

# THE IMPACT OF BOARD OF DIRECTORS CHARACTERISTICS ON FINANCIAL PERFORMANCE IN MANUFACTURING COMPANIES ON IDX

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### RESEARCH ARTICLE

#### THE IMPACT OF BOARD OF DIRECTORS CHARACTERISTICS ON FINANCIAL PERFORMANCE IN MANUFACTURING COMPANIES ON IDX

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#### Abstract

This study aims to determine the impact of the demographic characteristics of the director on the company's financial performance. The demographic characteristics used are age of the director, proportion of female directors, educational background of directors, and tenure of directors. This research begins with data collection. Collected data is in the form of secondary data obtained by downloading from the IDX, the downloaded data is the annual report of manufacturing companies 2017-2019 period. After that, the data were analyzed using multiple linear regression. Age of directors, proportion of female directors, educational background of directors, and tenure of directors were measured using proportions. The company's financial performance is measured using return on assets.

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#### Introduction:-

Every company has a goal to maintain its long term survival. Work activities in the companies are required to have performance that can generate optimal profits. For investors, company performance can be seen by measuring financial performance. The company's financial performance is used as a reflection of the company's ability to manage and allocate its own sources of funds. To have optimal financial performance, companies need good corporate governance. The existence of good corporate governance is needed to reduce agency problems that may occur hindering the progress of the company's financial performance. Good corporate governance is a tool / guide that can aim to achieve equality between the power and rights of the company in carrying out activities including the authority held by shareholders in the company (Cadbury Committee in Garbo and Wulandari 2018).

Good corporate governance is needed, but governance scandals still occur, for example the events of the big corporate scandals in the world such as Enron in the United States that raise questions on corporate governance practices. Currently in Indonesia, scandals of corporate governance also still occur. The Minister of Finance, Sri Mulyani Indrawati, said that governance is a weak point in Indonesia's state financial sector. Indonesia's financial sector is currently struck with many problems. From the Jiwasraya case, AJB Bumiputera, the unresolved problems at Bank Muallamat, and the issue of corruption in Asabri. The problems that occur cannot be separated from poor corporate governance (Iconomics, 2020 in [www.cnbcindonesia.com](http://www.cnbcindonesia.com) - Saturday, 18 January 2020, accessed on 08 July 2020).

Minister of Transportation Budi Karya Sumadi explained the reorganization of the board of directors and commissioners of PT. Garuda Indonesia (Persero) Tbk must be done to solve managerial problems. According to

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Budi, Garuda can handle these problems by proving better corporate governance (Andry Novelino, 2020 in [www.cnnindonesia.com](http://www.cnnindonesia.com) - Thursday, 23 January 2020, accessed on 08 July 2020).

These issues indicate that there are agency problems that occur. The agency problem starts with the management of the company which is carried out separately from its ownership. Managers can have more information than principals, because managers have the authority to act on behalf of principals. The existence of this information asymmetry can trigger moral hazard where managers can act opportunistically to benefit themselves and sacrifice the interests of investors (Connelly et al., 2010).

Agency problems can be overcome with a good corporate governance. According to Xu and Xia (2012) in Andriana and Panggabean (2017) the implementation of good corporate governance mechanisms must be supported by good managers. Managers have an important role in leading, making regulations/policies in business operations, directing the company's business, monitoring management performance and making decisions. Wrong decisions and policies can adversely affect the sustainability of a company. The role of a good manager can support good corporate governance for the company in order to generate optimal profits and improve performance.

Arifai et al. (2018) said that the Indonesian state adhere to a two tier system of governance. In a two tier system, there is a clear separation of duties between directors and commissioners. According to Hidayat and Utama (2016), commissioners have two functions, the first one is responsible for monitoring the director on behalf of the investor to avoid conflicts of interest between the principal and the agent. Second commissioners are responsible for enhancing the reputation of the company and providing advice to the director. Meanwhile, the role of the director according to Nugraheni and Khasanah (2018) is to manage the company's operations which are oriented towards the company's interests. The authority to use resources belongs to the board of directors. The director is the key to managing resources in order to improve the company's financial performance.

