

CITATION

Bahari S, Suriadi, Alzarliani WO, Sumail LO, (2026). Revisiting Corporate Governance in Emerging Economies: The Role of Board Size and Independence in Indonesian Banks. *Ilomata International Journal of Tax and Accounting*. 7(2), 1-8.
doi: 10.61194/ijtc.v7i2.2145

TYPE Original Research

PUBLISHED 30 April 2026
DOI 10.61194/ijtc.v7i2.2145
VOL 7 Issue 2 April 2026

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Revisiting Corporate Governance in Emerging Economies: The Role of Board Size and Independence in Indonesian Banks

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Abstract

Corporate governance remains a critical determinant of organizational performance in emerging markets, particularly in the banking sector, where transparency and accountability are essential. This study examines how board composition specifically board size and board independence affects financial performance among 38 Indonesian foreign exchange banks from 2017 to 2021. Using panel data regression with fixed effects, validated through Chow and Hausman tests, the study controls for unobserved heterogeneity and firm-specific characteristics. Results show that board size has a statistically significant positive association with both Return on Assets (ROA) and Return on Equity (ROE). From the perspective of Resource Dependence Theory, this relationship may reflect broader access to expertise and external resources associated with larger boards rather than a directly observed improvement in internal decision-making processes. However, board independence does not significantly impact financial outcomes, suggesting that structural independence lacks effectiveness without supporting institutional and cultural frameworks. These findings highlight the need for governance reforms emphasizing functional independence, director training, and stronger enforcement mechanisms to improve oversight. The study contributes to the literature by contextualizing Resource Dependence Theory within Indonesia's institutional environment and offering insights for tailoring international governance standards to local realities. Overall, the results underscore that governance effectiveness depends not merely on structure but on institutional capacity and cultural adaptation, providing guidance for policymakers and future research.

KEYWORDS

board composition, financial performance, corporate governance, board size, indonesia.

Introduction

Corporate governance has become an indispensable mechanism for ensuring financial stability, institutional resilience, and investor confidence in modern economies. In Southeast Asia, the 1998 Asian financial crisis served as a watershed moment that exposed deep-seated weaknesses in corporate oversight, transparency, and accountability. Since then, reforms have proliferated across the region, seeking to strengthen governance frameworks through regulatory modernization and adherence to international best practices. The crisis underscored the necessity of building governance systems capable of mitigating risk and fostering long-term sustainability. In Indonesia, the banking sector emerged as a focal point of reform, reflecting its systemic importance to national economic stability and growth. The establishment of the Financial Services Authority (Otoritas Jasa Keuangan, OJK) in 2011 marked a milestone in regulatory restructuring, transferring supervisory authority from Bank Indonesia to a specialized body with a broader mandate encompassing banks, capital markets, and non-bank financial institutions (Mayrendra & Suryono, 2023). These developments aligned Indonesia's financial oversight mechanisms with global governance principles, particularly those advocated by the OECD, which emphasize transparency, accountability,

and ethical stewardship (Wibisono, 2023; YULFASNI, 2023).

Efforts to reform corporate governance in Indonesia's banking sector have emphasized improving board structures as a means of strengthening organizational accountability and strategic decision-making. The integrity of corporate governance largely depends on how effectively boards of directors can align management actions with stakeholder interests while safeguarding institutional credibility. Several factors critically shape governance effectiveness within Indonesia's banking system, including regulatory independence, institutional autonomy, and board composition. The OJK's independent regulatory role allows it to implement oversight measures insulated from political pressures, enhancing both compliance and market confidence (Mayrendra & Suryono, 2023). Within banks, board characteristics such as size and independence have been recognized as essential components influencing decision quality and risk management. Larger boards can bring together diverse expertise and perspectives, improving the quality of oversight and strategic thinking (Mukhibad et al., 2020). Meanwhile, independent directors are expected to serve as impartial custodians of stakeholder interests, minimizing agency conflicts and promoting ethical governance (Meutia & Soediro, 2019). These structural and functional dimensions collectively determine how effectively boards perform their monitoring and advisory roles (Ernanda, 2022).

