

# The Influence of Executive Compensation, Independent Boards, and Liquidity on the Performance of Banking Firms Listed on the Indonesia Stock Exchange

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## Abstract

Banking institutions function as financial intermediaries that rely heavily on public trust, as their operations predominantly utilize funds sourced from depositors rather than shareholders. The stability and sustainability of these institutions depend on their ability to maintain sound financial performance, which reflects managerial effectiveness in balancing liquidity adequacy, profitability, and capital sufficiency. This study investigates the influence of executive compensation, independent boards, and liquidity on firm performance measured using return on assets (ROA) among banking firms listed on the Indonesia Stock Exchange. The research employs a purposive sampling technique and analyzes 235 firm-year observations from 47 banking companies over the 2018–2022 period. Data were processed using variance-based structural equation modeling (SEM-PLS) with Warp-PLS version 5.0. The findings demonstrate that executive compensation has a significantly positive impact on firm performance. Conversely, the independent board variable shows a negative but statistically insignificant relationship with firm performance. Furthermore, liquidity exhibits a positive influence on financial performance, indicating the importance of maintaining sufficient liquid resources in supporting operational efficiency and profitability.

**Keywords:** Executive Compensation, Independent Board, Liquidity, Firm Performance



## INTRODUCTION

Banking institutions function as financial intermediaries whose core operations rely fundamentally on public trust. Banks primarily utilize funds collected from the public, which are significantly larger and more cost-efficient than shareholders' equity, thereby requiring prudent management to maintain an optimal balance between liquidity, profitability, and adequate capitalization. Such equilibrium is essential in ensuring sound financial performance. In the Indonesian context, the banking sector serves as a critical pillar of national economic development, as mandated by national regulations (Law No. 21 of 2011 concerning the Financial Services Authority, 2011; Law No. 10 of 1998, 1998), performing functions that range from mobilizing public funds to channeling credit and supporting national economic stability and equitable growth.

As primary institutions that collect and redistribute public funds, banks are expected to maintain sufficient capital and manage credit distribution responsibly. However, imprudent lending practices, weak managerial oversight, and poor risk identification often lead to nonperforming credit exposures (Dwivedi, 2017; Soni & Duggal, 2014). Such conditions reflect deteriorating financial performance, which may erode public confidence and discourage investors. Financial performance indicators – including liquidity, profitability, solvency, and activity ratios – serve as fundamental metrics for evaluating a firm's success (Agrawal, 2013; Guest, 2009). Strong financial performance, as noted by Horváth & Spirollari (2012) and Suffari & Tahir (2021), signals organizational effectiveness in generating sustainable returns. Recent studies also emphasize that robust financial performance is increasingly critical in enhancing banking sector resilience, particularly in highly volatile economic environments (Ristanti & Pratiwi, 2025).

Fluctuations in bank profitability observed across major Indonesian banking firms from 2018–2022 highlight the importance of understanding the drivers of financial performance. Profit growth among major listed banks has shown inconsistencies, with notable declines followed by recoveries, suggesting the influence of multiple internal and external determinants. These cyclical variations underscore the need to evaluate governance and financial structures that may either mitigate or exacerbate performance volatility in the banking industry (Mubarok et al., 2025). One such determinant is executive compensation, which has long been a subject of debate in academic, legislative, and shareholder forums since the 1930s. In Indonesia, Bank Indonesia Regulation No. 8/4/PBI/2006 mandates disclosure of executive remuneration as part of Good Corporate Governance (GCG), reinforcing transparency among firms listed on the Indonesia Stock Exchange.

Executive compensation plays a strategic role in aligning managerial incentives with shareholder interests, encouraging executives to enhance firm value (Peng & Tan, 2022; Yang et al., 2020). Competitive compensation packages can foster stronger managerial motivation and organizational productivity (Abdalkrim, 2019; Dixon-Fowler et al., 2017). Conversely, compensation levels that fail to reflect firm performance may signal governance inefficiencies. Prior studies show mixed evidence, with some researchers finding positive relationships between compensation and firm performance (Chou & Buchdadi, 2017; Horváth & Spirollari, 2012; Ria Citra Dewi et al., 2019), while others reveal insignificant or inconsistent effects. Recent empirical

evidence further suggests that compensation-performance relationships may depend on broader governance environments and risk-taking behaviors specific to the banking industry (Qi et al., 2023).