The composition of the director is part of the company to ensure the implementation of good corporate governance so that the company can improve performance. Upper echelon theory explains that the composition of the director can be adjusted by looking at director demographic characteristics. Upper echelon theory (Hambrick, 2007; Hambrick and Mason, 1984 in Handika and Wibowo, 2018) emphasizes how director demographic characteristics affect the company's financial performance. The different of director demographic characteristics can increase diverse cognitive styles, with the hope of enriching knowledge, wisdom, ideas and of course improving the quality of decision making. Director demographic characteristics are an important factor to determining director behavior in making good corporate governance and influencing company performance.

The first demographic characteristic factor in this study was age of directors. Age is seen as a factor of experience. Getting older implies more experiences, values, skills and perceptions that will increase the ability of directors to make decisions. This decision is a strategy and affects company performance. Ararat, Mine and Cetin (2010). Mojambo, Tulung and Saerang (2020). Darmadi (2011) emphasizes that age of directors has a significant positive impact on the company's financial performance. In contrast to the research of Eulerich, Vete and Van Uum (2014). Horvath and Spirollari (2012) stated that age of directors has a significant negative impact on the company's financial performance. Meanwhile, Van Diepen's research (2015) explains that age of directors has no significant impact on the company's financial performance.

The second factor is proportion of female directors. Female directors on the board of directors also have an impact on behavior. There are differences between men and female in terms of emotional stability, leadership ability, aggressiveness, self-confidence, tenacity, seriousness, social knowledge and objectivity. Research conducted by Liu, Wei and Xie (2014). Cambrea et al. (2017) revealed a significant positive impact on the company's financial performance with a higher ratio of female directors. Research by Jeong and Harrison (2016) also supports this significant positive impact on the company's financial performance. Opstrup and Villadsen (2014) and Egerova (2019) also explains that proportion of female directors can improve financial performance. Meanwhile, research by Dankwano and Hassan (2018) states that the increase in the number of female directors in company has a significant negative impact on financial performance as calculated by the ROA, but has a significant positive impact on ROE. Sawitri, Untoro and Trimohono (2016). Ujunwa (2012) in their research also supports the significant negative impact of female directors on financial performance.

6  
The third factor is educational background of the directors. Educational background is related to the diversity of perspectives on the knowledge and expertise of the board of directors (Fernandez, Rodriquez and Pawlak 2014). According to Akpan and Amran (2014) stated that the highest educational background master's degree owned by members of the board of directors can help make better decisions so as to improve company performance. Ujunwa (2012) found a significant positive impact between directors with a PhD education background on financial performance. Research by Ujunwa is also supported by research conducted by Kim and Song (2016). Cambrea et al. (2017) who found that educational background of directors had a significant positive impact on financial performance. However, Adnan et al. (2016), said that educational background of directors had a significant negative impact on financial performance as measured by ROA and ROE. The research of Fernandez, Rodriquez and Pawlak (2014) also supports the significant negative impact of directors' educational background on financial performance as measured by ROA and ROS. Meanwhile, another study conducted by Bhagat, Bolton and Subramanian (2010) revealed that educational background of directors has no significant impact on financial performance.

The fourth factor is tenure of directors. According to Harrison and Klein (2007), tenure of directors is related to experience, information base and social network ties. The accumulated experience, information base, and social network ties can be considered to represent organizationally relevant knowledge. Differences in tenure are implied in the behavior of members of the board of directors to develop good corporate governance, so that the impact of demographic characteristics will be reflected in the company's financial performance. Fujianti (2018). Merika (2016). Van Ness, Miesing and Jaeyoung (2010) said that tenure of directors has a significant positive impact on the company's financial performance. However, Lu and Peng (2010) revealed that tenure of directors has a negative impact on short-term financial performance, but there is no significant impact on long-term financial performance. Tanikawa and Jung (2018). Muller (2014). Azar, Rad and Botyari (2014) found that tenure of directors has a significant negative impact on financial performance.

