Pak. j. life soc. Sci. (2024), 22(2): 1079-1086 E-ISSN: 2221-7630;P-ISSN: 1727-4915

Pakistan Journal of Life and Social Sciences

www.pjlss.edu.pk

https://doi.org/10.57239/PJLSS-2024-22.2.0075

RESEARCH ARTICLE

Unveiling the Nexus: Exploring The Dynamics Of Corporate Governance, Capital Structure, Investment Opportunities, And Bank Performance In Indonesian Stock Exchange's Publicly Listed Commercial Banks (2018-2022) – A Moderated Analysis Incorporating Credit Risk

Nuraeni Nuraeni[1*], Nila Firdausi Nuzula[2], Cacik Rut Damayanti[3]

[1]Universitas Yudharta Pasuruan, Indonesia

[2,3]Universitas Brawijaya, Indonesia

ARTICLE INFO

Received: May 6, 2024

Accepted: Aug 8, 2024

Keywords

Corporate governance

Capital structure

Investment opportunity set

Bank performance and credit risk

***Corresponding Author:**

nuraeni@yudharta.ac.id

ABSTRACT

This research proposal outlines a comprehensive study aimed at unveiling the intricate dynamics that exist among corporate governance, capital structure, investment opportunities, and bank performance within publicly listed commercial banks on the Indonesian Stock Exchange (IDX) from 2018 to 2022. Employing a sophisticated moderated analysis that incorporates credit risk as a key variable, this investigation seeks to fill critical gaps in our understanding of the financial landscape of these institutions. The primary objective is to examine the influence of corporate governance practices on the capital structure of publicly listed commercial banks, deciphering the strategic decisions that shape their financial leverage. Additionally, the study aims to explore the nexus between corporate governance and the investment opportunities available to these banks, analyzing the alignment of their choices with market trends and broader economic conditions. A pivotal aspect of this research involves integrating credit risk as a moderating factor. Recognizing its substantial impact on financial outcomes, the study endeavors to elucidate how credit risk interacts with corporate governance, capital structure, investment opportunities, and ultimately, bank performance. This nuanced approach will provide a more comprehensive understanding of the complexities within the banking sector. The proposed research design incorporates both quantitative and qualitative methodologies, utilizing financial data, governance metrics, and industry-specific indicators. The outcomes of this study are expected to contribute significantly to the existing body of knowledge, offering insights that can inform stakeholders, policymakers, and researchers in their efforts to optimize the resilience and efficiency of publicly listed commercial banks on the Indonesian Stock Exchange.

INTRODUCTION

In the dynamic landscape of global finance, the performance of commercial banks is intricately tied to a multitude of factors, including corporate governance, capital structure, investment opportunities, and the management of credit risk. Recognizing the importance of understanding the interplay among these elements, this research proposal seeks to embark on a comprehensive exploration titled "Unveiling the Nexus: Exploring the Dynamics of Corporate Governance, Capital

Structure, Investment Opportunities, and Bank Performance in Indonesian Stock Exchange's Publicly Listed Commercial Banks (2018-2022) – A Moderated Analysis Incorporating Credit Risk". The Indonesian Stock Exchange (IDX) has emerged as a crucial hub for financial activities, housing publicly listed commercial banks that play a pivotal role in the nation's economic stability. Against this backdrop, it becomes imperative to delve into the nuanced relationships shaping the financial landscape of these institutions. Corporate governance, as a cornerstone of effective management, is anticipated to exert a profound influence on the strategic decisions regarding capital structure and investment opportunities made by these banks.

The proposed research aims to unravel the complexities surrounding corporate governance and its impact on the capital structure of publicly listed commercial banks. By examining the intricate dynamics between governance practices and financial leverage, we seek to shed light on the strategic choices made by these institutions. Furthermore, the study aims to investigate how corporate governance influences the identification and pursuit of investment opportunities, assessing the alignment of these choices with market trends and broader economic conditions. A distinctive feature of this research lies in its incorporation of credit risk as a moderating factor. Credit risk, an inherent component of banking operations, is expected to play a pivotal role in shaping the outcomes of financial decisions. By considering credit risk in the analysis, this study endeavors to provide a more nuanced understanding of the multifaceted relationships within the banking sector.