Another critical governance factor influencing banking performance is the structure and role of independent boards. Independent commissioners serve as key agents in promoting objectivity, ensuring effective oversight, and supporting good corporate governance practices (Lumbanraja et al., 2018). Variations in the proportion of independent commissioners among major Indonesian banks over recent years indicate diverse governance approaches that may influence performance outcomes. Empirical findings regarding the impact of independent boards also remain inconclusive, with some studies observing positive effects on firm performance Kim & Rasheed (2014), Papangkorn et al., (2021), Sarafina & Saifi (2017) and others indicating limited or context dependent impacts. Given increasing regulatory emphasis on board independence, examining its role in banking firms becomes crucial for strengthening governance credibility and investor confidence.

In addition to governance mechanisms, liquidity stands as a central determinant of financial performance in the banking sector. Banks must ensure their ability to meet depositor withdrawals while managing credit expansion effectively Hassan et al., (2019). Liquidity risk emerges when banks cannot meet funding obligations or when borrowers fail to repay loans. To manage such risks, banks commonly monitor indicators such as Loan to Deposit Ratio (LDR), NonPerforming Loan (NPL), Net Interest Margin (NIM), and BOPO, all of which reflect the institution's operational efficiency and risk exposure. Variations in these risk indicators across Indonesian banking firms reveal differences in liquidity management and risk mitigation strategies. Understanding how liquidity interacts with governance mechanisms remains a pressing research area, particularly as global financial uncertainty continues to challenge traditional banking models (Eltweri et al., 2024). Therefore, investigating executive compensation, independent boards, and liquidity collectively offers a comprehensive framework for assessing the determinants of financial performance among banking firms listed on the Indonesia Stock Exchange.

## **LITERATURE REVIEW**

### **Executive Compensation**

Executive compensation refers to the total financial and non-financial rewards provided to top management as incentives for directing organizational strategy and enhancing firm value. Compensation typically includes salaries, bonuses, stock options, long-term incentives, and other performance-based rewards that aim to align managerial interests with those of shareholders (Peng & Tan, 2022; Yang et al., 2020). Common indicators used to measure executive compensation include total remuneration, CEO pay ratio, and performance-linked incentive structures. Prior studies highlight that well-designed compensation packages can strengthen managerial motivation, improve decision-making quality, and drive firm performance (Dixon-Fowler et al., 2017). Moreover, in the banking sector, performance-based incentives are increasingly tied to risk-adjusted outcomes to discourage excessive risk-taking and support sustainable financial stability.

## **Independent Board**

An independent board often represented by independent commissioners is a governance mechanism designed to ensure objective oversight, reduce managerial opportunism, and enhance accountability within the firm. Independent commissioners are non-executive members with no material relationship to management, enabling them to provide unbiased monitoring of corporate policies (Lumbanraja et al., 2018). Key indicators of board independence commonly include the proportion of independent directors, their attendance, committee participation, and independence tenure. Empirical research suggests that independent boards can strengthen decision-making quality and improve financial performance through enhanced monitoring and strategic guidance (Sarafina & Saifi, 2017). In banking institutions, board independence becomes even more critical due to higher regulatory requirements and the complexity of managing public funds.

## **Liquidity**

Liquidity refers to a bank's ability to meet short-term financial obligations, including depositor withdrawals and credit disbursements, without disrupting operational stability. Liquidity performance is generally measured through indicators such as the Loan-to-Deposit Ratio (LDR), Non-Performing Loans (NPL), Net Interest Margin (NIM), and Operating Expense Ratio (BOPO), which collectively reflect a bank's efficiency and risk exposure (Hassan et al., 2019). Adequate liquidity enables banks to maintain smooth operations and adapt to financial shocks, whereas poor liquidity management may result in funding difficulties and deteriorating profitability. Prior research confirms that liquidity levels significantly influence bank performance, particularly in emerging economies where banking sectors face higher volatility (Eltweri et al., 2024). Furthermore, effective liquidity governance is essential to prevent systemic risks and maintain long-term banking sector resilience.