4  
Previous studies have shown different results, therefore this study will examine the impact of the age of the directors, the proportion of female directors, the educational background of the directors, and tenure of the directors on the financial performance of manufacturing companies listed on the Indonesia Stock Exchange.

7  
The renewal of this research is to use the upper echelon theory as a theory that supports the grand theory of good corporate governance. Upper echelon theory is used as the basis for selecting members of the board of directors based on demographic characteristics. With the selection of the right directors, it can improve the quality of decision making to create good corporate governance. Good corporate governance can improve company performance.

### Hypothesis Development

Age is seen as experience. The older the age, the more experiences, values, skills, and perceptions that are believed to increase a person's ability to produce better performance. Carter (2003) in Abdullah, and Ismail (2013) argues that the age of directors is important for decision making. Santrock (1995) in Novitasari (2018) reveals that the age group of 34-50 years is the healthiest, calmest, most self-controlled group, and has a sense of responsibility. Tulung and Ramdani (2016) also say that psychologically people aged 40 years are considered to have more experience in thinking and seeing things. It can be concluded from the two studies above, that a good age for directors is between 34 years to 50 years. Darmadi (2011) said that the age of directors has a significant positive impact on financial performance.

H1: The older the directors, the higher company's financial performance.

The female director is able to bring change in a positive direction. Differences in managerial behavior between men and women provide several benefits in decision making that increase management effectiveness and ultimately affect the company's financial performance (Dezso and Ross, 2012). Female directors contribute to diversifying the perspectives available to members of the board of directors because female experience, uniqueness and knowledge are different from men's. Research conducted by Liu, Wie, and Xie (2014). Cambrea et al. (2017). Jeong and Harrison (2016) support a significant positive impact on financial performance.

H2 : The greater the proportion of female directors, the higher company's financial performance.

Dahlin et al. (2005) in Adnan et al. (2016) say educational background can be described as a set of distinct tasks with the relevant skills, knowledge and abilities possessed by members of the board of directors as a function of

their educational background. Following the assumptions of upper echelon theory, educational background is important because of it can be linked to better information and knowledge in a team. Ujunwa research (2012). Kim and Song (2016) and. Cambrea et al. (2017) showed a significant positive impact on financial performance.

H3 : The higher the educational background of directors, the higher the company's financial performance.

Barkena and Shvyrvkov (2007) in Tanikawa and Jung (2018) say that tenure of directors implies different skills and perspectives, indicating that the board of directors has different information, have better performance than boards of directors who serve for shorter periods, directors with longer tenures can help build good relationships with stakeholders to plan and implement long-term strategies that will improve the company's financial performance.

Fujianti (2018). Merika and Triantafyllou (2016). Van Ness, Miesing, and Jaeyoung (2010) said that the tenure of directors has a significant positive impact on company performance.

H4 : The higher tenure of directors, the higher the company's financial performance.

## Method

The data in this study are secondary data collected and taken from annual reports on manufacturing companies listed on the Indonesia Stock Exchange (IDX). Age of directors, proportion of female directors, educational background of directors, and tenure of directors can be seen in the annual report section on directors profile. The population of this study are manufacturing companies listed on the Indonesia Stock Exchange for three years, from 2017 to 2019. The sampling method in this study is purposive sampling with the following criteria

1. The companies studied are manufacturing companies listed on the Indonesia Stock Exchange.
2. Manufacturing companies that have consecutive annual reports for the 2017-2019 period.
3. Manufacturing companies that use rupiah.
4. Manufacturing companies that provide complete information related to research variables.