Despite such reforms, the actual impact of board composition on financial performance remains a contested issue in the literature. In emerging economies like Indonesia, the relationship between governance structures and firm outcomes often reflects complex interactions between institutional, cultural, and regulatory factors. The effectiveness of governance frameworks depends not only on formal rules but also on the broader socio-cultural environment in which they operate. For instance, hierarchical norms, patron-client relationships, and collectivist orientations influence managerial accountability and transparency, often moderating the effects of formal governance structures (Iska et al., 2024). In this context, examining board size and independence offers a valuable lens to understand whether international governance prescriptions are compatible with local institutional realities.

The persistent debate regarding optimal board size encapsulates a classic governance dilemma: balancing efficiency with diversity. Research has found that smaller boards can enhance coordination, communication, and decision-making efficiency, while larger boards tend to foster richer deliberation and access to diverse skills and resources (Mukhibad et al., 2020). Similarly, the role of independent directors has received extensive attention as a cornerstone of good governance, intended to bring external perspectives that curb managerial opportunism (Hanafi et al., 2021). However, independence in name does not always translate into independence in function. In many emerging markets, independent directors face structural and cultural constraints that undermine their oversight capacity, including limited autonomy, information asymmetry, and deference to dominant shareholders. As a result, the expected benefits of board independence may not materialize, particularly in contexts where governance institutions are still maturing.

A growing body of literature highlights that corporate transparency and accountability in Indonesia's banking sector are closely tied to the composition and behavior of boards. Empirical evidence suggests that while independent directors play a symbolic role in enhancing governance legitimacy, their influence on financial performance can be negligible without genuine autonomy and strong regulatory support (Nugroho et al., 2022). Conversely, larger boards have been linked to improved performance outcomes due to their ability to pool diverse expertise, better allocate responsibilities, and ensure

robust deliberation in decision-making (Mukhibad et al., 2020). This tension between formal structures and practical realities underscores the need to reassess how governance mechanisms operate in institutional settings characterized by rapid economic transformation but uneven regulatory enforcement.

The Financial Services Authority (OJK) has sought to address these challenges by intensifying its regulatory reach and promoting uniform compliance across the banking sector. As the central authority governing corporate conduct, the OJK has introduced frameworks mandating governance disclosures, risk management policies, and board structure regulations (Ernanda, 2022). These reforms aim to cultivate a culture of accountability, where transparency and ethical management practices are prioritized as integral elements of financial integrity. Nevertheless, the impact of these reforms depends heavily on the willingness and ability of financial institutions to internalize governance principles rather than merely comply with procedural mandates. Enforcement gaps and institutional inertia continue to pose barriers to the realization of effective governance outcomes (Wibisono, 2023).

Socio-cultural dynamics may also influence how governance mechanisms operate in Indonesia. Prior studies suggest that relational networks, hierarchical organizational cultures, and institutional norms may shape the practical role of governance structures such as board size and board independence within financial institutions. The coexistence of traditional values and modern corporate systems creates a hybrid institutional landscape where personal relationships, trust, and social harmony influence organizational behavior. While such cultural embeddedness can promote cohesion and trust within firms, it can also limit the capacity of independent directors to challenge managerial decisions or demand transparency (Iska et al., 2024). Moreover, the influence of religious and community norms can shape governance approaches, particularly within banks that integrate sharia principles or seek legitimacy through local cultural alignment (Rusydiana, 2016). These dynamics highlight the necessity of understanding governance not as a purely structural construct but as a socio-institutional process influenced by context-specific factors.

The theoretical foundations for examining board composition and firm performance lie primarily in three frameworks: agency theory, resource dependence theory, and stewardship theory. Agency theory posits that effective boards mitigate conflicts between management and shareholders by enhancing monitoring and control mechanisms (Risdiyanto, 2021). From this perspective, board independence is viewed as a safeguard against managerial self-interest. In contrast, resource dependence theory emphasizes the board's strategic role in connecting the firm with external resources, information, and legitimacy, suggesting that larger and more diverse boards can enhance firm performance by broadening strategic perspectives (Mukhibad et al., 2020). Meanwhile, stewardship theory challenges the assumption of inherent managerial opportunism, arguing instead that executives act as stewards of organizational interests when governance structures foster trust and empowerment (Nikmah et al., 2023). These complementary frameworks provide a multidimensional understanding of how board characteristics influence organizational performance, underscoring the need to contextualize governance mechanisms within institutional realities.

