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# Good Corporate Governance, Compliance, and Financial Performance: Risk Management as a Mediating Variable

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**Abstract**

This study aims to determine, test and analyze the effect of Corporate Governance (number of directors and number of commissioners), level of compliance (NPL correction) and risk management (NPL) on financial performance (ROA), and examine the role of risk management (NPL) as a mediating variable in the relationship between Corporate Governance and level of compliance on financial performance at BPR BKK in Central Java Province during the period 2019 - 2023. This study uses multiple regression analysis methods and Sobel tests, with 34 BPR BKK research objects and 33 BPR BKK samples. The results of the study show that simultaneously, the number of directors, the number of commissioners, the level of compliance and risk management have a significant effect on financial performance. Partially, only the number of directors and the number of commissioners have a significant positive effect on financial performance, while risk management (NPL) has a significant negative effect. Furthermore, simultaneously the number of directors, the number of commissioners and the level of compliance also have a significant effect on risk management (NPL), but partially only the number of directors has a significant negative effect. Meanwhile, risk management (NPL) is unable to mediate the influence of the number of directors, number of commissioners and level of compliance on financial performance.

## 1. Introduction

Performance is a barometerkey in evaluating the success of an entity, especially in the banking sector which has a central role in the economy. Accurate and comprehensive performance measurement is the foundation for management to assess operational effectiveness, resource utilization efficiency, and achievement of strategic goals

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(Kartikasari & Wahyuati, 2014). Valid performance information is not only the basis for identifying areas of improvement and implementing more appropriate strategies, but also a crucial reference in future profit planning and evaluating management performance (Indonesian Accounting Association, 1995).

The context of Rural Credit Banks (BPR) in Indonesia, especially BPR BKK in Central Java Province, is interesting to study further considering the dynamics of increasingly stringent regulations and cases of BPR closures that are still occurring (see Table 1.). Weak governance and risk management are identified as one of the main factors causing the closure (Financial Services Authority). The decline in BPR BKK's financial performance in recent years, reflected in the decline in ROA and the increase in NPL, further strengthens the urgency of this research.

Bank performance evaluation can be done through in-depth analysis of financial reports. Financial ratios such as Return on Assets (ROA), Return on Equity (ROE), Net Profit Margin (NPM), Debt to Equity Ratio (DER), and other liquidity ratios provide a quantitative perspective on the bank's ability to generate profits, manage assets, and control risks (Winarno, 2019; Kusumo, 2018). ROA, in particular, is often used as a measure of a bank's efficiency in generating profits from total assets owned (Sofyan, 2003).

Various studies have identified factors that influence bank financial performance. In addition to internal financial ratios such as Capital Adequacy Ratio (CAR), Operating Expenses to Operating Income (BOPO), Non-Performing Loans (NPL), Net Interest Margin (NIM), and Loan to Deposit Ratio (LDR) (Pinasti & Mustikawati, 2018; Roosdiana, 2022; Gianni et al., 2020; Nasution et al., 2022), non-financial factors also play a significant role.

Non-financial factors that have been studied include ownership structure (Sabrina & Muharam, 2015), Corporate Social Responsibility practices (Saadouni & Salah, 2022), adoption of financial technology (Kristianti & Tulenan, 2021), implementation of Sustainable Development Goals (Iqbal & Nosheen, 2023), quality of intellectual capital (Islamadina et al., 2021), and bank size (Allen & Liu, 2007; Gandhi & Lustig, 2015; Rhoades, 1998). These studies enrich the understanding of the complexity of banking performance determinants.

Studies examining the impact of the number of directors on financial success have yielded inconclusive findings. Some studies suggest that an ideal number of directors can improve performance by facilitating faster and more concentrated decision-making (Martinez, 2020), while others show no significant relationship or even a negative relationship if the number of directors is too large and causes coordination inefficiencies (Rahayu & Utiyati, 2018).

Similarly, research on the effect of the number of commissioners on financial performance also produces mixed findings. Widagdo and Chariri (2014) identified a substantial positive correlation between board size and firm performance, indicating that increased oversight can improve accountability and performance. Putri and Muid (2017) found that the frequency of board meetings, not its size, significantly positively affected performance, but board size had no effect in their study.

The effect of compliance on financial performance is also a focus of research. High levels of compliance are often associated with better financial performance because they reduce operational and legal risks (Sari & Basukianto, 2022). Compliant banks often have a good reputation among regulators and the public, thereby increasing consumer and investor confidence (Zulfikar et al., 2020). However, some studies may not find a significant relationship or even find that excessive compliance costs can depress profitability in the short term (Sudana et al., 2022).

The discrepancies in research results regarding the influence of the number of directors, the number of commissioners, and compliance on financial performance

indicate a research gap that needs to be addressed. Variations in research context, methodology used, and specific characteristics of the banking industry in different countries or regions may be the cause of these differences in findings. Therefore, further research in the specific context of Rural Credit Banks (BPR) in Indonesia, taking into account the dynamics of regulation and operational characteristics, is relevant.

The importance of including risk management as a mediating variable is based on the idea that good implementation of Good Corporate Governance and high levels of compliance do not automatically guarantee optimal financial performance if not accompanied by effective risk management practices (Rahayu & Utiyati, 2018; I. Permatasari & Novitasary, 2014). Risk management can be a transmission mechanism where good governance and strong compliance translate into more prudent risk management, which ultimately has a positive impact on financial performance (Paulina et al., 2020; Setiawaty, 2016).