This study was analyzed using multiple linear regression analysis using Eviews, with the following model :

$$ROA = \alpha + \beta_1 UD + \beta_2 DW + \beta_3 LP + \beta_4 MJ + \varepsilon$$

ROA : Financial Performance  
 $\alpha$  : Constant  
 $\beta$  : Regression coefficient  
 DW : Proportion of female directors  
 UD : Age of directors  
 LP : Educational background of directors  
 MJ : Tenure of directors  
 $\varepsilon$  : error

There are 4 independent variables in this study, age of the directors, proportion of female directors, educational background of the directors, and tenure of directors. Horvath and Spirollari (2012) formulate age by calculating the average age of members of the board of directors. Horvath and Spirollari (2012) measure the proportion of female directors in the company using the formula for the number of female directors divided by total number of directors. Educational background of the board of directors is seen from the formal educational background of the board of directors. This study calculates educational background with reference to Akpan and Amran's (2014) research, using the formula for the number of directors with the latest education  $\geq$  S2 (master's degree) divided by the total number of directors. Fujianti (2018) calculates tenure of director using the ratio of tenure in years with the formula for the number of tenure divided by the total number of directors.

In this study, there is 1 dependent variable, that was financial performance which is an indicator of the company's success while carrying out operational activities for a certain period. Handika and Wibowo (2018) calculate financial performance with the formula net profit divided by total assets.

**Results:-**

This study analyzes the impact of demographic characteristics of the board of directors on financial performance. The data used in this descriptive statistical research are age of directors (UD), proportion of female directors (DW), educational background of directors (LP), tenure of directors (MJ), and financial performance (ROA).

Based on the results of research conducted in the 2017-2019 period, it can be seen in table 2. Age of directors (UD) has a minimum value 41 and a maximum value 67.67. The smaller the age of directors, show that more companies employ more young employees. The average age of the directors in the company is 53,15245 with a standard deviation of 5,062817.

Proportion of female directors (DW) obtained a minimum value 0.00. These results explain that there are companies that do not have female directors. The maximum value generated is 0.56. This indicates that the company has a number of female directors equal to half of the total number of directors in the company. The average value of DW is 0.114 and has a standard deviation of 0.152928 which indicates that the company has a high level of data variability in terms of the proportion of female directors because the standard deviation value is greater than the average value.

Educational background of directors (LP) has a minimum score 0.00 and a maximum value 0.86. The minimum value indicates that there are companies that have directors with the latest education degree below master's degree. However, the maximum value indicates that there are companies that have directors with the latest education degrees of Masters and Doctoral Degrees. The educational background variable of the directors (LP) has an average value of 0.247550 or 25%, this illustrates that the last educational degree of master's and doctoral degrees taken by members of the board of directors is still a minority in manufacturing companies for the period 2017 – 2019. The deviation in this study was 0.233693 or 23%, this indicates that the data of the latest educational background of directors, master's and doctoral degree has a low tendency of variation.

Tenure of directors (MJ) has a minimum value 0. This minimum value indicates that there are companies that change the composition of the old directors with the composition of the new directors. The maximum value generated is 24.20, this shows that there are companies that do not change the composition of the directors. The average value shows 7.495150. This means that manufacturing companies for the 2017-2019 period are more likely not change the position of the old director with new one. The standard deviation shows a value of 6.077469 which means that the data for tenure of the company's directors has a tendency of variation that is almost the same with each other.

Financial performance (ROA) has a minimum value -0.07. This means that the company's lowest ability to generate net loss from total assets is -7%. The ROA maximum value in this study is 0.14 which indicates that the company's highest ability to generate net income from total assets is 14%. ROA average value is 0.042350 indicates that the average company in the manufacturing sector for the 2017-2019 period in obtaining net profit is 42%. In addition, the standard deviation of ROA is 0.040474, which indicates that the sample company ROA data has a low level of variability.