Existing empirical studies on board composition in Indonesia provide fragmented findings. Some studies report that larger boards contribute positively to profitability, while others indicate coordination inefficiencies that may reduce performance. Similarly, empirical evidence regarding board independence remains inconclusive (Hanafi et al., 2021). Similarly, the evidence regarding board independence remains inconclusive, with several studies reporting no significant

impact on firm performance (Ernanda, 2022). This divergence highlights a persistent empirical gap regarding whether internationally endorsed governance mechanisms, particularly board independence, generate measurable financial benefits in emerging economies where institutional enforcement and informal governance practices coexist. Moreover, much of the existing research aggregates financial institutions without distinguishing between different bank types, overlooking the specific governance challenges faced by foreign exchange banks, which operate under stricter international regulatory frameworks.

To address these gaps, the present study investigates the relationship between board composition and financial performance in Indonesian foreign exchange banks during 2017–2021. Specifically, it examines the effects of board size and board independence on two key indicators of financial performance: Return on Assets (ROA) and Return on Equity (ROE). The study's novelty lies in its integration of structural governance variables with institutional and cultural contexts unique to Indonesia's banking system. By employing panel data regression, the research aims to provide empirical clarity on whether structural attributes of boards translate into improved performance outcomes in practice. This analysis not only contributes to the theoretical refinement of corporate governance models in emerging markets but also offers policy-relevant insights for regulatory bodies like the OJK seeking to enhance governance effectiveness. Ultimately, the study advances the argument that governance mechanisms must evolve in harmony with institutional maturity and socio-cultural dynamics rather than merely replicate models derived from developed economies.

Methods

This study employs a quantitative, non-experimental research design utilizing panel data regression analysis to examine the effect of board composition on the financial performance of Indonesian foreign exchange banks. The quantitative approach enables objective measurement of relationships between governance attributes and financial outcomes in a statistically rigorous manner. The use of panel data integrates both cross-sectional and time-series dimensions, allowing for examination of firm variations across banks and over time. This methodological approach is consistent with prior corporate governance studies emphasizing the importance of longitudinal data in capturing institutional and temporal dynamics (Nazir et al., 2022; Suherman et al., 2023).

The design is non-experimental because it relies on naturally occurring variations in board composition rather than controlled manipulation. As Shariff et al. (2022) highlight, such designs are well-suited for governance studies where experimental manipulation of institutional structures is neither ethical nor feasible. Statistical modeling thus serves as the primary tool to infer causal tendencies within a realistic institutional framework.

The population comprises all foreign exchange (forex) banks operating in Indonesia between 2017 and 2021, given their systemic importance and compliance with stricter governance and reporting standards. From this population, 38 banks were selected using purposive sampling, resulting in a balanced panel of 190 firm-year observations. Selection criteria emphasized completeness of data and adherence to Financial Services Authority (OJK) disclosure regulations to ensure consistency and comparability.

This research relies exclusively on secondary data, drawn from publicly available annual reports, corporate governance disclosures, and audited financial statements. Supplementary governance data were obtained from the OJK

database to ensure accuracy and regulatory verification. The selected time frame (2017–2021) reflects a period of significant reform in Indonesia's financial governance landscape, marked by post-crisis regulatory enhancements (Muhaimin, 2023). Using audited, verified data sources enhances validity, reliability, and ethical compliance by avoiding direct involvement of human subjects.

• Dependent Variables:

Financial performance is measured using Return on Assets (ROA) and Return on Equity (ROE), both standard indicators of profitability and efficiency (Widarwati et al., 2022).

- ROA measures how effectively banks use total assets to generate profit.
- ROE evaluates the return generated from shareholders' equity.

• Independent Variables:

- Board Size (BSIZE): Total number of directors on the board, representing diversity and decision-making capacity.
- Board Independence (BIND): Proportion of independent commissioners relative to total board members.