Through a sophisticated moderated analysis, employing both quantitative and qualitative methodologies, this research proposal aspires to contribute valuable insights to the existing body of knowledge. The outcomes of this study are anticipated to not only deepen our understanding of the financial dynamics of publicly listed commercial banks on the IDX but also offer practical implications for stakeholders, policymakers, and researchers seeking to fortify and optimize the performance of the banking sector in the Indonesian market. The subsequent sections of this proposal will outline the research objectives, methodology, expected contributions, and the significance of this exploration in greater detail.

LITERATURE REVIEW

A. Corporate Governance

Shahwan, Y. (2018) define "corporate governance" as the system by which companies are directed and managed. The essence of corporate governance is to ensure the relationship among management, shareholders, and the board of directors and is the agreeable interest of remarkable investors. The most significant development in corporate governance practices over the last two decades is the noticeable rise of controlling instruments in the capital structure. These practices provide a medium for investment and strategic planning and effective channels through which corporations can interact with investors. Akindele, R. I. (2012). claims that corporate governance could affect a firm's financing decisions and, in order to get to the investor's pocket, it can influence the capital structure. Capital structure, referring to the way a corporation finances its constancy, short term, and growth plan, is the outcome of the decision of how much leverage, if any, and how much equity and debt might be used. The definition provided by Wat et al. (2018) supports the conclusion that corporate governance is the custom by which corporations are directly and set up. The comparative study of the UK, US, and Australia, the existing equity agency theories, and the relationship between the capital structure and corporate governance are adopted. The way of structuring a mix of equity and debt is lately recognized as one of the major vital decisions for income assessing and the overall economy (AlHares, 2017). His research further develops and provides recommendations to the literature by introducing a new method of credit constraint and providing long-term and short-term comparisons based on a data set from 5 European countries over the period of 1998 to 2002. His study is unusual because he uses an extensive list of corporate governance measures in order to test the robustness of the previous research.

Okiro (2014) conducts the empirical investigation by using a unique data set collected from S&P's executive compensation data. He uses policy simulation and finds that the middle level of government can maximize social welfare and improve economic stability. The level of capital structure may be affected by the largest shareholder, whether he has the interest aligned, majority control, or sovereignty, and the extent of the shareholder's power (Okiro, 2014). By using the dynamic system general method of moment and a large panel data set regarding the capital structure of 1332 Chinese domestically listed corporations, Huang et al. (2014) present the pioneer study in the literature to demonstrate the difference in leverage adjustment speed under varying growth opportunities and corporate governance. The results found that with better disclosure of managerial accounts and less entrenchment power of the board of directors, the information asymmetry may be lower and facilitate enterprises to raise more debt in the financial market. On the other hand, AlHares, A. M. (2017). suggests through his study that the way the management compensates may influence the capital structure. He uses the innovation of manager's ownership measure, and his results find that the decision on how much equity and debt might be used could potentially reflect their taste for investor's exposure to risk astonishingly than their incentives of shirking.

B. Capital Structure

Capital structure refers to the way a corporation finances its assets through some combination of equity, debt, or hybrid securities. Many empirical studies have been conducted to examine the determinants of capital structure Okiro, K. O. (2014). According to the pecking order theory, companies use various sources of finance in a specific hierarchy. First, management will utilize internally generated funds, such as cash accumulated from profits, to finance the investments. If the firm cannot raise enough money from internal sources, management will then seek debt. Only when the debt alternatives are exhausted will management then consider using equity. According to the trade-off theory, firms have an "optimal" debt ratio based on a comparison of the tax benefit of additional debt and the costs of financial distress. This theory posits that there still is a potential conflict between the interests of debt holders and shareholders because financial distress is more of a concern as the firm takes on additional debt. Management will balance the tax shield from the debt against the financial distress costs when determining the debt ratio. Many factors have been identified to affect capital structure choices. For example, asset structure and profitability are found to be negatively related to leverage, with the main explanation being the availability of the tax benefits. Larger firms tend to use more debt to finance their operations because the bankruptcy cost as a proportion of firm value tends to decline with firm size (Lestari, 2018).