**Table 1:-** Research Variables.

Variable	Equation	Source
Age of directors (UD)	$\frac{\text{total age of directors}}{\text{total number of directors}}$	Horvath dan Spirollari (2012)
Proportion of female directors (DW)	$\frac{\text{number of female directors}}{\text{total number of directors}}$	Horvath dan Spirollari (2012)
Educational background of directors (LP)	$\frac{\text{number of directors with the latest education} \geq S2}{\text{total number of directors}}$	Akpan dan Amran (2014)
Tenure of directors (MJ)	$\frac{\text{total tenure of directors}}{\text{total number of directors}}$	Fujianti (2018)

Financial Performance (ROA)	$\frac{\text{net profit}}{\text{total assets}}$	Handika dan Wibowo (2018)
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**Table 2:-** Descriptive Statistics.

Variable	N	Mean	Std. Dev	Max	Min
UD	200	53,15245	5,062817	67,67000	41,00000
DW	200	0,114000	0,152928	0,560000	0,000000
LP	200	0,247550	0,233693	0,860000	0,000000
MJ	200	7,495150	6,077469	24,20000	0,000000
ROA	200	0,042350	0,040474	0,140000	-0,070000

**Table 3:-** Regression Analysis.

Variable	Coefficient	Sig. t
(constant)	0,085037	0,0097
UD	-0,001041	0,0904
DW	0,034090	0,0670
LP	0,029697	0,0203
MJ	0,000190	0,7137

Notes = significance 0,05

Based on the results of hypothesis analysis in table 3, it can be concluded that the age of directors has no impact on financial performance. Proportion of female directors has no impact on financial performance. Educational background of directors has a significant positive impact on financial performance. Tenure of directors has no impact on financial performance.

### 11 Discussion:-

#### Age of directors and financial performance

Results of hypothesis analysis indicate that the age of directors has no impact on financial performance. This shows that age of directors who are old or young does not cause an increase in financial performance. A person's age is related to openness to ideas of alternative perspectives on various problem solving, but different views can also lead to conflict. Conflicts that occur can make it difficult to carry out a cooperative relationship. The average age of the directors is 53 years with a standard deviation of 5.062817, which means that the members of the directors are dominated by the middle-aged group. This middle-aged person tends not to want to change so that his experience is getting less and less because he is just in the same place. In addition, the age of directors has no impact on financial performance because the research data obtained is only for a period of 3 years, so that many companies have not change the composition on the board. Financial performance changes every year, but the characteristics of age have the same pattern. From this 3-year data, it can also be seen that the experience of directors at the age of early adulthood (18-40 years) is less supportive to improve the financial performance of the current company.

Results of this hypothesis do not confirm the results of research from Ararat, Mine and Cetin (2010). Moimbo, Tulung and Saerang (2020). Darmadi (2011) who said that there was a significant impact of age of directors on the company's financial performance. The results of this hypothesis are also not in line with the research of Eulerich, Vete and Van Uum (2014). Horvath and Spirollari (2012) who say that the age of directors has a significant negative impact on the company's financial performance. However, the results of this study are in line with the research of Van Diepen (2015). Handika and Wibowo (2018). Cambrea et al. (2017). Van Ness, Miesing, and Jaeyoung (2010) who found no impact of age directors on financial performance.

#### Proportion of female directors and financial performance

Results of the research hypothesis in table 3 show that the proportion of female directors has no impact on financial performance. The results of the hypothesis reveal that the number of female directors does not cause an increase in financial performance. The proportion of female directors in the company has an average of 0.114, which means that the position of director is dominated by male directors. The proportion of female directors as a minority causes the positive side of female directors to be less than optimal. female also have a tendency to be more comfortable in the safe zone and try to avoid risk compared to men, so there are fewer female directors compared to male directors (Charness and Gnezzzy, 2004 in Astuti, 2017).

Results of this hypothesis do not confirm the results of research from Liu, Wei and Xie (2014). Cambrea et al. (2017). Jeong and Harrison (2016) who stated that the proportion of female directors had a significant positive impact on financial performance. The results of this study are also not in line with the research of Sawitri, Untoro and Trinugroho (2016). Ujunwa (2012) who said the proportion of female directors had a significant negative impact on financial performance. The results of this study are in line with the findings of Solakoglu and Demir (2016). Shehata, Salhin and El-Helaly (2017).