• Control Variables:

Managerial ownership, educational background, average board age, and board tenure are included to account for potential demographic and structural effects (Mooney et al., 2021).

These operational definitions align with international governance standards.

Analytical Model

Panel data regression was selected for its ability to control for inter-firm heterogeneity and temporal dynamics, minimizing omitted variable bias (Nazir et al., 2022; Ponce & Wibowo, 2023). This method enhances statistical efficiency and allows exploration of changes in governance composition over time (Baltagi, 2021).

The regression equations are expressed as:

$$ROA_{it} = \alpha + \beta_1 BSIZE_{it} + \beta_2 BIND_{it} + \beta_3 MOWN_{it} + \beta_4 EDU_{it} + \beta_5 TENURE_{it} + \beta_6 AGE_{it} + \mu_i + \lambda_t + \varepsilon_{it}$$

$$ROE_{it} = \alpha + \beta_1 BSIZE_{it} + \beta_2 BIND_{it} + \beta_3 MOWN_{it} + \beta_4 EDU_{it} + \beta_5 TENURE_{it} + \beta_6 AGE_{it} + \mu_i + \lambda_t + \varepsilon_{it}$$

where:

- i = bank,
- t = time period,
- α = intercept,
- β_1, β_2 = coefficients of explanatory variables,
- ε = error term.

Model suitability was evaluated through econometric diagnostics:

- Chow Test determined the appropriateness of pooled OLS versus fixed effects.
- Hausman Test compared fixed versus random effects, with significant results supporting the fixed effects model (Naseem et al., 2020).
- AIC and BIC criteria confirmed the model's optimal fit and parsimony (Putri & Muhammad, 2023).

Pre-estimation diagnostics were performed to ensure robustness:

- Variance Inflation Factor (VIF): Confirmed absence of multicollinearity.
- Breusch–Pagan Test: Indicated homoscedasticity.
- Durbin–Watson Statistic: Verified no serial correlation.

Robustness checks were further conducted through sensitivity analyses, adjusting definitions and excluding outliers to ensure consistency of results.

Data validity was maintained by cross-verifying board composition data from banks' disclosures against OJK records. Reliability was achieved through consistent measurement across all years (2017–2021). All financial indicators were standardized to prevent scaling bias and improve comparability among banks of varying asset sizes (Widarwati et al., 2022).

The exclusive use of audited financial data further enhances confidence in data integrity.

The analytical framework integrates Resource Dependence Theory and Agency Theory to explain expected relationships:

- Resource Dependence Theory posits that larger boards enhance access to knowledge and resources, improving decision-making and firm performance.
- Agency Theory (Ali, 2020) argues that independent directors improve monitoring and mitigate managerial opportunism.

Based on these perspectives, two hypotheses were formulated:

- H1: Board size positively influences financial performance.
- H2: Board independence positively influences financial performance.

This study acknowledges inherent limitations of panel data research. Although the fixed effects model accounts for unobserved, time-invariant factors, it cannot control for time-varying omitted variables or potential endogeneity between governance and performance (Mooney et al., 2021). Due to limited availability of suitable instrumental variables, the relationships identified are interpreted as associative rather than strictly causal. Nevertheless, rigorous model diagnostics and robustness checks mitigate these concerns and strengthen the validity of the conclusions.

In summary, the methodological framework combines panel data regression, robust diagnostics, and theoretical grounding to evaluate the governance-performance relationship in Indonesia's banking sector. The design ensures statistical rigor, replicability, and policy relevance, offering a reliable foundation for empirical insights and future governance reforms in emerging financial markets.

Result and Discussion

The empirical analysis of this study aimed to determine how board composition, specifically board size and board independence, influences the financial performance of Indonesian foreign exchange banks between 2017 and 2021. The findings are presented in two major subsections: the first explores the relationship between board composition and Return on Assets (ROA), and the second examines the relationship between board composition and Return on Equity (ROE). Each subsection integrates statistical results from the panel data regression analysis and compares them with relevant empirical literature to contextualize the outcomes.