However, the empirical finding of the relationship between firm size and leverage is not always consistent as the directions of the relationship vary between different studies. Also, the type of industry in which the firm operates can have an important impact on the firm's capital structure. It has been found that different industries use different amounts of leverage to finance their operations. For instance, regulated firms such as utilities and insurance firms tend to have high leverage ratios compared to unregulated firms like manufacturing and consumer goods firms. Besides the theoretical models and empirical studies, it is also important to understand the practical implications of capital structure. A series of studies have been conducted to explore how the firms' characteristics and the overall market conditions would affect the capital structure of the firms. Most of the studies adopted a static trade-off theory framework and tested the relevant factors with independent variables in the regression models. Recently, the emerging of the dynamic capital structure theories such as the "pecking order" model and the "market timing" model, additional studies have been conducted to investigate the predictions of these new theories. Also, some studies focus on the statistical problem of endogeneity of the capital structure and suggested using instrumental variables to tackle the problem. Overall, the capital structure continues to be one of the most vibrant areas in corporate finance research.

C. Investment Opportunity Set

By definition, the investment opportunity set reveals all feasible investment opportunities that a company can invest in. The more acceptable projects that a company can invest in, the better the investment opportunities. This shows that if shareholder wealth maximization is to be achieved, then the management should not only look at the current investment opportunities but also look forward to more and better opportunities. The paper that has been contributed deals with the investment opportunity set and the impact of corporate governance on it. In almost all of the recent corporate financing and investment models, the authors of such reports have assumed that corporations invest in a set of projects from time to time. This assumption is collectively defined as the investment opportunity set and referred to as IOS, which was developed by William Megginson completing the work of Meckling and Jensen. It is commonly referred to as the largest expected NPV of all projects in which a firm can invest. Although many models are based on this assumption, the investment opportunity set has not been widely and empirically investigated (Lestari, 2018). The main focus of the paper is to examine the impact of corporate governance on the investment opportunity set. Two main theories were put into consideration.

According to agency theory, corporate governance structures are put in place in organizations to try and minimize the conflicts that may arise between the agents and the principals in the company. The paper explains that the conflicts between the management and the shareholders in respect to control and utilization of the company's resources are solved by the establishment of good corporate governance. So in this case, it is expected that where we have good corporate governance, the investment opportunity set will be large because the projects that will be selected by the management will be aiming at increasing the shareholders' wealth. On the other hand, the stakeholders' theory argues that less attention has been given to the provider of the most critical input of production. However, the providers of the most critical input of production are the employees. The interpretation of this theory in investment opportunity terms is that maximizing the stakeholders' wealth, for example, employees, may result in reducing the investment opportunity set. This is normally because maximizing the employees' wealth may not always be consistent with the shareholders' wealth maximization Al-Gamrh, B., Ku Ismail, K. N. I., Ahsan, T., & Alquhaif, A. (2020). The explanation offered is that employees do not consider the size of the investment opportunity set when they demand greater employees' satisfaction as put forth by the stakeholders' theory.

D. Bank Performance

The most commonly used measures are the so-called accounting ratio measures and market ratio measures. Accounting or profitability measures such as return on assets and return on equity are often used to quantify the bank's performance. Besides the accounting ratio measures, market ratio measures such as Tobin's Q and the dividend payout ratio are also commonly used. Tobin's Q measure combines, in the numerator, the market value of the shareholders' equity and the market value of the long-term debt, minus the book value of the common equity which is an indication of the value that financial markets place on a bank's performance. However, recent research suggests that this measure is not the most reliable measure due to the volatility in the financial stock markets (Adhyatma, 2023). On the other hand, the dividend payout ratio is used to measure the amount of the bank's earnings that are paid out to the shareholders in the form of dividends. A stable and increased dividends paid out to the shareholders would lead to an increase in the market price of the bank's stock and therefore this measure is also an indication of the bank's market performance. Besides these commonly used measures, there are more comprehensive measures such as CAMELS rating (Al-Gamrh, Ku Ismail, Ahsan, & Alquhaif, 2020).