This study aims to empirically test the effect of the number of directors, the number of commissioners, and compliance on the financial performance of BPR BKK in Central Java Province, and to examine the mediating effect of risk management in the relationship. The results of this study are expected to provide theoretical and practical contributions to BPR management, regulators, and other stakeholders in an effort to improve the performance and stability of the BPR sector in Indonesia.

## 2. Methods

This study uses a quantitative design with a causal associative methodology. This associative design aims to test the correlation between research variables, namely the number of directors, the number of commissioners, the level of compliance (NPL correction), and risk management (NPL) in relation to financial performance (ROA). The causal approach analyzes the impact of one or more independent variables on the dependent variable and tests the role of the mediating variable (NPL) in the relationship between the independent variables (number of directors, number of commissioners, level of compliance) and the dependent variable (ROA).

This research is included in the type of explanatory research. Explanatory research aims to explain the relationship between variables and test hypotheses that have been formulated based on theoretical studies and previous research. Through quantitative data analysis, this study will attempt to explain the direct influence of the number of directors, the number of commissioners, and the level of compliance on financial performance and risk management, as well as the mediating role of risk management in the relationship at BPR BKK during the period 2019-2023. To test the research hypothesis, several regression models were developed.

## 3. Results and Discussion

### *Test Results*

*1. Model Testing 1*

Hypothesis testing is performed at a significance threshold of 0.05. If the significance value of the variable related to the hypothesis exceeds the established significance level, it can be concluded that the variable does not have a significant effect on the dependent variable. Likewise, if the p-value of the variable being studied is less than the established significance level, then the variable has a significant effect on the dependent variable.

From the results of data processing, the regression coefficients of the first equation are obtained as listed in table 4.6 below, so that the regression equation can be compiled as follows:

**ROA = 1.604 + 0.510 X1 + 0.300 X2 - 0.042 X3 - 0.051 X4 + e**

*Table 1.*
*Multiple Linear Regression Model 1*

| | Model | UnStd Coefficient | Std Error | Std Coefficient | t | Sign | Conclusion |
|---|---|---|---|---|---|---|---|
| | Constant | 1,604 | 0.367 | | | | |
| H1 | Number of Directors | 0.510 | 0.131 | 0.307 | 3,901 | 0,000 | Accepted |
| H2 | Number of Commissioners | 0.300 | 0.139 | 0.180 | 2,156 | 0.033 | Accepted |
| H3 | NPL | -0.042 | 0.014 | -0.217 | -3,046 | 0.003 | Accepted |
| H4 | Compliance (NPL Correction) | -0.051 | 0.078 | -0.044 | -0.654 | 0.514 | Rejected |

*Dependent Variable: ROA*
*Source: Processed secondary data*

Based on the table of hypothesis test results, it shows that the effect of the number of directors on financial performance produces a positive coefficient value (standardized coefficient) of 0.307 with a significance value of 0.000 or less than 0.05. This shows that the number of directors has a significant effect on financial performance (ROA).

The effect of the number of commissioners on financial performance produces a positive coefficient value (standardized coefficient) of 0.180 with a significance value of 0.033 or less than 0.05. This shows that the number of commissioners has an effect on company performance (ROA). The effect of NPL on financial performance produces a negative coefficient value (standardized coefficient) of 0.217 with a significance value of 0.003 or less than 0.05. This shows that NPL has a negative effect on financial performance (ROA).

The effect of Compliance (NPL Correction) on financial performance produces a negative coefficient value (standardized coefficient) of 0.044 with a significance value of 0.514 or greater than 0.05. This shows that compliance (NPL correction) has no effect on financial performance (ROA). Meanwhile, the coefficient of determination (R2) of the test results is 0.282 or 28.2%, then the number of directors, number of commissioners, NPL and compliance (NPL correction) affect performance (ROA) by 28.2% while the remaining 71.8% is explained by other variables outside the model. The test results are as follows:

*Table 2.*
*Coefficient of Determination*

| R | R Square | Adjusted R Square | Std. Error of the estimate |
|---|---|---|---|
| 0.547 | 0.299 | 0.282 | 1,15082 |

*Source: Processed secondary data*

This result is also supported by the F test which shows the result is statistically significant with a value of 0.000. This means that the proportion of the total financial

performance variables (ROA) can be significantly explained by the dependent variable in the regression model used. Thus it can be concluded that the number of directors, the number of commissioners, risk management (NPL) and the level of compliance (NPL correction) together affect financial performance (ROA).

*Table 3.*
*F Test*

| Model | Sum of Square | df | Mean square | F | Sign |
|---|---|---|---|---|---|
| Regression | 90,507 | 4 | 22,627 | 17,085 | 0,000 |
| Residual | 211,901 | 160 | 1,324 | | |

*Dependent Variable: ROA*
*Predictor: Constant, Compliance, NPL, Directors, Commissioners*
*Source: Processed secondary data.*

Based on the explanation above, it shows that the number of directors, number of commissioners, risk management (NPL) and level of compliance (NPL correction) together affect financial performance (ROA).