Board Composition and Return on Assets (ROA)

The first model assessed the relationship between board size, board independence, and the banks' ability to generate profits from their total assets. The regression analysis reveals that board size has a positive and statistically significant relationship with ROA (coefficient = 0.254, $p = 0.007$). This implies that an increase in the number of directors on a bank's board corresponds with an improvement in asset utilization efficiency and overall profitability. The finding supports the Resource Dependence Theory, which suggests that larger boards enhance organizational performance by broadening the pool of expertise, resources, and external linkages available for strategic decision-making (Shariff et al., 2022; Widarwati et al., 2022). It also corroborates earlier findings by Kılıç & Kuzey (2016), who reported that well-

structured boards positively influence performance indicators such as ROA when governance mechanisms are effectively implemented.

However, this result diverges from the observations of Pradeep (2023), who found that larger boards can impede profitability by complicating coordination and slowing decision-making processes. Pradeep argued that smaller boards foster greater agility and focus, resulting in improved ROA performance. This discrepancy reflects the contextual variability in governance outcomes across different institutional environments. In Indonesia's case, the positive effect of board size may be attributed to the diversity of professional backgrounds within the board, which enhances oversight quality and supports strategic adaptability in the highly regulated banking sector.

In contrast, board independence does not exhibit a statistically significant effect on ROA (coefficient = 0.155, $p = 0.222$). Despite the positive direction of the coefficient, the lack of significance suggests that independent directors' presence alone may not substantially improve profitability. This outcome aligns with Mititean (2022), who noted that while independent directors theoretically strengthen oversight and reduce agency costs, their actual influence often depends on institutional enforcement and the cultural willingness to accommodate dissenting opinions within board discussions. Previous studies suggest that institutional and cultural dynamics may influence the practical role of independent directors in emerging markets (Habtoor, 2022; Siregar et al., 2024). However, these contextual factors are not directly measured in this study and should therefore be interpreted cautiously.

This interpretation is consistent with Majeed et al. (2020), who found that board independence can enhance ROA in markets with stronger regulatory regimes and greater transparency. These authors emphasized that independent directors contribute meaningfully to operational efficiency and asset management when their roles are empowered by institutional support and information access. The absence of a significant relationship in the Indonesian sample may thus reflect limited regulatory enforcement and informational asymmetries that weaken the intended oversight function. Furthermore, cultural and institutional norms may prioritize relational trust and cohesion over confrontation, limiting the practical independence of board members (Iska et al., 2024).

The model's control variables, including managerial ownership, education, board tenure, and board age, were not statistically significant predictors of ROA. This finding reinforces previous arguments that structural and demographic board characteristics may have limited explanatory power without considering behavioral and contextual dimensions (Mooney et al., 2021). The adjusted R-squared value of 0.097 indicates that only a modest proportion of the variation in ROA is explained by the governance variables included in the model, suggesting that additional institutional or firm-specific factors may influence bank profitability (Baltagi, 2021).

Overall, the results indicate that board size plays a more prominent role than board independence in shaping banks' asset-based profitability in Indonesia. The findings suggest that governance reforms should focus not only on enforcing structural compliance but also on improving the functional capacity of boards, including information transparency, director training, and institutional autonomy. Table 1 summarizes the estimated results, reinforcing the relationship between board composition and financial performance.

Table 1. Fixed Effects Regression Results for ROA and ROE

Variable	ROA Coefficient	ROA T-Statistic	ROA P-Value	ROE Coefficient	ROE T-Statistic	ROE P-Value
BSIZE	0.254	2.707	0.007**	1.976	3.340	0.001**
BIND	0.155	1.224	0.222	1.296	1.622	0.106

Variable	ROA Coefficient	ROA T-Statistic	ROA P-Value	ROE Coefficient	ROE T-Statistic	ROE P-Value
MOWN	0.219	0.672	0.502	0.239	0.116	0.907
EDU	-0.122	-1.108	0.269	-1.037	-1.494	0.136
TENURE	0.064	0.635	0.525	0.712	1.128	0.260
AGE	0.081	1.042	0.298	0.416	0.845	0.398
Constant	-1.392	-2.355	0.019	-13.35	-3.599	0.000
Prob F			0.001			0.004
Adj R-Sq			0.097			0.163

Significance at the 0.05 level is indicated by.

