

CHAPTER I

INTRODUCTION

1.1 Background

The banking sector has an important role in stimulating economic growth in Indonesia. The poor stability of the banking sector can cause the country's economy to experience a multidimensional crisis (Bastomi et al., 2017). The existence of a bank can assist the state in meeting economic needs, such as providing funds to support existing businesses on domestic and other activities impacting economic development. With the important role of the banking sector, it is necessary to maintain or improve the financial performance of banking companies. In maintaining company performance, banks need to minimize risks that may occur, such as by deferring variable remuneration to material risk takers.

Remuneration is a reward given to the board of directors, directors, and other employees for the performance they provide. Based on Financial Services Authority Regulation No. 45/POJK.03/2015, there is a variable remuneration given to bank employees. The remuneration is related to performance and risk of the bank, such as the provision of bonuses. In order to anticipate the risks that may occur in banks, banks are obliged to determine the parties who are material risk takers, as well as defer the payment of variable remuneration to the material risk takers (FSA Regulation No. 45 of 2015 article 22 and article 23). The policy for deferred remuneration to the board of directors, directors, and other bank employees is provided in order to reduce the risk that occurs in the bank. Malus is a method of deferred variable remuneration payment that can be used by banks.

Based on FSA Regulation No. 45 of 2015, malus is a policy that allows banks to defer the payment of deferred variable remuneration. By using malus, banks can defer the variable remuneration payment to parties who are material risk takers. Banks may defer payment of variable remuneration in the amount of a certain percentage to material risk takers (FSA Regulation No. 45 of 2015 article 23). Directors, board of directors, or other employees can be designated as

material risk takers by the bank if they meet certain criteria as contained in FSA Regulation No. 45 of 2015 article 22. The existence of a policy of deferral variable remuneration payments is expected to control the performance of bank employees so that they do not use their power excessively and take risky decisions.

Gillan and Nguyen (2018) state that the company has more control over the holdback because the compensation has not been paid. The bad performance or poses a risk from employees has the possibility to make the compensation received by employees in the company to be deferred. In addition, their research shows that companies use deferred compensation as a contract option if the CEO leaves the company. Executive compensation is paid less by the company if the executive leaves the company without a good reason on a contract basis. Compensation payment that is deferred by using holdback or malus is conducted to reduce the risk, if executives or other employees leave for a bad reason, such as committing fraud. Holdback compensation is given to directors and other employees based on the company's future financial performance, so that poor financial performance can reduce their compensation.

The policy regarding malus is included in the policy regarding remuneration for commercial bank based on Financial Services Authority Regulation in Indonesia. Research such as Chou and Buchdadi (2018) and Harymawan et al. (2020) concluded that compensation has a relationship with performance. The provision of benefits that satisfy executives can improve their performance in carrying out their duties. Thus, the existence of a policy regarding malus has the possibility to affect the performance of a bank. Chou and Buchdadi (2018) conducted study on listed banks in Indonesia capital market. They found that executive compensation has an effect on bank performance, that are non-performing loans (NPL) and return on assets (ROA), and otherwise. The research is also supported by Harymawan et al. (2020), where remuneration has a positive and significant relationship with firm performance in Indonesia that have a remuneration committee. Providing remuneration in accordance with what is

expected by the board of directors, can encourage the board of directors to improve their performance. The application of *malus* in the payment of variable remuneration is carried out so that in improving performance, the directors and other employees still consider the risk in making decisions. Risky decisions will affect the variable remuneration they will receive.

In several studies, the application of *malus* in a company is influenced by corporate governance. Rinaldi (2020) uses banks in Indonesia to see the influence of corporate governance on the possibility of choosing *malus*. The research shows that corporate governance, such as the independent board of directors and the number of board of directors meetings affect the probability of a bank choosing *malus*. The more independent board of directors and the number of board of directors meetings in the bank, the less likely the bank is to choose *malus*. Another researcher, Gillan and Nguyen (2016), use other indicators in corporate governance. They show that the application of *malus* to companies in the S&P 500 is influenced by corporate governance, namely the board of directors tenure. Companies with a lower board of directors tenure are more likely to use *malus*.

Companies that have holdback tend to be companies that have higher CEO replacement costs, companies with greater information asymmetry, companies that have bad experiences such as fraud, lawsuits, or restatements (Gillan and Nguyen, 2018). Deferral in the payment of variable remuneration, namely *malus* or holdback are used by companies in order to reduce the possible risks that occur in their companies. Companies use *malus* or holdback to make directors and other employees do their jobs more responsibly. Moreover, the research shows that the use of *malus* or holdback can be chosen by the companies, because the costs incurred by the companies are not too large. By using *malus*, the companies does not need to pay all the variable remuneration that is deferred at that time. The companies uses deferred variable remuneration payments to reduce the risk if the companies suffers a loss.

The implementation of the policy on *malus* is included in the policy on the implementation of good governance in the provision of remuneration for banks in

Indonesia. Based on FSA Regulation No. 45 of 2015, improving governance in the provision of remuneration is carried out to maintain the continuity of the bank's business, by encouraging prudent decision making. The use of deferral of variable remuneration payments, such as *malus*, is one way for banks to maintain their business continuity. Banks can choose *malus* or clawback on variable remuneration payments to material risk takers. The choice of *malus* in a company or a country is influenced by several factors, including banks in Indonesia. This study uses thirteen performance indicators contained in the bank performance and corporate governance, to see what factors influence the use of *malus* in banks, especially in Regional Development Bank (BPD) in Indonesia. This research is a quantitative research using secondary data, which are the annual reports.

Regional Development Bank (BPD) is one of the sources of income for regional development in Indonesia. By improving or maintaining the performance of BPD, it could have a good impact on finances in developing the economy in the regions. This research was conducted because research on the use of *malus* in bank is still few, and there is no research that specifically uses Regional Development Bank (BPD). In addition, the policy regarding payment of deferred variable remuneration such as *malus* is still relatively new in Indonesia. Because of this, this research will be conducted to determine the factors that influence *malus* at Regional Development Bank (BPD) in Indonesia.

1.2 Problem Statement

The formulation of the problem in this study is what are the factors that influence Regional Development Bank (BPD) in Indonesia in choosing *malus* as deferred variable remuneration payments.

1.3 Research Objective

Based on the formulation of the problem made, the purpose of this study is to determine the factors that influence Regional Development Bank (BPD) in Indonesia in choosing *malus* as deferred variable remuneration payments.

1.4 Research Benefits

This research is expected to be useful for future researchers who study the choice of deferred variable remuneration payments such as *malus* in bank industry. In addition, this research is also expected to provide benefits to Regional Development Bank (BPD) as well as other banks, by providing additional information regarding policies on deferred variable remuneration.

1.5 Writing Systematic

This research consists of five parts of the chapter with systematic writing as follows:

1) Chapter I: Introduction

Explain the background of the research, problem statement, research objective, benefits of the research, and systematic writing.

2) Chapter II: Literature Review

Explain the theoretical basis of the research, the explanation of the topics used, and previous research related to the research topic.

3) Chapter III: Research Method

Explain the methods used in the research, the sources of sample data used, and the techniques used in analyzing the data.

4) Chapter IV: Research Results and Discussion

Explain the description of the research object and provide information about the results of data analysis in research.

5) Chapter V: Conclusions and Suggestions

Contains conclusions of the research, research implications, limitations on the research, and suggestions for future research.