*2. Model 2 Testing*

From the results of data processing, the regression coefficients of the second equation are obtained as listed in table 4.9 below, so that the regression equation can be compiled as follows:

**ROA = 16,159 01,650 X1 - 1,960 X2 + 0.038 X3 + e**

*Table 4.*
*Multiple Linear Regression Model 2*

| | Model | UnStd Coefficient | Std Error | Std Coefficient | t | Sign | Conclusion |
|---|---|---|---|---|---|---|---|
| | Constant | 16,159 | 1,563 | | | | |
| H5 | Number of Directors | -1,650 | 0.695 | -0.190 | -2,375 | 0.019 | Rejected |
| H6 | Number of Commissioners | -1,960 | 1,888 | -0.083 | -1,038 | 0.301 | Rejected |
| H7 | NPL | 0.038 | 0.467 | 0.006 | 0.081 | 0.936 | Rejected |

*Dependent variable: Risk Management (NPL)*
*Source: Processed secondary data*

Based on the table of hypothesis test results, it shows that the effect of the number of directors on risk management (NPL) produces a negative coefficient value (standardized coefficient) of 0.019 with a significance value of 0.019 or less than 0.05. This shows that the number of directors has a significant negative effect on risk management (NPL).

The effect of the number of commissioners on risk management (NPL) produces a negative coefficient value (standardized coefficient) of 0.083 with a significance value of 0.301 or greater than 0.05. This shows that the number of commissioners does not have a significant effect on risk management (NPL).

The effect of compliance level (NPL correction) on risk management (NPL) produces a positive coefficient value (standardized coefficient) of 0.006 with a significance value of 0.936 or greater than 0.05. This shows that the level of compliance (NPL correction) does not have a significant effect on risk management (NPL). Meanwhile, the determination coefficient (R2) is 0.034 or 3.4%, so the number of directors, number of commissioners and level of compliance (NPL correction) affect risk management (NPL) by only 3.4% while the remaining 96.6% is explained by other variables outside the model as shown in the following test results:

*Table 5.*
*Coefficient of Determination*

| R | R Square | Adjusted R Square | Std. Error of the estimate |
|---|---|---|---|
| 0.227 | 0.052 | 0.034 | 6,95552 |

*Source: Processed secondary data*

The F test confirms this, producing a statistically significant result of 0.036, indicating that the dependent variable in the regression model covers part of the total risk management variables (NPL). As a result, it can be concluded that the number of directors, the number of commissioners, and the level of compliance (NPL correction) collectively do not affect risk management (NPL). The results of the F test analysis are as follows.

*Table 6.*
*F Test*

| Model | Sum of Square | df | Mean square | F | Sign |
|---|---|---|---|---|---|
| Regression | 424,627 | 3 | 141,542 | 2,926 | 0.036 |
| Residual | 7789,065 | 161 | 48,379 | | |

*Dependent Variable: NPL*
*Predictor: Constant, Compliance, Directors, Commissioners*

*Table 7.*
*Sobel Test Results*

| No | Hypothesis | Sat | t | Conclusion |
|---|---|---|---|---|
| H8 | The number of directors influences financial performance (ROA) through management risk(NPL). | 0.028 | 0.041 | Rejected |
| H9 | Number of commissioners influential on financial performance (ROA) through Risk Management (NPL). | 0.030 | 0.600 | Rejected |
| H10 | The level of compliance (NPL correction) affects financial performance (ROA). | 0.141 | 0.000 09 | Rejected |

***a. Number of Directors Affects Financial Performance (ROA) Through Management Risk** (NPL)*

The results of the sobel test calculation on path analysis obtained a t-count value of 0.041 while the t table was 1.701. Thus, the t-count value is smaller than the t table (0.041 <1.701). It is concluded that risk management (NPL) cannot mediate the effect of the number of Directors on financial performance (ROA).

***b. Number of commissionersInfluentialOn Financial Performance (ROA) ThroughManagementRisk** (NPL)*

The results of the sobel test calculation on path analysis obtained a t-count value of 0.600 while the t table was 1.701. Thus, the t-count value is smaller than the t table (0.600 <1.701). It is concluded that risk management (NPL) cannot mediate the effect of the number of commissioners on financial performance (ROA).

c. ***Compliance Level (NPL Correction) Affects Financial Performance*** *(ROA)*
The results of the sobel test calculation on path analysis obtained a t-count value of 0.063 while the t table was 1.701. Thus, the t-count value is smaller than the t table (0.00009 <1.701). It is concluded that risk management (NPL) cannot mediate the effect of compliance level (NPL correction) on financial performance (ROA).

## 4. Discussion

### *The Influence of the Number of Directors on Financial Performance (ROA)*

This study examines the effect of the number of directors on the financial performance (ROA) of Rural Banks (BPR). The main findings indicate that there is a significant positive effect between the number of directors and ROA. This indicates that increasing the number of board members, within limits appropriate to the operational scale and applicable regulations, is correlated with increased profitability of BPRs. The mechanisms underlying this relationship likely involve more effective decision-making, more comprehensive oversight of various aspects of the business including operations and compliance, and a more specialized division of tasks among board members, which collectively contribute to improved financial performance."

From an agency theory perspective, these findings support the idea that the board of directors serves as a key governance mechanism to reduce information asymmetry and potential conflicts of interest between shareholders (principals) and management (agents). An adequate number of directors can strengthen the board's monitoring function, ensuring that management decisions are aligned with shareholders' goals of maximizing firm value (Jensen & Meckling, 1976).