## **Firm Performance**

Firm performance in the banking industry represents the effectiveness of institutions in generating profits, managing risks, and maintaining operational efficiency. Performance is commonly assessed using profitability ratios (ROA, ROE), liquidity ratios, asset quality indicators, and capital adequacy measures that collectively signal financial health and stability (Agrawal, 2013; Horváth & Spirollari, 2012). Strong financial performance indicates the institution's ability to allocate resources efficiently, achieve strategic goals, and sustain competitive advantage. Literature suggests that governance mechanisms, capital structure decisions, liquidity conditions, and managerial incentives substantially influence performance outcomes in the banking sector (Mousa et al., 2023). Given increasing financial market volatility, evaluating firm performance through multi-dimensional indicators has become essential to capture the dynamic risk environment faced by modern banks.

**METHOD**

This study employed a quantitative research design, which relies on numerical data that allow generalization of findings (Lumbanraja & Junaidi, 2021). The research utilized secondary data obtained from the annual reports of banking firms listed on the Indonesia Stock Exchange. The population consisted of 58 banking issuers recorded as of 31 December 2022 and observed over the 2018–2022 period. Samples were selected using a purposive sampling technique based on the completeness of annual report disclosures and the availability of executive compensation information. Executive compensation was measured using the total remuneration received by members of the board of directors and commissioners. The independent board variable was assessed based on the proportion of independent commissioners within the board structure. Liquidity was measured using the Loan to Deposit Ratio, while firm performance was proxied by Return on Assets. Definitions of variables, their indicators, and measurement scales are presented in Table 1.

**Table 1.** Definitions and Operationalization of Variables

Variable	Definition	Indicator	Scale
Return On Assets (ROA) (Y)	A measure of the firm’s ability to generate net income from its total assets	$ROA = \frac{EAT}{Total\ Aset} \times 100\%$	Ratio
Executive Compensation (X1)	A corporate mechanism to align managerial and shareholder interests by increasing incentives and managerial effort	Total annual remuneration received by executive directors and commissioners	Ratio
Independent Board (X2)	A board structure in which commissioners have no material relationship with the company	$INT = \frac{Number\ of\ Independent\ Commisioner}{Total\ Commisioner}$	Ratio
Loan to Deposite Ratio (LDR) (X3)	A measure of a bank’s risk associated with meeting its maturing obligations using cash flow funding sources or high quality liquid assets	$LDR = \frac{Total\ Loans\ Disbursed}{Total\ Third\ Party\ Fund} \times 100\%$	Ratio

Sources: Brigham & Ehrhardt (2024)

Data were collected through documentation by extracting financial and governance information from the official annual publications of each banking issuer. The data analysis employed Partial Least Squares due to the non normal distribution characteristics of the dataset, making PLS a robust and suitable technique for this study (Jogiyanto & Abdillah, 2015; Surydana, 2017). The analytical process included measurement model evaluation to assess indicator reliability and construct validity, followed by structural model evaluation to test the relationships among executive compensation, independent board composition, liquidity, and firm performance within Indonesia’s banking sector.

## ANALYSIS AND DISCUSSION

Prior to estimating the research model, the procedure for determining the sample size is first outlined to ensure that the analyzed units adequately represent the target population. The sample selection was conducted using purposive sampling, with the criteria summarized in Table 6.

**Table 2.** Description of Research Sample Based on Criteria

Criteria	Total
All banking companies listed on the Indonesia Stock Exchange (IDX) in 2018–2022	58
Banking companies without complete financial statement data published on IDX or on the company website	3
Companies that do not provide remuneration or executive compensation data	8
<b>Total Sample</b>	<b>47</b>
<b>Years Observed</b>	<b>5 years</b>
<b>Financial Statements Observed</b>	<b>235</b>

Source: Data processing, 2025

Based on Table 2, the final sample consists of forty seven banking firms listed on the Indonesia Stock Exchange over a five year observation period, resulting in a total of two hundred and thirty five firm year observations. This selection is considered sufficient to portray the overall characteristics of the Indonesian banking sector during the study period.

