. Interestingly, the lag-effect analysis showed a strong relationship between financial indicators and the remuneration of directors. The study also showed positive and significant correlation between the remuneration of directors with firm size (firm's size) and rotation of firms (firm's turnover) is consistent with previous research in the UK and Hong Kong (Firth et al, 1999).

After Hassan *et al.*(2003), Abdullah (2006) continued these studies by adding variables based company that is experiencing financial problems. Their work shows the remuneration of directors is not related to corporate profitability as measured using the ROA. Significant negative outcomes on the basis of observations between the remuneration of directors and lagged ROA. While the remuneration of directors is positively related to growth (growth) and firm size (size).

**Table 2.3.**  
**Previous Study about Directors and Commissioners Remuneration  
and Firm Performance**

Researcher	Dependent Variables	Independent Variables	Data	State
Conyon, (1997)	Cash remuneration The Board of Directors	Market return, firm size, sales, the remuneration committee as dummy variables, separation of CEO with the Chairman as a dummy variable	213 companies (1988-1993)	UK
Hassan et al. (2003)	Cash remuneration The Board of Directors	Net income, ROE, ROA, EPS, company size, turnover	100 firms (1996-1998)	Malaysia
Abdullah (2006)	Cash remuneration The Board of Directors	ROA, commissioner of directors structure, ownership structure, board of commissioners	164 companies (2000-2001)	Malaysia
Doucouliaagos et al. (2007)	(1) Cash remuneration The Board of Directors, CEO. (2) Remuneration of CEO stock	ROA, ROE, EPS, return shareholders, board size, meeting, composition, committes, board turnover, age of the CEO & board of commissioners, directors shareholding CEO & Commissioner, company size, revenue.	10 banks (1992-2005)	Australia

Source: Oviantari&Rossieta (2010).

Based on the above, the proposed hypothesis:

H1: The firm performance are positively related to the remuneration of directors

### 3. Research Methods

#### 3.1. Data and Sample

The data used in the form of primary data and secondary data. Primary data litelatur required in the preparation of a theoretical framework of research and discussion of material for analysis and research results. Secondary data in the form of financial statements and reports of good corporate governance. Type of sample is purposive sampling with the following criteria: (1) Registered as a public company in Indonesia Stock Exchange (IDX) from 2007 to 2009, (2) the company's annual report 2007-2009 is available. In the annual report included in it there is the audited Financial Statements and Report of Good Corporate Governance, (3) Disclose the value of total remuneration for directors and commissioners from 2007 to 2009.

#### 3.2. Model Research

Testing of the hypothesis presented in this study will be conducted using multiple regression analysis (multiple regression). Our regresssion models are similar to those used by Hassan *et al.* (2003), Abdullah 92006). Specifically, this regression equation is as follow:

$$LN(DCREM)_{it} = a_i(t-1) + b1 ROA_i(t-1) + b2 EPS_i(t-1) + b3 LNSALES_i(t-1) + b4 LN(ASSET)_{it} + e_{it}$$

Dependent variable Directors and Commissioners Remuneration (LN DCREM) is calculated as a natural logarithm of total remuneration of the directors of commissioners divided by the total number of members of the board of directors and commissioners. Remuneration is stated in terms of Indonesian rupiah. In this research we use cash remuneration.

We use three alternative accounting-based measures of firm performance. The first, return on Assets (ROA) is calculated as net income divided by total assets. Next, earning per share (EPS) is calculated as earnings after taxes divided by the weighted average number of shares. Our third measure, sales (LN SALES), is a natural logarithm of total sales.

We include firm size (LN ASSET) as a control variable because CEO pay has been shown to be directly related to firm size (Unite *et al.*, 2008). Firm size (LN ASSET) calculated as a natural logarithm of total assets of the company.

## **4. Result Analysis**

### **4.1. Overview of Research Sample**

The sample in this study are all public companies listed in the directory ICMD (Indonesian Capital Market Directory) during the period 2007-2009. Company financial data obtained from the Indonesian Stock Exchange website, [www.idx.co.id](http://www.idx.co.id) as of December 5, 2010.

### **4.2. Hypothesis Testing**

The results of empirical regression models can be seen in table 4.1, shows that the value of the F-statistic has Prob (F-statistic) is significant 0.00. This suggests that free variables are tested jointly significant (at least with  $\alpha = 5\%$ ) affects the dependent variable (DCREM). This means that the amount of remuneration for directors and commissioners (DCREM) can be explained by the ROA, EPS, LN ASSET, LN SALES of 96%. The remaining 4% is explained by other variables not addressed in this study.