Furthermore, regulations issued by the Financial Services Authority (OJK), as stated in Article 62 paragraph 1 of Financial Services Authority Regulation Number 62/POJK.03/2020 concerning Rural Banks (which was updated by Article 44 paragraph 1 of Financial Services Authority Regulation Number 7 of 2024 concerning Rural Banks), require BPRs to have a board of directors of at least two people, with one of them serving as the president director. In addition, Article 4 of Financial Services Authority Regulation Number 4/POJK.03/2015 concerning the Implementation of Rural Bank Governance requires a minimum of two board members for BPRs with core capital of less than IDR 50 billion and a minimum of three people for BPRs with core capital of IDR 50 billion or more. This regulation clearly underlines the regulator's view on the importance of an adequate number of directors for effective governance and is expected to contribute to better performance.

This finding is consistent with the studies of Sukandar & Rahardja (2014), Sulistyowati and Fidiana (2017), and Euodia Pracinthea & Djuminah (2019) which found a positive effect of the size/number of boards of directors on the company's financial performance. These studies strengthen the view that an effective board of directors contributes to improved financial performance. However, this finding differs from the

studies of Audita Setiawan (2016) and Laras Clara Intia & Siti Nur Azizah (2021) which found insignificant or even negative results for the effect of the number of directors on financial performance. This difference may occur due to the research context, the performance variables used, or the methodology. Despite these differences, these findings provide empirical support for agency theory, which states that an adequate board of directors can improve supervision and decision-making, thereby improving financial performance.

***The Influence of the Number of Commissioners on Financial Performance (ROA)***

This study examines the effect of the number of commissioners on the financial performance (ROA) of Rural Banks (BPR). The results of statistical analysis show that the number of commissioners has a significant positive effect on ROA. This finding indicates that the existence of an adequate number of commissioners, in accordance with the scale of the business and applicable provisions, contributes to improving the financial performance of BPRs. This increase is thought to come from more optimal supervision of the direction and strategy implemented by the board of directors, as well as increased independence in providing constructive direction and input. With a greater number of commissioners, it is expected that the supervisory function can run more effectively, thereby minimizing the potential for deviations and encouraging more responsible company management.

From the perspective of agency theory, the board of commissioners plays a crucial role in mitigating conflicts of interest between shareholders (principals) and management (agents). The greater the number of competent and independent commissioners, the stronger the monitoring mechanism for the board of directors, which can ultimately align management actions with the interests of the owners (Jensen & Meckling, 1976). The diversity of backgrounds and expertise brought by a greater number of commissioners also enriches the perspective in providing advice and direction to the board of directors, which has the potential to improve the quality of strategic and operational decision-making, and have a positive impact on the financial performance of BPRs.

The Financial Services Authority (OJK) Regulation also clearly regulates the minimum and maximum number of members of the board of commissioners at BPR. Article 65 paragraph 1 of POJK Number 62/POJK.03/2020 (updated by Article 45 paragraph 1 of POJK Number 7 of 2024) requires BPR to have at least two members of the board of commissioners and a maximum of the same number of members of the board of directors, with one of them serving as the main commissioner. Furthermore, Article 24 of POJK Number 4/POJK.03/2015 requires the number of members of the board of commissioners to be at least two people and a maximum of the same number of directors for BPRs with core capital of less than IDR 50 billion, and a minimum of three people with the same limit for BPRs with core capital of IDR 50 billion or more. This regulation reflects the regulator's recognition of the importance of effective supervision through an adequate number of commissioners to maintain the health and performance of BPRs.

These results are consistent with the studies of Febrina (2022), Sulistyowati and Fidiana (2017), and Hasibuan and Sushanty (2018), which found a positive influence of the board of commissioners on company performance. These studies strengthen the view that an adequate board of commissioners contributes to improved financial performance through better supervision. However, these findings differ from the studies of Panky Pradana Sukandar and Rahardja (2014) and Audita Setiawan (2016), which found that the size/composition of the board of commissioners had no significant effect or even had an insignificant negative effect on financial performance. This difference may occur due

to variations in the dependent variable, methodology, or sample characteristics. Overall, these findings provide empirical support for the important role of the board of commissioners in corporate governance and its impact on BPR financial performance, in line with agency theory.

***The Influence of Risk Management (NPL) on Financial Performance (ROA)***

Hypothesis 3 examines the effect of risk management (NPL) on financial performance (ROA). Statistical analysis clearly shows a significant negative relationship between Non-Performing Loan (NPL) and Return on Asset (ROA). This finding indicates that an increase in NPL is substantially related to a decrease in BPR financial performance. This increase in non-performing loans is likely to burden BPR profitability through an increase in allocations for loan loss reserves, which directly reduces the profit available to the bank.

This finding is relevant to the regulatory framework set by the Financial Services Authority (OJK), specifically Financial Services Authority Regulation Number 33/POJK.03/2018 concerning Productive Asset Quality and the Formation of Allowance for Productive Asset Write-offs of Rural Credit Banks. This regulation requires BPRs to form credit loss reserves, with the amount increasing along with the decline in asset quality. Therefore, an increase in NPL directly increases the provision burden, which has a negative impact on ROA. This regulation aims to encourage BPRs to maintain a healthy NPL level, ideally below 5% of total outstanding credit.

Agency Theory provides a useful lens to understand the implications of these findings. In the context of BPRs, management (agents) have more information about the quality of the loan portfolio than the owners (principals). An increase in NPLs may indicate potential agency problems, such as: first, Management may take excessive credit risk to achieve short-term performance targets, even if it increases the likelihood of future NPLs. Second, high NPLs may indicate weak oversight of the credit granting and collection process, which can occur if the principal does not have sufficient information to effectively monitor the agent's actions. Third, if management incentives are not tied to healthy credit risk management, they may be less motivated to minimize NPLs. Thus, high NPLs may signal potential agency problems that can harm the financial performance of BPRs.