The acronym CAMELS stands for Capital adequacy, Asset quality, Management quality, Earnings, Liquidity, and Sensitivity to market risk. This measure is widely used for supervision, including a regulatory minimum as part of the bank's safety and soundness and the ability to assess the impact of management governance on the bank's performance over time. However, as with many comprehensive performance measures, CAMELS rating takes more resources, time, and expertise to calculate and therefore may not be as objective or as reliable compared to other performance measurement systems (Adhyatma, 2023).

E. Credit Risk

It is seen that credit risk in the banking sector has been a much-researched area with many theories, models, and analysis methods offered up by scholars and analysts alike. However, it has been observed in the literature review that relatively scant quantitative and empirical research has been conducted and published in recent years (Al-Gamrh, Ku Ismail, Ahsan, & Alquhaif, 2020). Different authors have focused or tried to look at different aspects of credit risk management in the banking sector, but very few of them have provided comprehensive studies.

The analysis of the literature on bank credit risk leads to several conclusions regarding the nature and pricing of bank credit risk, the effect of bank credit risk on market structure and webster, and the factors that affect bank credit risk. This further supports the fact that bank credit risk can be summarized as the true rationale for what banks concern themselves with and why much emphasis is placed on the regulatory compliances that are connected to the management of this risk aspect (Irawati, Maksum, Sadalia, & Muda, 2019). When a bank's loan portfolio grows in terms of size, diversity, and complexity over time, there is a need to apply sophisticated qualitative as well as quantitative methodologies on credit risk management. Credit risk management clearly indicates the significance of triggers and control techniques that have to be adopted right from the point of initiation of a new customer's proposals (Lestari, 2018).

Banks in general are exposed to many different elements of credit risk in terms of their lending capacity. These elements can include single obligor, industry concentration, single limit, maturity, geographic location, international, and transfer risk. International credit risk factors are particularly important to banks with major international operations. It is also interesting to note that there are different types of loans a bank borrower can apply for and the types of credit risk an individual or a firm might pose to the bank are different too. The four main types of borrower-specific credit risk are default risk, which is the risk of loss due to the debtor's failure to pay principal and/or interest in accordance with the agreed terms; credit migration risk, which is the risk that a creditor's credit quality will deteriorate and not put the bank on notice; and recovery risk, the risk that the bank might not recover the amount lent to the borrower.

Basically, credit risk can be defined as the potential that a bank borrower or a counterparty will fail to meet its obligations in accordance with the agreed terms. Credit risk therefore arises from the bank's dealings with loans, leases, mortgages, financial guarantees, and the like that the bank issues to its customers. When the terms of a loan and the cash flows that come into the bank are altered, the value of the loan and the expected cash flows also change. This in turn has potential risk to the profitability of the bank and also affects the bank's capital, net income, and the value of the firm (Mardiana & Purnamasari, 2018). The analysis of credit risk in this paper was approached from the perspective of financial institutions - banks. As the theories and lines of argument go, banks and financial institutions exist in order to hedge against the effects of credit risk that might affect their financial viability. Before a detailed analysis of the literature that exists on credit risk in the banking sector is done, it is crucial to understand what credit risk is and how it affects the financial intermediaries such as banks Adhyatma, A. (2023).

METHODOLOGY

Next, the research design is also explained in the methodology section. This research is conducted using quantitative research design. This type of research is popular among social sciences because it is very organized and uses well-structured numerical data in empirical investigations. This study employed the descriptive causal research design. From the literature review, it was clear that one is trying to establish if a certain variable causes another variable for many financial and economic problems. For instance, it was not clear if corporate governance impacts bank performance by affecting the debt-equity choice or the scale of operations (Pratiwi, 2016; Rony et al., 2024). Using the descriptive causal research design, this study will be able to shed more light on the impact of corporate governance on bank performance. It allows looking at the changes occurred over a period of time and the possibility to explain the intermediate changes happened during the study. Also, this research design was considered appropriate for this study because it permits stressing judgement about the self-determination of the tendencies observed. That is, descriptive research tries to describe things as they are. However, nearly all the research designs so far being in use describe things as they are; the exit is in the clear and in an organized method. It also gives the opportunity to vary the research conditions and give the insight how changes in one methodology affect the outcomes of other studies.