For independent variables ROA shows a significant value for the measurement DCREM, where the variable has a value of -0.011 ( $\alpha = 5\%$ ). This shows the value of ROA negative effect on remuneration (DCREM).

The value of regression coefficient estimates ROA variable indicating a negative direction indicate the opposite relationship with the dependent variable (DCREM). The interesting thing was the discovery of the value of ROA has significant influence but show a negative direction to the remuneration of directors of commissioners in this study. These results were also found in the study Abdullah (2006) in Malaysian public corporations observation period of 2003. Abdullah (2006) argued that the negative value of ROA is significant because the observation period is the period of recovery after the financial crisis hit Asia in 1998. So even if the value of a negative ROA, shareholders are increasing the remuneration of management to motivate management to maintain the condition of the company in a going-concern conditions.

Likewise with the results in this study, shareholders tend to show an increase of remuneration in order to improve company performance. One of the decisions to improve the performance of the company is changing the position of board of commissioners with a new team. Of course, shareholders will choose the composition of the board of commissioners that the new team consisting of professional bankers with a good track record. The impact of the new commissioners election of directors is greater remuneration in the hope of change of directors commissioners can improve performance.

The relationship between variable remuneration EPS is not significant. The results of this study differ from research Doucouliagos et al. (2007) who showed positive results and significantly related.

Results of regression coefficient estimates of variables (LNSALES) also showed significant values of 0.16 ( $\alpha = 5\%$ ). This shows sales (LNSALES) positive effect on remuneration (DCREM). This is consistent with the Hassan et al. (2003) that uses a variable sales and have a positive and significant influence on performance management.

#### 4.1. Empirical Regression Model Results

	Predicted Direction	Dependent Variabel: DCREM
Intercept		19.03 (0.0000)
ROA	+	-0.011 (0.0253)**
EPS	+	-6.3 (0.8885)
LNASSET	Control variable	-0.11 (0.1262)
LNSALES	+	0.16 (0.0287)**
Adj.R <sup>2</sup>		0.96
F-statistic		50.19
Prob (F-statistic)		0.0000***
N (firm year)		216
LN (DCREM) is a natural logarithm of total remuneration of the directors of commissioners divided by the total number of members of the board of commissioners. ROA = net income divided by total assets (Return on Assets). EPS = earnings after taxes divided by the weighted average number of shares (Earning per Share). LNSALES = natural logarithm of total sales. *1% significant, **5% significant, ***10% significant		

*Source: Eviews 6*

## 5. Conclusions and Suggestions

The study aims to determine the influence of the company's performance against the remuneration for directors and commissioners (DCREM). This study also shows the initial data disclosure of remuneration for directors and commissioners in Indonesia. The picture shows that corporate earnings have an impact on remuneration for directors and commissioners.

Return On Assets in this research has a significant negative influence on the remuneration of directors of commissioners. Similar to the study of Abdullah (2006) examine public companies in Malaysia in 2003. Abdullah (2006) stated the reason for the results significantly negative ROA is because in those days was the period after the 1998 economic crisis so that the value of ROA are still experiencing negative conditions.

In contrast to the reasons stated Abdullah (2006), when the value of ROA has decreased shareholders react by changing the team of directors and commissioners. Of course by placing directors and commissioners who have a good track record. The impact of the replacement team that the new commissioner of directors is greater remuneration in the hope, the new management can contribute to a better performance improvement.

LNSALES that shows the company's sales showed that sales had a positive and significant influence on the remuneration for directors and commissioners. This findings are interesting in light of comparison to study of Hassan *et al.*(2003) and Abdullah (2006). Hassan *et al.*(2003) proposed that there is a positive but weak relationship between remunerationa and firm performance.

Suggestions for future research is to further explore the influence of firm performance is not only performance based on accounting measures, but also the size of non-accounting measurement.