The findings of this study are consistent with previous studies on the relationship between NPL and financial performance. Dirwan (2016) found a significant negative effect of NPL on Bank Mandiri's ROA. Similarly, Hidayati, Rispantyo & Kristianto (2020) and Prahesti & Abudanti (2017) also reported a significant negative relationship between NPL and the financial performance of the banking sector. These convergent results confirm the adverse impact of credit risk on bank profitability.

***The Influence of Compliance Level (NPL Correction) on Financial Performance (ROA)***

The fourth hypothesis states that the Compliance Level (NPL Correction) affects Financial Performance (ROA). The results of statistical testing in this study indicate that the compliance level, which is proxied by NPL correction, does not have a significant effect on BPR financial performance (ROA). This finding indicates that NPL correction does not directly affect BPR profitability.

Descriptive statistical data can be used to explain why the level of compliance (NPL correction) does not directly affect financial performance (ROA). The NPL Correction Value is Relatively Small where the average NPL correction is 0.6852 with a standard deviation of 1.17269. This low average value indicates that in general, the magnitude of the NPL correction (which reflects the level of non-compliance) is relatively small compared to the NPL value itself which has an average of 12.55 and a standard deviation of 7.07697. This small NPL correction has a limited impact on ROA. ROA is influenced by various factors, and if the NPL correction is only a small part of total assets or income, the effect is not statistically significant. The ROA in the table has an average of 2.5880 and a standard deviation of 1.35792, which shows variation in financial performance. This variation may be more explained by other factors such as operational efficiency, cost management, or income from activities other than credit. In other words, although NPL correction reflects the level of compliance, its impact on ROA is reduced due to its relatively small value and the presence of other factors that are more dominant in determining BPR financial performance.

These findings need to be interpreted in the context of regulations set by the Financial Services Authority (OJK). OJK regulations, such as POJK Number 13/POJK.03/2019 and SEOJK Number 12/SEOJK.03/2022, regulate BPR reporting and sanctions related to non-compliance. It should be emphasized that although this study found an insignificant impact of NPL correction on ROA, this does not reduce the importance of compliance with OJK regulations. Good compliance remains crucial to maintaining stability and trust in the banking industry.

In the context of agency theory, these findings can create a long debate. First, owners and regulators have carried out effective supervision (monitoring) so that management maintains credit quality even though it does not have a direct impact on profitability, as explained by Jensen and Mackling (1976). Second, a good governance structure in BPR has succeeded in minimizing moral hazard in taking credit risks, as found by Pathan (2009) in the context of general banking. Third, the existence of information asymmetry allows management to manage NPL recognition through certain accounting policies, so that corrections are not directly visible in ROA (Bushman & Williams, 2012). This finding is also in line with the research of Laeven and Levine (2009) which shows that regulatory pressure can cause bank management to prioritize compliance over profit optimization. Thus, through the lens of agency theory, it can be understood why in the context of BPR, compliance measured through NPL correction does not necessarily correlate with financial performance, due to the complexity of agency relationships and monitoring mechanisms that apply in this microfinance institution.

This finding is in line with Berger & De Young's (1997) research which states that low NPL does not always reduce bank profitability if it is managed well. Athanasoglou et al.'s (2008) study also supports this argument by showing that ROA is more influenced by internal factors such as operational efficiency than NPL.

However, this result is contrary to several previous studies such as Louzis et al. (2012), which found a negative relationship between NPL and bank profitability. This difference can be explained by the unique characteristics of BPR, which tends to be more resistant to NPL shocks due to its simple business model, as shown in the study of Fiordelisi et al. (2011). In addition, Dietrich & Wansenried (2014) revealed that bank financial performance is more influenced by macroeconomic conditions than NPL, so if BPR operates in a stable economic environment, the impact of NPL on ROA may be minimal. Thus, this finding enriches the literature by showing that in the context of BPR, small NPL corrections are not significant to ROA, but further research is needed to explore moderating variables such as loss provision policies or bank size.

***Influence Number of Directors Against Risk Management (NPL)***

Hypothesis 5 states that the Number of Directors has a negative effect on Risk Management (NPL). The results of statistical analysis show that the number of directors has a negative and significant effect on Non-Performing Loans (NPL). This finding indicates that an increase in the number of directors is correlated with a decrease in the NPL level. This decrease in NPL can be distributed to an increase in the effectiveness of credit decision making, where the diversity of backgrounds, expertise, and perspectives of directors that are more numerous contribute to more comprehensive credit risk mitigation. In addition, an increase in the number of directors also strengthens the internal control function, which reduces the potential for errors in the credit process.

This finding is relevant to the regulatory context that emphasizes the importance of board of directors' competence. In this case, the requirements for candidates for BPR BKK directors by the Central Java Provincial Government, which include level 1 and 2 certification from the National Professional Certification Agency (BNSP) as stipulated in the Financial Services Authority Regulation Number 44/POJK.03/2015, as well as BSMR level 3 risk management certification from the Risk Management Certification Agency, show an emphasis on improving the quality and competence of directors. These competency requirements are expected to improve the ability of directors to manage and mitigate credit risk.