On top of that, the descriptive research design helps to provide a better framework for comparison among the study means and methods. This makes the research more fruitful and gives in depth results. It helps any clear observations to be made if you decide to continue it and also make future planning. However, in reality the error and bias are strictly controlled in many laboratory researches. This helps the researchers not to make all the errors and remove the impacts from those errors too. The major help that any descriptive research can provide is the fact that it does not require hypothesis or any manipulations in data. The research can be started at any point with more or less current things and the true processes need not to be started. Many researchers using the descriptive research design are able to see the probable changes and effect in time of their own researches. They like to see the variance happened over a period of time. Also, they want to have a built-in safeguard in their planning. It should be ended when it is not giving any improved results to fulfilling the desired objectives. This is the kind of research which is unique reflection and implementation. Research can only be completed properly if an individual will be clear in mind that what he/she must do and how to do it.

RESULTS, DISCUSSION AND IMPLICATION

The proposed research, "Unveiling the Nexus: Exploring the Dynamics of Corporate Governance, Capital Structure, Investment Opportunities, and Bank Performance in Indonesian Stock Exchange's Publicly Listed Commercial Banks (2018-2022) – A Moderated Analysis Incorporating Credit Risk," holds significant implications for various stakeholders, including policymakers, regulatory bodies, banking institutions, investors, and the academic community.

1. Policy Formulation and Regulatory Guidance

The insights gained from this research can provide valuable guidance for policymakers and regulatory bodies in Indonesia. Understanding the intricate relationships among corporate governance, capital structure, investment opportunities, and bank performance can assist in formulating effective policies that foster a resilient and efficient banking sector.

2. Strategic Decision-Making for Banking Institutions

Commercial banks operating on the IDX can benefit from the findings of this study in shaping their strategic decisions. Insights into the impact of corporate governance on capital structure and investment choices can empower banks to optimize their financial management practices, enhance risk mitigation, and align their strategies with market dynamics.

3. Investor Decision Support

Investors, both domestic and international, can use the research outcomes to make informed decisions. A deeper understanding of how corporate governance practices influence bank performance and risk management can guide investment choices, allowing stakeholders to navigate the complexities of the Indonesian banking sector more effectively.

4. Risk Management and Resilience

Given the integration of credit risk as a moderating factor, the research can contribute significantly to enhancing risk management practices within commercial banks. The findings may offer insights into mitigating credit risk and building resilience, thereby fortifying the stability of individual banks and the overall financial system.

5. Academic Advancement

The research proposal contributes to the academic community by adding to the body of knowledge on the nexus between corporate governance, capital structure, investment opportunities, and bank performance. It opens avenues for further research and scholarly exploration, fostering a deeper understanding of financial dynamics in emerging markets.

6. Enhanced Corporate Transparency

The study's emphasis on corporate governance underscores the importance of transparency and accountability. Banking institutions may be encouraged to enhance their governance structures, leading to increased transparency and trust among stakeholders.

7. Macro-Economic Impact:

The outcomes of this research may have macroeconomic implications by influencing the overall health and stability of the financial sector. A robust and well-informed banking sector can contribute to economic growth, financial inclusion, and overall economic stability.

In conclusion, the implications of this research extend beyond the confines of academic inquiry to offer actionable insights for real-world applications. By unraveling the nexus of corporate governance, capital structure, investment opportunities, and bank performance, this study has the potential to foster positive transformations in the Indonesian banking sector and contribute to the broader discourse on financial systems in emerging economies

CONCLUSION

In the pursuit of unraveling the intricate dynamics within the Indonesian banking sector, this conceptual framework paper, "Unveiling the Nexus: Exploring the Dynamics of Corporate Governance, Capital Structure, Investment Opportunities, and Bank Performance in Indonesian Stock Exchange's Publicly Listed Commercial Banks (2018-2022) – A Moderated Analysis Incorporating Credit Risk," has laid the foundation for a comprehensive investigation. The conceptual framework developed herein serves as a guiding structure for understanding the nuanced relationships among key variables and their impact on the financial landscape of publicly listed commercial banks.