### Descriptive Statistics

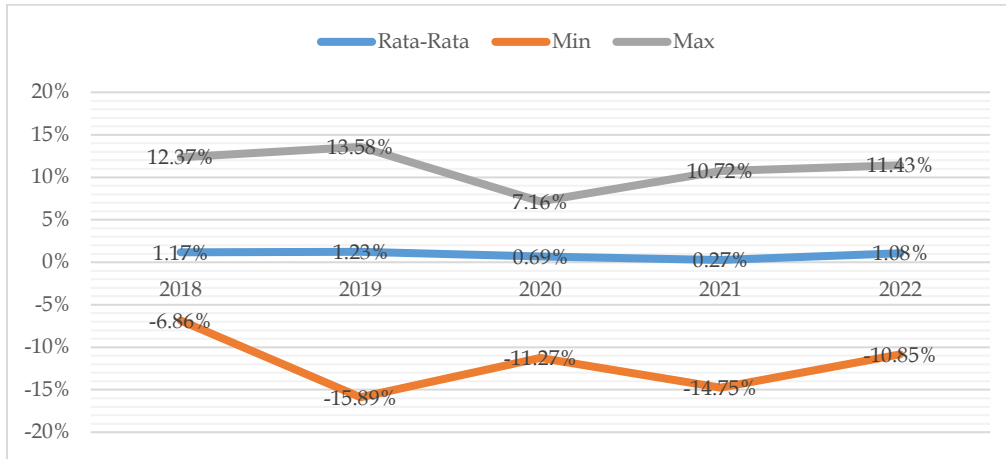
The descriptive assessment was carried out both in aggregate and across the observation years. The general descriptive results are summarized in Table 3.

**Table 3.** Summary of Descriptive Statistics

	Descriptive Statistics				
	N	Minimum	Maximum	Mean	Std. Deviation
ROA	240	-.1589	.1358	.008880	.0331782
EC	240	21.94	27.48	24.2931	1.26885
IB	240	.25	1.00	.5839	.13246
Liquidity	240	.0000	3.9392	.873362	.3375078

Source: Data processing, 2025

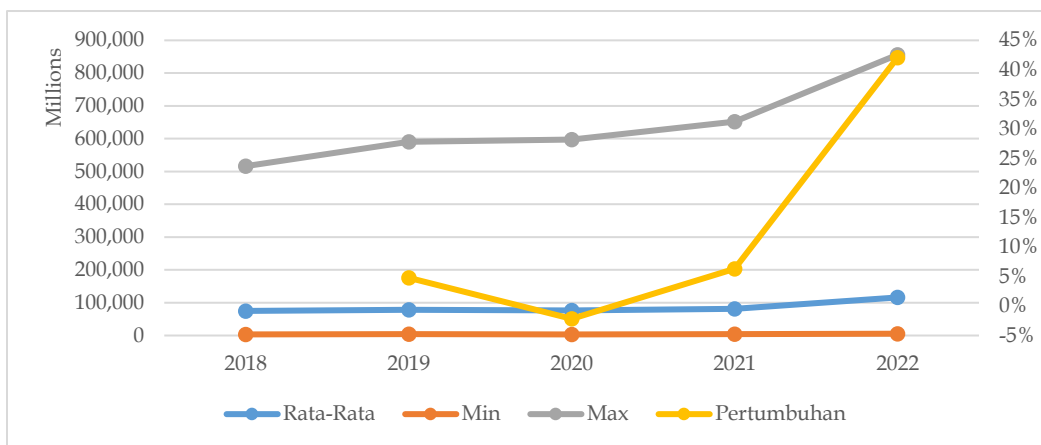
Based on Table 3, the distribution of several variables appears to deviate from normality, suggesting the presence of heterogeneity across firms and years. Consequently, an annual breakdown is provided in the subsequent figures to illustrate year to year variations and to obtain a more refined interpretation of the pattern of changes.



**Figure 1.** Summary of Financial Performance (ROA) of Listed Banking Firms

Return on Assets (ROA) is an indicator used to assess a firm’s ability to generate net income relative to its total assets. Based on Figure 1, the average ROA of banking firms in 2018 was 1.17 percent. This value increased to 1.23 percent in 2019, reflecting a growth of 0.05 percent. The ratio then declined significantly to 0.69 percent in 2020 and further decreased to 0.27 percent in 2021. A recovery occurred in 2022, when the ratio rose to 1.06 percent. According to financial performance theory, a downward trend in ROA generally indicates reduced efficiency and effectiveness in managing assets, which was evident in the banking sector during this period.