From the perspective of agency theory and corporate governance, increasing the number of directors can be seen as a mechanism to reduce agency risk. A larger board of directors can increase oversight of management in the credit granting process, ensuring that credit decisions are made prudently and in accordance with the bank's risk policies. The diversity of board expertise also enriches the decision-making process and reduces the potential for bias or error in risk assessment.

The findings of this study are consistent with the results of previous studies. Okky Andrian & Supatmi (2010) concluded that the NPL ratio is negatively related to the number of Directors and the size of BPR. This study supports the idea that an adequate board of directors size, in this context seen as a larger number of directors, contributes to a decrease in the risk of non-performing loans. Furthermore, this finding is in line with previous studies showing that aspects of GCG, including the structure of the board of directors, can affect risk management. Several studies have found that the size of the board of directors or governance structure represented by the number of directors has a positive effect on financial performance (Sukandar & Rahardja, 2014), reflecting the importance of board structure in a broader context. However, there are variations in the findings of previous studies, where several studies found that the number of boards of directors had no significant effect or even had an insignificant negative effect on financial performance (Setiawan, 2016). This difference highlights the complexity of the relationship between board structure, governance, risk management, and financial performance, which are influenced by contextual and methodological factors. Overall, this study strengthens the argument that the structure of the board of directors plays an important role in credit risk management.

***Influence Jamount Commissioner Against Risk Management (NPL)***

Hypothesis 6 states that the Number of Commissioners affects Risk Management (NPL). The results of the statistical analysis show that the number of commissioners does not have a significant effect on Non-Performing Loans (NPL). This finding indicates that variations in the number of commissioners are not statistically related to changes in the NPL level in the BPRs studied.

Descriptive statistical data shows that the average number of commissioners is 1.6364 with a standard deviation of 0.81219. This indicates that the variation in the number of commissioners among BPRs in the sample is relatively small. Most BPRs may have a similar number of commissioners, making it difficult to identify a significant effect of small differences in the number of commissioners on NPL. On the other hand, NPL has an average of 12.55 with a fairly large standard deviation of 7.07697. This indicates that there is a significant variation in the level of NPL among BPRs. This variation may be more influenced by factors other than the number of commissioners, such as credit policy, local economic conditions, or management quality. Overall, the descriptive data shows that the limited variation in the number of commissioners, together with the larger variation in NPL that is likely influenced by other factors, can explain why the hypothesis that the number of commissioners has a significant effect on NPL is rejected.

These findings underscore the complexity of the board of commissioners' role in risk management in corporate governance. The board of commissioners, although tasked with supervising management, may experience a decline in supervisory effectiveness due to various reasons, which has the potential to create agency difficulties. The independent board of commissioners exists solely to comply with PBI Regulation Number 8/14/PBI/2006. At the same time, the adverse effects may reflect the economic acumen of each independent board of commissioners, as not all of them have equal expertise. Furthermore, the proportion of independent commissioners is below 30% of the total board membership, resulting in many simultaneous meetings among independent commissioners, despite having different interests. Agency problems arise when the interests of the agent (management) and principal (owner/local government) are not fully aligned, which may reduce the effectiveness of commissioners in controlling management related to credit risk.

These findings are relevant to theoretical discussions on the role of the board of commissioners in corporate governance. Agency theory predicts that an effective board of commissioners can reduce agency risk and improve management oversight. However, the findings of this study suggest that simply increasing the number of commissioners may not be enough to achieve effective oversight. Factors such as independence, competence, and alignment of interests of commissioners also play an important role.

The findings of this study are similar to several previous studies examining the influence of the board of commissioners. Research by Darwis (2009) and Wulandari (2006) found that independent boards of commissioners did not have a significant effect, which may be due to formalities in appointment and lack of independence. This finding supports the idea that the quality and effectiveness of board of commissioner supervision is more important than the number.

***Influence Compliance (NPL Correction) Towards Risk Management (NPL)***

Hypothesis 7 believes that Compliance (NPL correction) affects Risk Management (NPL). The empirical results show that Compliance has no significant effect on Risk Management. This finding indicates that changes in Compliance do not statistically significantly affect the level of Risk Management. In the context of this research data, it

can be interpreted that Compliance, which focuses on the accuracy of credit quality reporting (NPL correction), and Risk Management (which reflects the quality of the credit portfolio) are two constructs that do not have a strong direct causal relationship.

Empirical data shows that the Average Compliance (NPL Correction) is 0.6852 with a standard deviation of 1.17269. This indicates that the average NPL correction rate is relatively low compared to the much higher average NPL. The standard deviation of Compliance (1.17269) also shows that the variation in the level of Compliance among BPRs is not too large. This means that most BPRs have similar and low levels of NPL correction. In contrast, Risk Management as proxied by NPL has a higher average of 12.55 with a standard deviation of 7.07697. This indicates that there is significant variation in Risk Management among BPRs. With a low average Compliance and limited variation, its effect on Risk Management (NPL) which has a larger variation is limited. Small changes in Compliance are unlikely to be strong enough to cause significant changes in NPL.

This finding is relevant to the regulations set by the Financial Services Authority (OJK). Financial Services Authority Regulation Number 33/POJK.03/2018 and Financial Services Authority Regulation Number 1 of 2024 emphasize the importance of accurate credit quality reporting. This regulation directs supervisors to focus on the accuracy of credit quality reporting during the examination. Therefore, Compliance carried out during the examination reflects efforts to ensure compliance with reporting regulations, and does not directly reflect or affect the dynamics of Risk Management itself.