Board Composition and Return on Equity (ROE)

The second regression model examined the impact of board composition on Return on Equity (ROE), a measure of profitability that reflects how effectively banks utilize shareholders' investments to generate returns. Similar to the findings for ROA, board size exhibits a statistically significant and positive relationship with ROE (coefficient = 1.976, $p = 0.001$). This reinforces the notion that larger boards contribute positively to overall financial performance by enhancing the strategic decision-making process and strengthening internal governance mechanisms. These results are consistent with Nurkhin et al. (2023), who found that board size positively affects ROE when accompanied by effective governance practices and clear delegation of responsibilities.

Nevertheless, this positive association stands in contrast to studies such as Habtoor (2022) and Kasanah et al. (2022), which reported that larger boards might undermine ROE by increasing coordination costs and diluting accountability. Habtoor argued that as board size grows, decision-making becomes slower and more susceptible to conflicts of interest, especially in firms with complex hierarchical structures. The divergence in results once again emphasizes the contextual dependency of governance-performance relationships. In Indonesia, where board members often possess diverse professional experiences and institutional affiliations, a larger board may enhance strategic adaptability and investor confidence rather than hinder performance.

Board independence, as in the ROA model, does not demonstrate a significant influence on ROE (coefficient = 1.296, $p = 0.106$). Although the positive direction suggests a potential association between higher independence and improved equity-based profitability, the absence of statistical significance implies that the presence of independent commissioners does not translate into measurable financial gains. This result echoes the findings of Boachie (2021), who argued that ownership concentration and limited board autonomy can constrain the effectiveness of independent directors in emerging markets. When major shareholders dominate decision-making processes, independent directors may serve a symbolic rather than substantive role, reducing their impact on firm value and equity performance.

Further evidence from Potharla & Amirshetty (2021) supports this interpretation, noting that institutional and cultural factors in emerging economies play a decisive role in shaping governance outcomes. In environments with hierarchical organizational cultures and weak shareholder activism, board independence alone cannot guarantee effective monitoring or improved returns. These findings align with those of Tran (2021), who suggested that the influence of board independence on firm performance is contingent upon complementary governance structures, such as transparent reporting systems and regulatory enforcement.

The regression diagnostics for the ROE model confirmed its statistical soundness, with an adjusted R-squared of 0.163 and an F-statistic p-value of 0.004, indicating overall model significance. As with the ROA model, none of the control variables reached significance, underscoring that performance outcomes in Indonesian banks are driven more by institutional and governance factors than by demographic

characteristics of board members (Mooney et al., 2021). The results collectively reveal that while board size exerts a tangible and positive effect on financial performance, the influence of board independence remains muted in the Indonesian context.

Taken together, the findings across both ROA and ROE models indicate that board size serves as a more decisive determinant of financial performance in Indonesia's foreign exchange banks. The positive effects observed in both profitability indicators suggest that larger boards enhance governance effectiveness by pooling diverse knowledge and facilitating broader strategic perspectives. Conversely, the non-significance of board independence underscores persistent institutional limitations, such as hierarchical decision-making structures and limited regulatory enforcement. These patterns reflect broader challenges in emerging economies, where formal governance reforms often outpace the development of functional accountability mechanisms.

In summary, the empirical evidence reinforces the argument that board structure influences financial performance differently across governance dimensions. Board size consistently emerges as a significant predictor of both ROA and ROE, supporting the idea that larger, more diverse boards enhance resource access and decision-making quality. However, board independence remains an area of limited functional impact in Indonesia, requiring further institutional strengthening to realize its theoretical benefits. The study's findings emphasize that governance effectiveness in emerging markets must be evaluated within the broader institutional and cultural context rather than through the mechanical application of international standards. This nuanced understanding contributes to refining governance frameworks and provides an empirical basis for policy reforms aimed at enhancing the accountability and performance of Indonesia's banking institutions.