The descriptive results also show that the dependent variable ROA has a mean value of 0.88 percent and a standard deviation of 3.32 percent, suggesting substantial variability in profitability among the sample banks. The lowest ROA was recorded by Bank Jago in 2019 at minus 0.1589, when the bank experienced a net loss of IDR 121 billion with total assets amounting to IDR 1,321 billion. The highest ROA was achieved by Bank BTPN Syariah in 2019 at 0.1358, with net income of IDR 1,399 billion and assets totaling IDR 15,282 billion.



**Figure 2.** Summary of Executive Compensation Levels and Growth

The measurement of Executive Compensation follows the approach adopted by Sihono & Munandar (2023), in which total annual compensation received by executives serves as the primary indicator. Figure 2 illustrates the distribution and growth of executive compensation among banking firms from 2018 to 2022. The data reveal considerable variation in compensation structures that reflect each institution's governance practices and financial capacity. The observed fluctuations in executive compensation may also signal changes in incentive alignment, whereby firms adjust compensation schemes in response to profitability trends or evolving regulatory expectations.

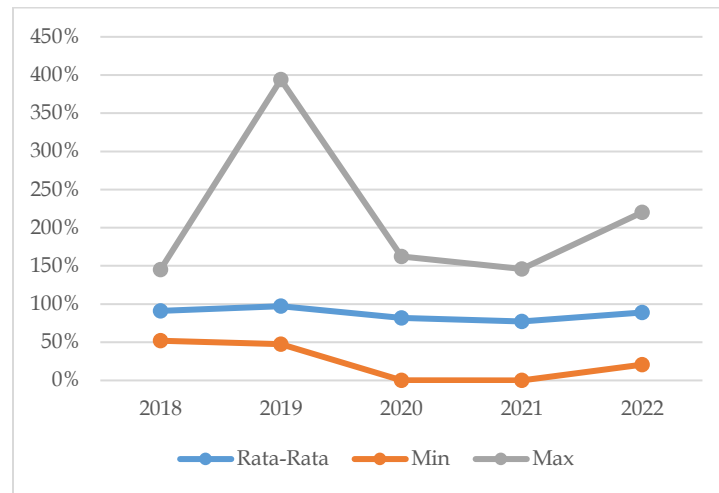
According to Table 3, the Independent Board variable has a mean value of 0.5839 and a standard deviation of 0.13246. Figure 3 shows that the proportion of independent commissioners in banking firms was 59.05 percent in 2018 and slightly decreased to 58.93 percent in 2019. The proportion declined further in 2020 to 55.80 percent, before rising again in 2021 and 2022 to 58.65 percent and 59.02 percent respectively. The decrease in 2020 can be attributed to the increase in the total number of commissioners during that year while the number of independent commissioners declined.

An Independent Board refers to members of the board of commissioners who neither hold ownership in the firm nor maintain any affiliation with management or controlling shareholders. This structure is intended to ensure unbiased oversight and objective decision-making. On average, each company had two to three independent commissioners. Variations in the composition of the Independent Board may also reflect adjustments made in response to governance reforms introduced by regulators or internal restructuring efforts aimed at reinforcing oversight quality.



**Figure 3.** Summary of Independent Commissioners Compared to Total Commissioners

Figure 3 confirms that all banks included in the study maintained at least two independent commissioners during the 2018–2022 period. Notably, PT Bank Rakyat Indonesia (Persero) Tbk had as many as eight independent commissioners in 2022. A reduction in the proportion of independent commissioners may occur either when the number of total commissioners increases, often signifying a stronger presence of representatives from majority shareholders, or when the number of independent commissioners decreases due to resignations, structural changes, or board realignments.