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**APPENDIX 1**  
**Preliminary test results of Multiple Regression SPSS 13**

Dependent Variable: DCREM?  
Method: Pooled Least Squares  
Date: 02/12/11 Time: 06:14  
Sample: 2008 2009  
Included observations: 2  
Cross-sections included: 108  
Total pool (balanced) observations: 216

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	19.03695	1.909190	9.971214	0.0000
ROA?	-0.011124	0.004902	-2.269099	0.0253
EPS?	-6.31E-05	0.000449	-0.140498	0.8885
LNASSET?	-0.118360	0.076769	-1.541769	0.1262
LNSALES?	0.163432	0.073681	2.218087	0.0287
Fixed Effects (Cross)				
_ABBA--C	-0.271581			
_ABDA--C	0.499712			
_ACES--C	0.541238			



_ADES--C	-0.496543
_ADHI--C	-0.102316
_ADMF--C	1.792047
_AGRO--C	0.570003
_AHAP--C	-1.035399
_AKRA--C	-5.251079
_ALFA--C	-0.642267
_AMRT--C	1.192175
_ANTA--C	-0.561526
_ARTA--C	1.063872
_ASBI--C	-0.037694
_ASDM--C	0.060789
_ASJT--C	-0.292989
_ASRI--C	-0.186996
_BAPA--C	-1.378818
_BAYU--C	-0.298622
_BBLD--C	1.206657
_BFIN--C	2.220866
_BHIT--C	-0.174806
_BKDP--C	-0.542993
_BKSL--C	0.343196
_BMTR--C	0.837360
_BSDE--C	-1.189824
_BSWD--C	-0.215942
_BTEL--C	0.994284
_BVIC--C	-0.172623
_CENT--C	-0.766981
_CFIN--C	0.147846
_CKRA--C	-1.057092
_CMNP--C	0.431960
_CMPP--C	-0.511624
_COWL--C	-0.369125
_CSAP--C	0.330394
_CTRP--C	0.479973
_DEFI--C	-1.387538
_DGIK--C	-0.044710
_DILD--C	0.680805
_DUTI--C	0.308990
_ELSA--C	0.860791
_ELTY--C	0.684907
_EPMT--C	0.240502
_FORU--C	0.258821
_GMTD--C	-1.408203
_GPRA--C	-0.731255
_HITS--C	1.054797
_IATA--C	-0.123161
_ICON--C	-3.784326
_IDKM--C	0.892239
_INDY--C	1.628530
_INTA--C	1.370115
_JIHD--C	0.104589
_JKON--C	0.907614
_JRPT--C	0.337696
_JSPT--C	0.653110
_JTPE--C	-1.250153
_KONI--C	-1.447661
_KPIG--C	-1.712131

_LAMI--C	-0.164591
_LMAS--C	-0.799684
_LPCK--C	-0.506506
_LPGI--C	0.616435
_LPKR--C	1.022387
_LPPS--C	0.706470
_LTLS--C	1.463840
_MCOR--C	0.202402
_MDLN--C	0.463861
_MDRN--C	0.159054
_META--C	-0.079259
_MFIN--C	1.423652
_MICE--C	0.442044
_MIRA--C	1.925482
_MITI--C	-0.871714
_MNCN--C	1.037661
_MREI--C	0.543990
_MTDL--C	1.383721
_OCAP--C	6.140140
_OMRE--C	0.471779
_PANS--C	0.071068
_PEGE--C	-0.378522
_PJAA--C	1.286867
_PLIN--C	1.170619
_PNSE--C	-0.787342
_POOL--C	-0.507731
_RAJA--C	-2.219320
_RELI--C	-0.565977
_RIMO--C	-1.474481
_RODA--C	-1.420809
_SAFE--C	-1.851484
_SCBD--C	-0.387423
_SCMA--C	0.529571
_SHID--C	-0.517247
_SIIP--C	-1.368491
_SMDR--C	0.129979
_SMRA--C	1.256597
_TMPO--C	-0.459298
_TRAM--C	0.838977
_TRIL--C	-0.958859
_TRIM--C	1.658417
_TURI--C	0.585700
_UNTR--C	1.358084
_VRNA--C	0.088527
_WAPO--C	-2.318207
_WEHA--C	-1.571800
_WICO--C	-0.707827
_YULE--C	-2.310650

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Effects Specification

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Cross-section fixed (dummy variables)

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R-squared	0.981677	Mean dependent var	20.06968
Adjusted R-squared	0.962120	S.D. dependent var	1.340339
S.E. of regression	0.260868	Akaike info criterion	0.456543
Sum squared resid	7.077402	Schwarz criterion	2.206687

Log likelihood	62.69340	Hannan-Quinn criter.	1.163605
F-statistic	50.19640	Durbin-Watson stat	3.963303
Prob(F-statistic)	0.000000		

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