Institutional and Cultural Factors Affecting Board Independence in Emerging Economies

The findings of this study provide stronger empirical support for Resource Dependence Theory than for Agency Theory in the Indonesian banking context. While Agency Theory predicts that board independence improves monitoring effectiveness, the empirical results show no significant relationship between board independence and financial performance. In contrast, the positive association between board size and profitability supports Resource Dependence Theory, which emphasizes the board's role in providing access to external resources, expertise, and strategic networks.

Cultural and social norms further compound this challenge. Indonesia's corporate environment remains influenced by collectivist values and relational hierarchies that often prioritize harmony and respect for authority over open dissent. This cultural predisposition discourages independent directors from challenging executive decisions, thereby weakening their oversight function (Waheed & Malik, 2019). Similarly, Widyaning & Hadiwidjaja (2020) argue that reliance on informal business networks and patron-client relationships undermines the autonomy of independent directors, especially in state-linked or family-controlled enterprises. As a result, board independence in Indonesia operates within an ecosystem where loyalty and consensus often outweigh critical scrutiny,

ultimately limiting its effectiveness in enhancing firm performance.

This institutional limitation resonates with global findings from other emerging markets, such as those observed by Almoneef and Samontaray (2019), who demonstrated that formal board independence does not necessarily lead to improved governance outcomes in the absence of institutional maturity. The same pattern holds in Indonesia, where formal structures have evolved more rapidly than the cultural and behavioral foundations necessary to sustain them. Without robust legal frameworks, shareholder activism, and transparent enforcement systems, independent directors may lack both the authority and motivation to perform their roles effectively. This study therefore adds to the growing consensus that in developing economies, governance reforms must extend beyond structural compliance to address behavioral and institutional constraints that hinder the practical functionality of independence.

Resource Dependence Theory and the Relationship Between Board Size and Firm Performance

The positive and statistically significant relationship between board size and financial performance observed in this study offers strong empirical support for the Resource Dependence Theory (RDT). According to RDT, organizations form governance structures to secure critical resources from their external environments, with the board acting as a vital conduit for knowledge, legitimacy, and connections (Buchdadi et al., 2023). In the case of Indonesian foreign exchange banks, larger boards likely provide greater access to diverse expertise, industry experience, and strategic linkages all of which are essential in navigating an increasingly competitive and regulated financial landscape. These findings align with Meilani et al. (2023), who found that larger boards can improve risk management practices and long-term planning in financial institutions, particularly where the operating environment is complex and dynamic.

However, the relationship between board size and performance is not universally linear. As Pratiwi & Chariri (2021) noted, while larger boards can enhance resource availability and strategic decision-making, excessively large boards may lead to inefficiencies, slow decision processes, and coordination difficulties. The current study's results suggest that Indonesian foreign exchange banks have achieved a relatively optimal board size that balances resource diversity with operational effectiveness. This equilibrium allows them to maximize the strategic advantages of larger boards while minimizing the risks of bureaucratic inertia.

Moreover, the observed relationship may also reflect the unique characteristics of Indonesia's financial sector. Banks with larger boards often include members with backgrounds in finance, law, risk management, and government regulation fields that are particularly relevant for compliance with the Financial Services Authority (OJK) guidelines. Consequently, the diversity of expertise inherent in larger boards may strengthen both external relationships and internal governance capacity, translating into improved performance outcomes as measured by ROA and ROE. This interpretation supports the findings of Ayamga et al. (2024), who observed that board heterogeneity enhances innovation and strategic foresight in highly regulated industries.

Nevertheless, these benefits are contingent on effective communication and collaboration among board members. Resource Dependence Theory emphasizes that it is not merely the size of the board but the quality of interaction among directors that determines governance success. Therefore, while this study validates the positive contribution of board size to firm performance, it also highlights the need for ongoing assessment of board dynamics, decision-making efficiency, and the alignment of expertise with strategic goals.