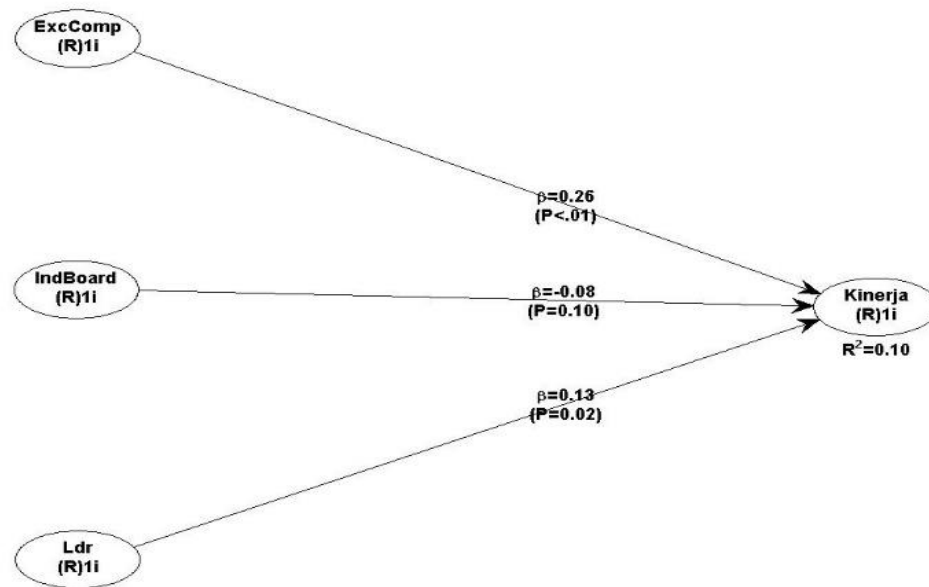
**Figure 4.** Summary of Liquidity (LDR) of Banking Firms

Table 3 shows that the liquidity variable, measured using the Loan-to-Deposit Ratio (LDR), has a mean value of 0.873362 and a standard deviation of 0.3375078. Figure 4 indicates that the average LDR in 2018 was 91.28 percent. The ratio increased to 97.18 percent in 2019, then declined to 92.04 percent in 2020 and further decreased to 77.22 percent in 2021. In 2022, liquidity improved to 88.96 percent. The highest liquidity ratio, 394 percent, was recorded by PT Maybank Finance Tbk in 2019, whereas the lowest liquidity ratio, 0 percent, occurred at PT Bank Aladin Syariah Tbk in 2021.

Liquidity is a critical indicator of a bank’s ability to meet short-term obligations and support lending activities. Higher liquidity ratios typically signal stronger capacity to absorb financial shocks. The pronounced volatility in LDR throughout the observation period suggests that Indonesian banking firms were responding to macroeconomic pressures, including changing credit demand, shifts in saving behavior during the pandemic, and adjustments to risk management practices. This pattern highlights the sector’s sensitivity to external economic conditions and underscores the importance of maintaining prudent liquidity management strategies.

### **Inferential Statistical Analysis of the Research Data**

The empirical examination of the structural relationships among the variables is illustrated in Figure 5 below.



**Figure 5.** Results of the Research Model Testing

Based on the estimation results, the structural equation of this study can be formulated as follows:

$$\text{Performance} = 0.26 \text{ Executive Compensation} - 0.08 \text{ Independent Board} + 0.13 \text{ Liquidity}$$

This structural equation indicates that an increase of one unit in financial performance is associated with an increase of 0.26 units in Executive Compensation, a decrease of 0.08 units in Independent Board, and an increase of 0.13 units in Liquidity. These results imply that improvements in firm performance tend to occur when executive compensation increases, the proportion of independent commissioners becomes smaller, and the level of corporate liquidity rises.

The evaluation of the research model using Partial Least Squares follows the assumption that a hypothesis is accepted when the p value obtained from the direct effect testing is smaller than the predetermined significance threshold. This study applies a significance level of 5%.

## Discussion

### *Influence of Executive Compensation on Financial Performance*

The findings indicate that executive compensation plays a significant role in shaping the financial performance of banking firms. Based on agency theory, individuals are primarily motivated by their own interests, and executives who possess substantial authority within the organization

may exhibit self-serving behavior. Compensation mechanisms serve as an essential governance tool for aligning managerial incentives with shareholder objectives by encouraging greater effort and reducing agency conflicts. Kim & Rasheed (2014) argue that incentives alone are insufficient to mitigate agency issues; effective monitoring mechanisms within good corporate governance structures are also necessary. The results of this study are consistent with prior research, including Chou & Buchdadi (2017), who found a positive relationship between executive compensation and firm performance measured by ROA. Similar findings were reported by Zoghلامي (2021), as well as by Azzam et al., (2025), who also documented a positive association between compensation and firm outcomes.