Reporting errors do not necessarily increase NPL because at the time of the examination, the corrections made to the credit quality are only based on the examination sample so that they do not fully describe the NPL conditions of the entire BPR. Although after the examination there are corrections, the NPL resulting from the correction will decrease by itself along with the increase in outstanding credit, so even though corrections are made during the examination period, the NPL in the following month will decrease again in line with the increase in outstanding credit.

From an agency theory perspective, this finding may invite discussion on the effectiveness of monitoring mechanisms. If Compliance does not significantly affect Risk Management, this may indicate that reporting-focused monitoring mechanisms are not sufficient to address the underlying credit risk issues. Agents (BPR management) may prioritize Compliance to avoid regulatory sanctions, but do not necessarily change their lending or risk management practices that affect Risk Management.

### *Influence Amount Board of Directors on Financial Performance (ROA) Through Risk Management*

Hypothesis 8 states that risk management mediates the effect of the Number of Directors on Financial Performance. The results of statistical tests indicate that risk management (NPL) does not mediate the effect of the number of directors on financial performance (ROA). Theoretically, a complete board of directors is assumed to increase the effectiveness of risk management, which in turn will have a positive impact on financial performance. However, this finding indicates that in the context of this study, this indirect relationship is not empirically confirmed.

Descriptive data shows that the number of directors has an average of 2.0606 with a standard deviation of 0.81672. This shows that the variation in the number of directors

between BPRs in the sample is relatively small. If the variation of the independent variable (number of directors) is limited, it will be difficult to detect its effect on the mediating variable (NPL) and subsequently on the dependent variable (ROA). ROA has an average of 2.5880 with a standard deviation of 1.35792. Although there is variation in ROA, its standard deviation is not as large as NPL. If the dependent variable (ROA) does not have a very large variation, this can make it difficult to identify the mediation effect. NPL has an average of 12.55 with a standard deviation of 7.07697. This shows a fairly large variation in NPL. However, this large variation alone does not guarantee that NPL will function as an effective mediator between the number of directors and ROA. These empirical data suggest that limited variation in the number of directors and ROA, as well as greater variation in NPL, may be factors explaining why the hypothesis that NPL mediates the effect of the number of directors on ROA is rejected.

These findings need to be interpreted in the context of regulations and specific conditions that may affect the relationship between the number of directors, risk management, and financial performance. During the study period, there was the enactment of the Financial Services Authority Regulation regarding the Covid-19 restructuring policy. This policy provides banks with flexibility in classifying the credit quality of restructured debtors as current and in forming or not forming credit loss reserves. This condition may have reduced the variation in NPL and ROA that is usually expected, thus affecting the ability to detect mediation effects.

From an agency theory perspective, an effective board of directors plays a role in overseeing management and mitigating risks. However, the influence of the board of directors on financial performance can be influenced by external factors that cannot be controlled by the bank, such as regulations and economic conditions. In this case, regulations related to Covid-19 restructuring may be the dominant external factor affecting BPR financial performance, regardless of the board of directors structure.

In the context of research on GCG, risk management, and financial performance, several studies have found that risk management can mediate the effect of GCG on financial performance (Setiawaty, 2016; Rahayu, 2018). This suggests that under normal conditions, risk management can indeed be an important pathway through which GCG affects performance. However, other studies have shown that the relationship between GCG and financial performance can be complex and influenced by various factors (Muslih & Maghfiroh, 2023; Intia & Azizah, 2021). The findings of this study add to the evidence that the relationship between board structure, risk management, and financial performance can be influenced by specific external conditions, such as crisis regulations, which need to be considered in interpreting research results.

### *Influence Number of Commissioners on Financial Performance (ROA) Through Risk Management*

Hypothesis 9 states that risk management mediates the Effect of the Number of Commissioners on Financial Performance (ROA). The results of statistical tests indicate that risk management (NPL) does not mediate the effect of the number of commissioners on financial performance (ROA). This finding indicates that the effect of the number of commissioners on ROA does not occur through the risk management channel as measured by NPL. This can be interpreted that the supervisory role of commissioners does not directly affect the risk management mechanism reflected in NPL, which in turn affects ROA.

Empirical data shows that the variation in the Number of Commissioners is Limited, where the number of commissioners has an average of 1.6364 with a standard deviation of 0.81219. This shows that the variation in the number of commissioners between BPRs

in the sample is relatively small. If the independent variable (number of commissioners) does not have a large enough variation, it will be difficult to detect its effect on the mediating variable (NPL) and subsequently on the dependent variable (ROA). Meanwhile, ROA has an average of 2.5880 with a standard deviation of 1.35792. Although there is variation in ROA, its standard deviation is not as large as NPL. If the dependent variable (ROA) does not have a very large variation, this can make it difficult to identify the mediation effect. Furthermore, NPL has an average of 12.55 with a standard deviation of 7.07697. This shows a fairly large variation in NPL. However, this large variation itself does not guarantee that NPL will function as an effective mediator between the number of commissioners and ROA. Therefore, the limited variation in the number of commissioners and ROA, compared to the variation in NPL, may be a factor explaining why NPL does not mediate the effect of the number of commissioners on ROA.