#### **Educational background of directors and financial performance**

Results of hypothesis analysis in table 3 show that the educational background of directors has a significant positive impact on financial performance. This shows that the educational background of directors plays an important role in increasing financial performance. This is because the knowledge and expertise of directors with a high educational background, has more ability to solve problems and make the best decisions for the company. With superior knowledge and skills, it can provide benefits such as helping companies develop unique processes and products through strategies that are difficult to imitate, being able to search for more complete information resulting in a richer collection of information for strategic decision making. Frey and Detterman (2004) in King, Srivastav and Williams (2016) suggest that directors who graduate from schools that require a high average score to enter the school, show better managerial abilities.

Results of this study are not in line with the research of Adnan et al. (2016). Fernandez, Rodriguez and Pawlak (2014) who found a significant negative impact of directors' educational background on financial performance. The results of this study are also not in line with Bhagat, Bolton and Subramanian (2010) revealing that the educational background of the board of directors has no significant impact on financial performance. However, this study supports the findings found by research by Ujunwa (2012). Kim and Song (2016). Cambrea et al. (2017) which reveals that the educational background of directors has a significant positive impact on the company's financial performance.

#### **Tenure of directors and financial performance**

Results of hypothesis analysis indicate that tenure of directors has no impact on financial performance. This shows that the length of tenure does not cause an increase in financial performance. Tenure of directors with a long term is filled by directors who have an family relationship. The maximum value of tenure of directors is 24 years with an average tenure is 7.49, proving that the appointment of the same director occurs repeatedly. The appointment of the same director may be because the appointed director has an affiliation with the majority shareholder. There is a phenomenon in Indonesia, where giving a director position to someone is not based on competence and professionalism, but as a respect or appreciation, so it can be said that the selection of directors does not make a significant contribution to the progress of the company because it does not have these factors (Sudana and Aristina, 2017). This causes no change in performance. The minimum value for tenure of directors is 0.00, the meaning is there are directors who have just served in the company, these newly appointed directors have not contributed to improving performance. In addition, tenure of directors has no impact on financial performance because the data obtained is only for a period of 3 years, so that many companies have not change the composition on the board. Financial performance changes every year, but the characteristics of tenure have same pattern.

Results of this hypothesis do not confirm the results of research from Fujianti (2018). Merika (2016). Van Ness, Miesing and Jaeyoung (2010) said that the tenure of members of the board of directors has a significant positive impact on the company's financial performance. The results of this study are also not in line with the research of Lu and Peng (2010). Tanikawa and Jung (2018). Muller (2014). Azar, Rad and Botyari (2014) found that the tenure of directors has a significant negative impact on financial performance.

#### **Managerial Implications**

Good corporate governance is needed in agency relations. Good corporate governance serves to assure the capital owners that managers will not commit fraud, steal, embezzle the funds, or invest funds in other projects that are not profitable. Problems that occur can incur costs. These costs are incurred to monitor the managers performance. Good corporate governance mechanisms can reduce the occurrence of opportunistic behavior of managers, provide satisfaction to capital owners, and improve company performance. The composition of managers must be determined, chosen properly to support the creation of good corporate governance. According to the upper echelon theory, the selection of the composition of managers can take in to account with demographic characteristics. Decision making in selecting managers based on appropriate demographic characteristics is expected to meet the



rules of good corporate governance, with good corporate governance, it is hoped that it will create an equal relationship between the relevant shareholders and improve the company's performance.

#### Conclusion:-

Based on hypothesis analysis, it was found that the age of directors, proportion of female directors and the tenure of directors had no effect on financial performance, so the older the directors, the greater the proportion of female directors and the longer tenure of directors in a company had no impact on financial performance. Meanwhile, educational background has a positive impact on financial performance. It can be concluded that the higher the educational background of the directors, the better the financial performance.

The educational background of the board of directors contributes to improving financial performance because the knowledge and expertise of the board of directors with a high educational background has more ability to solve problems, make decisions and have better managerial abilities.

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