These findings suggest that appropriate compensation structures may enhance managerial motivation, thereby leading to improved performance indicators, particularly in the banking sector where executive decisions are highly influential. The consistency of the results with previous studies strengthens the argument that compensation contributes to better alignment between managerial actions and shareholder value creation. Furthermore, these results reinforce the strategic importance of designing performance-based compensation schemes that discourage excessive risk-taking while maintaining long-term organizational stability.

### *Influence of Independent Boards on Financial Performance*

Based on the statistical results, the p-value of 0.10 indicates that the relationship between independent boards and financial performance is negative and not statistically significant at the 5 percent error level. This result suggests that Hypothesis 2 is rejected and that the proportion of independent commissioners does not contribute positively to firm performance. Although independent commissioners are expected to strengthen corporate governance by monitoring managerial actions, this study does not support the proposition that their presence enhances financial performance. These findings are aligned with Arsh et al., (2025), who also reported that independent commissioners do not exert a positive influence on firm performance. The arguments of Basyith et al., (2015) similarly suggest that an increase in board size may hinder effective governance, ultimately weakening corporate outcomes.

Despite organizational efforts to strengthen independent oversight, independent commissioners may still face limitations in monitoring effectiveness, particularly in contexts where information asymmetry and agency problems persist. The descriptive findings from 2020 indicate that a decline in the proportion of independent commissioners occurred simultaneously with a decline in financial performance, which may be attributable to the disruptions caused by the COVID-19 pandemic. The nationwide implementation of work-from-home (WFH) policies likely reduced supervisory intensity and operational efficiency, affecting firm performance. This suggests that the effectiveness of independent boards may depend not only on their proportion but also on institutional capacity, communication systems, and crisis conditions, which can moderate their ability to carry out oversight responsibilities.

### *Influence of Liquidity on Financial Performance*

The results demonstrate that liquidity has a positive and significant influence on financial performance, thus supporting Hypothesis 3. A high liquidity ratio reflects the firm's ability to fulfill short-term obligations using its current assets, which indicates sound financial health. Firms with strong liquidity conditions are generally more capable of maintaining smooth operational activities and are more attractive to investors due to lower perceived risk. As liquidity risk decreases, the probability of financial distress declines, resulting in stronger financial performance. This supports Stefvy & Djohan (2023) definition that liquidity measures a firm's capacity to meet short-term financial obligations upon maturity.

The findings of this study align with the results of Paramitha et al., (2018) and Khoza (2025), who reported that liquidity risk significantly affects bank performance, with higher liquidity associated with improved financial outcomes such as ROA. The consistency of these results emphasizes the importance of maintaining adequate liquidity levels in banking institutions, especially given their reliance on continuous operational flows and customer deposit stability. In addition, this relationship highlights the need for banks to implement proactive liquidity management policies to mitigate risk exposure, enhance resilience, and support sustainable financial performance under varying economic conditions.

### **CONCLUSION**

This study concludes that executive compensation and liquidity exert a significant positive influence on the performance of banking firms listed on the Indonesia Stock Exchange. These findings indicate that higher compensation packages for executives, along with strong liquidity positions, tend to enhance financial performance by improving managerial motivation, operational flexibility, and the firm's overall capacity to respond to market conditions. In contrast, the independent board variable demonstrates a negative yet statistically insignificant effect on firm performance, suggesting that the mere presence of independent commissioners does not automatically strengthen governance mechanisms or contribute to improved financial outcomes. This result implies that the effectiveness of independent oversight may depend on broader governance structures, authority distribution, and the actual role played by independent members within the decision-making process.

Despite providing valuable insights, this research still contains several limitations. The study focuses exclusively on banking firms listed on the Indonesia Stock Exchange from 2018 to 2022, which may restrict the generalizability of its findings to other industries or broader economic conditions. Future studies are therefore encouraged to expand the sample to include multiple sectors and apply longer observation periods to capture more dynamic patterns in firm performance. Researchers may also incorporate additional governance mechanisms, risk management indicators, or macroeconomic controls to provide a more comprehensive understanding of how corporate governance structures interact with financial outcomes across different organizational contexts.

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