This finding needs to be related to the function and role of the board of commissioners. The board of commissioners has the main function of supervising bank operations, including risk management, but is not directly involved in operational decision-making related to credit provision. The effectiveness of commissioner supervision depends on the quality and competence of individual commissioners. In the context of this study, commissioner characteristics, such as professional background and potential agency problems, can affect the effectiveness of supervision and the relationship between commissioners, risk management, and financial performance.

From the perspective of agency theory, the board of commissioners acts as a monitoring mechanism to reduce agency problems between management and owners. However, if the commissioners do not have relevant competencies or have conflicting interests, the effectiveness of monitoring may be reduced. This finding suggests that in the context of BPR BKK, the characteristics of commissioners may affect their ability to mediate the relationship between the number of commissioners and financial performance through risk management.

Previous studies have provided mixed insights into the role of the board of commissioners in corporate governance and its impact on performance. Several studies found that an independent board of commissioners has no significant effect on performance (Hasibuan & Sushanty, 2018) or risk management disclosure (Utami & Cahyono, 2022), which may be due to formality or lack of independence. Other studies have shown that GCG can generally affect risk management and financial performance (Setiawaty, 2016; Rahayu, 2018), but the specific relationship between the board of commissioners, risk management, and financial performance can be complex. The findings of this study add to the evidence that the role of commissioners in influencing financial performance through risk management can be influenced by contextual factors, such as commissioner characteristics and corporate governance structure.

### *Influence of Level Compliance (NPL Correction) Towards Financial Performance (ROA) Through Risk Management*

Hypothesis 10 believes that risk management mediates the effect of Compliance Level (NPL Correction)ToFinancial Performance (ROA). The results of statistical testing show that risk management (NPL) does notmediatethe effect of compliance level (NPL correction) on financial performance (ROA). This finding indicates that the impact of

compliance, as measured by NPL correction, on ROA does not occur through the risk management channel (NPL). In other words, changes in credit quality reporting compliance do not significantly affect ROA through changes in NPL. This suggests that there are other factors at play.

Descriptive statistical data shows that Compliance (NPL Correction) has a very low average of 0.6852, with a standard deviation of 1.17269. This indicates that in general, the level of NPL correction in BPRs in the sample is low. The relatively low standard deviation of Compliance (1.17269) indicates that variation between BPRs in the level of compliance is also limited. The lack of variation in the independent variables can make it difficult to identify the mediating effect. Meanwhile, NPL has a higher average of 12.55 with a standard deviation of 7.07697. These data indicate that there is quite a large variation in NPL between BPRs. However, this variation may be more influenced by other factors than the low and less varied level of compliance. ROA has an average of 2.5880 with a standard deviation of 1.35792. The variation in ROA is not as large as NPL, which may also affect the ability to detect the mediating effect. These descriptive data show that the level of Compliance (NPL Correction) is generally low and the variation between BPRs in compliance is limited, while NPL has a greater variation. This condition can explain why NPL does not mediate the effect of Compliance on ROA.

A possible explanation for this finding is that NPLs are influenced by factors other than reporting corrections. These factors include the amount of outstanding credit, the quality of collateral, the bank's internal policies regarding credit management, and macroeconomic conditions. NPL corrections made by supervisors focus more on the accuracy of credit quality reporting, while NPLs reflect actual credit risk. Therefore, NPL corrections do not always directly and proportionally affect the NPL level.

From an agency theory perspective, these findings highlight the complexity of the relationship between supervision, risk management, and financial performance. While supervision (as reflected in NPL correction) is important to ensure accountability and compliance, its effectiveness in influencing financial performance through risk management may be limited. Agents (bank management) may be more focused on meeting reporting requirements to avoid sanctions than on changing underlying risk management practices. Furthermore, sanctions for non-compliance may not be significant enough to induce substantial behavioral change.

Previous studies have examined the relationship between GCG, risk management, and financial performance, which is relevant to this finding. Several studies have found that risk management can mediate the effect of GCG on financial performance (Setiawaty, 2016; Rahayu, 2018). This suggests that in a broader context, risk management can indeed be an important pathway through which corporate governance affects performance. However, other studies have shown that the relationship between GCG and financial performance can be complex and influenced by various factors (Muslih & Maghfiroh, 2023; Intia & Azizah, 2021). The findings of this study add to the evidence that the relationship between compliance, risk management, and financial performance can be influenced by contextual factors and that risk management is not always an effective mediator in every situation.

## 5. Conclusion

This study provides new insights into the dynamics of corporate governance and risk management in the financial sector. Key findings indicate that the size of the board of directors and the board of commissioners have a significant positive correlation with financial performance, indicating the important role of oversight and strategic direction in improving profitability. In contrast, risk management practices reflected in the level of

Non-Performing Loans (NPL) significantly negatively impact financial performance, highlighting the importance of effective risk management.

Interestingly, the study found that the level of compliance, as measured by NPL correction, did not directly affect financial performance. This suggests that the compliance mechanism, in the context studied, may operate through other channels or require specific conditions to affect financial outcomes. Furthermore, this study reveals a significant inverse relationship between the number of directors and the level of risk (NPL). This finding implies that a larger board structure can contribute to more conservative risk management practices, potentially through increased oversight and diverse expertise. However, board size and compliance level do not show a direct effect on risk management.

An important implication of this study is that risk management (NPL) does not significantly mediate the effect of board size (directors and commissioners) and the level of compliance on financial performance. This suggests that the effect of governance and compliance on financial performance is likely to be direct or mediated by other factors not tested in this study.

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