Governance Reforms and Capacity-Building Strategies

The study's results highlighting the limited functional impact of board independence and the positive contribution of board size carry critical implications for governance reforms in Indonesia and other developing economies. To strengthen board effectiveness, reforms must focus on building both institutional capacity and individual competencies. Habtoor (2022) argues that one of the most effective strategies for improving governance outcomes is targeted training for directors, emphasizing their fiduciary responsibilities and enhancing their understanding of complex financial and regulatory environments. Such capacity-building initiatives can empower board members to act independently, interpret financial risks more effectively, and contribute meaningfully to strategic decision-making.

In addition to individual competency enhancement, legislative and regulatory reforms play a pivotal role in institutionalizing transparency and accountability. Buallay (2019) highlights that mandating disclosure of board structures, independence ratios, and performance evaluations can increase public scrutiny and stakeholder confidence. Similarly, Saidat et al. (2019) suggest that establishing clear criteria for evaluating board effectiveness such as regular self-assessment and external audits can reduce symbolic compliance and ensure genuine governance functionality. Within Indonesia's banking sector, such reforms could strengthen the OJK's supervisory capacity and enhance the credibility of corporate governance disclosures.

Beyond regulation and training, diversity and inclusion have emerged as central dimensions of governance reform. Mititean (2022) notes that diverse boards by gender, experience, and professional background are more likely to foster innovation, mitigate groupthink, and enhance decision quality. These advantages are particularly relevant in the Indonesian context, where many boards remain demographically and ideologically homogeneous. Encouraging gender and professional diversity can introduce fresh perspectives and challenge entrenched hierarchies, thereby fostering a more dynamic and independent governance culture.

Moreover, effective governance reform must also address the socio-political environment in which boards operate. As Arayssi & Jizi (2019) observe, providing legal protection and tenure security for independent directors is essential for encouraging assertive and autonomous oversight. Independent directors who fear dismissal or political retaliation are unlikely to challenge dominant stakeholders, thereby perpetuating passive governance. Similarly, Wijethilake & Ekanayake (2019) emphasize that governance effectiveness depends on stakeholder engagement. Strengthening collaboration among regulators, shareholders, and civil society can create a collective ecosystem that supports transparency and discourages corruption.

In this regard, Indonesia's recent efforts to align governance standards with OECD principles represent a positive step forward. However, as this study's findings indicate, formal alignment must be accompanied by deeper institutional transformation. Developing mechanisms to enforce accountability, incentivize transparency, and reward good governance practices will be crucial for sustaining reform momentum. Integrating governance education into professional certification programs and encouraging inter-organizational learning among banks could further promote institutional maturity and cross-sectoral consistency in governance practices.

The broader implications of these results extend beyond Indonesia. They highlight that corporate governance effectiveness is inherently context-dependent, shaped by the interplay of structural design, institutional strength, and cultural norms. Emerging economies seeking to enhance governance quality must therefore tailor reforms to their unique institutional realities rather than uncritically adopting global

models. As this study demonstrates, while board size can significantly enhance firm performance through resource access and diversity, the functionality of board independence requires an enabling environment that combines institutional enforcement with cultural adaptation. Strengthening these dimensions collectively can pave the way for more resilient and performance-oriented governance systems in developing markets.

Conclusion

This study investigates the influence of board composition specifically board size and board independence on the financial performance of Indonesian foreign exchange banks between 2017 and 2021. The empirical findings reveal that board size exerts a statistically significant and positive effect on both Return on Assets (ROA) and Return on Equity (ROE), implying that larger boards contribute to enhanced profitability and strategic oversight through greater diversity

of expertise and resource access. Conversely, board independence demonstrates no significant effect on either performance indicator, suggesting that structural independence alone is insufficient without robust institutional support and cultural adaptability. These results confirm that governance effectiveness in emerging markets is context-dependent, shaped by the interplay between regulatory enforcement, institutional maturity, and socio-cultural norms. Theoretically, the study extends Resource Dependence Theory by contextualizing its application within Indonesia's governance environment, where larger boards function as strategic assets in resource acquisition and decision-making. Practically, it underscores the necessity for capacity-building initiatives, improved transparency, and institutional reforms that transform formal independence into functional accountability. Future research should explore behavioral dynamics within boards, assess the long-term effects of governance reforms, and incorporate comparative analyses across developing economies to deepen the understanding of governance-performance linkages.

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