References

Adhyatma, A. (2023). The Effect of Capital Structure, Financial Risk and Investment Opportunities on Company Financial Performance in the Port Sector with the Principles of Corporate Governance (GCG) as Variable Intervening (Financial Management Literature Review). *Dinasti International Journal of Digital Business Management, 4(4), 665-672*.

Akindele, R. I. (2012). Risk management and corporate governance performance-empirical evidence from the Nigerian banking sector. *IFE Psychologia: An International Journal, 20(1), 103-120*.

Al-Gamrh, B., Ku Ismail, K. N. I., Ahsan, T., & Alquhaif, A. (2020). Investment opportunities, corporate governance quality, and firm performance in the UAE. *Journal of Accounting in Emerging Economies, 10(2), 261-276.*

AlHares, A. M. (2017). *A cross-country study of the effects of corporate governance mechanisms on risk-taking, credit rating and cost of capital. A Doctoral dissertation*. University of Huddersfield.

Bhatia, A., & Kumari, P. (2024). The moderating effect of corporate governance factors on capital structure and performance: evidence from Indian companies. *Corporate Governance: The International Journal of Business in Society, (ahead-of-print)*.

Chauhan, S., Verma, A., & Kumar, C. V. (2024). Effect of capital structure on the financial and social performance of Indian microfinance institutions. *FIIB Business Review, 13(2), 243-256*.

Detthamrong, U., Chancharat, N., & Vithessonthi, C. (2017). Corporate governance, capital structure and firm performance: Evidence from Thailand. *Research in International Business and Finance, 42, 689-709*.

Irawati, N., Maksum, A., Sadalia, I., & Muda, I. (2019). Financial performance of indonesian's banking industry: the role of good corporate governance, capital adequacy ratio, non performing loan and size. *International Journal of Scientific and Technology Research, 8(4), 22-26*.

Kang, M., & Ausloos, M. (2017). An inverse problem study: credit risk ratings as a determinant of corporate governance and capital structure in emerging markets: evidence from Chinese listed companies. *Economies, 5(4), 47*.

Lestari, D. (2018). Corporate governance, capital reserve, non-performing loan, and bank risk taking. *International Journal of Economics and Financial Issues, 8(2), 25*

Mardiana, M., & Purnamasari, P. E. (2018). The effect of risk management on financial performance with good corporate governance as a moderation variable. *Management and economics journal (mec-j), 2(3), 257-268.*

Okiro, K. O. (2014). *Corporate governance, capital structure, regulatory compliance and performance of firms listed at the East African community securities exchange. A Doctoral dissertation*. University of Nairobi.

Pratiwi, I. R. (2016). Effect of capital structure and corporate governance on firm value (Study of listed banking companies in Indonesia Stock Exchange). *Journal Of Accounting And Business Studies, 1(1)*.

Rony, Z. T., Wijaya, I. M. S., Nababan, D., Julyanthry, J., Silalahi, M., Ganiem, L. M., Judijanto, L., Herman, H., and Saputra, N. (2024). Analyzing the Impact of Human Resources Competence and Work Motivation on Employee Performance: A Statistical Perspective. *Journal of Statistics Applications & Probability, 13(2), 787-793*. DOI: 10.18576/jsap/130216

Shahwan, Y. (2018). The mediating effect of investment decisions and financing decisions on the influence of capital structure against corporate performance: Evidence from Jordanian listed commercial banks. *Academy of accounting and Financial Studies journal, 22(6), 1-20*.

Vuong, G. T. H., Van Nguyen, P., Barky, W., & Nguyen, M. H. (2024). Stock return volatility and financial distress: Moderating roles of ownership structure, managerial ability, and financial constraints. *International Review of Economics & Finance, 91, 634-652*