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Analysis of the Effect of *Islamic Corporate Governance* on the Financial Performance of Islamic Banking in Indonesia

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Abstract

This research is motivated by the importance of financial performance for the company as a consideration for the management in making financial decisions. The purpose of this study is to analyze the influence of *Islamic Corporate Governance* on the Performance of Islamic Banking in Indonesia. In this study, *Islamic Corporate Governance is* measured by indicators of the board of commissioners, the composition of the board of commissioners and the audit committee. While the financial performance variable is measured by *Return On Assets* (ROA). The population in this study are Islamic Commercial Banks (BUS) registered at Bank Indonesia as many as 11 banks. Based on the *purposive sampling method* , the samples obtained were 8 Islamic banks that met the criteria. The research data was obtained from the *annual report* during the 2016-2020 period. The analytical method used is panel data regression analysis with *Eviews for windows version 9.0 software* . The results of the study show that *Islamic corporate governance* has a positive and significant effect on the performance of Islamic banking. Thus, to improve the performance of Islamic banking, it is necessary to improve *Islamic corporate governance.*

Keywords: *Islamic Corporate Governance, Financial Performance, Islamic Bank*

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1. INTRODUCTION

UU no. 21 of 2008 concerning Sharia Banking states that Sharia Banking is everything related to Sharia Banks and Sharia Business Units, including institutions, business activities, as well as methods and processes in conducting their business activities. Sharia Bank is a Bank that carries out its business activities based on Sharia Principles and according to its type consists of Sharia Commercial Banks and Sharia People's Financing Banks. Sharia principles are principles of Islamic law in banking activities based on fatwas issued by institutions that have the authority to determine fatwas in the field of sharia.

Islamic banking uses sharia principles in its operational activities. Sharia principles are based on fatwas issued by institutions that have the authority to determine fatwas in the sharia sector. In article 1 paragraph 13 of Law no. 10 of 1998 Sharia Principles are agreements based on Islamic law between banks and other parties for depositing funds and or financing business activities, or other activities declared in accordance with sharia, including financing based on the principle of profit sharing (mudharabah), financing based on the principle of equity participation. (musharakah), the principle of buying and selling goods with a profit (murabahah), or financing of capital goods based on the principle of pure lease without choice (ijarah), or with the option of transferring ownership of the goods leased from the bank by another party (ijarah wa iqtina) .

Performance is a description of the achievement of the implementation/program/policy in realizing the goals, objectives, mission and vision of an organization (Suryani, & FoEh, 2018). Financial performance is an analysis carried out to see the extent to which a company has implemented it using financial implementation rules properly and correctly (Fahmi, 2012). Meanwhile, according to IAI (2007)

Financial Performance is the company's ability to manage and control its resources.

Bank performance can be observed from its ability to generate profits or profitability which can be measured using Return On Assets (ROA) and Return On Equity (ROE). ROA focuses on the company's ability to earn earnings in the company's operations, while ROE only measures the return obtained from the company owner's investment in the business (Yundi, & Sudarsono, 2018). ROA was chosen as a measure of bank performance because ROA can be used to measure how well the bank's ability to manage its assets as a whole.

One of the factors that influence financial performance is Islamic Corporate Governance. Islamic Corporate Governance can be defined as a management system that places responsibility for spirituality, with the basic principles of transparency, responsibility, accountability, morality and reliability only as a measuring tool that is material in nature, while the most important and essential is the worship of creatures towards the path that is blessed by Allah (mardhatillah) (Sri, Sari, & Nurhayati, 2014). This definition shows that in corporate governance, management responsibility is not only limited to material responsibility to shareholders or other stakeholders, but there is a more essential responsibility, namely accountability to the Khaliq Allah SWT. Islamic Corporate Governance is a set of rules for the relationship between owners, managers, investors, government, employees and stakeholders based on Islamic values (Gustani, 2021).

Therefore, Islamic Corporate Governance is a value system and mechanism based on Islamic values that regulates the relationship of various parties involved in the company, so that they can carry out their rights and obligations correctly to improve the welfare of all interested parties (stakeholders) in the context of worship. creatures to the path that is pleasing to Allah (mardhatillah). The conception of Islamic Corporate Governance adopts an Islamic value system, namely: Shiddiq, amanah, tabligh, fathonah, istiqamah and qanaah (Sri, Sari, & Nurhayati, 2014). measurement of Islamic Corporate Governance in Sharia Commercial Banks, in accordance with regulations from Bank Indonesia that each bank is required to conduct a comprehensive self-assessment on the adequacy of the implementation of Islamic Corporate Governance.

Research on the influence of ICG on financial performance has been widely studied by previous researchers. Several studies have shown that ICG has an effect on bank financial performance, such as the Werdiningtyas Research, (2020) entitled "The Effect of *Islamic Corporate Governance* (ICG) on Islamic Financial Performance With *Islamic Social Reporting* (ISR) as a Moderating Variable". Lestari Research, (2020) entitled "The Influence of *Sharia Compliance and Islamic Corporate Governance* on the Financial Performance of Islamic Commercial Banks", the results show that *Islamic Corporate Governance* has an effect on the financial performance of Islamic banks. Trilaksono et al (2021)'s research entitled "The Influence of *Islamic Corporate Governance* and *Islamic Social Reporting* on the Financial Performance of Islamic Banks in Indonesia", the results show that *Islamic Corporate Governance* and *Islamic Social Reporting* affect the Financial Performance of Islamic Banks in Indonesia. Furthermore, Najib, & Rini, (2016) entitled *Sharia Compliance, Islamic Corporate Governance* and Fraud in Sharia Banks, the results of this study indicate that *Sharia Compliance*, *Islamic Corporate Governance* and Fraud in Sharia Banks affect the financial performance of Islamic banks.

In addition, several previous studies have shown that ICG has no effect on the financial performance of banks, Budiman's research, (2017) entitled "The influence of *sharia compliance* and *Islamic corporate governance* on the financial performance of Islamic commercial banks in Indonesia for the period 2012-2016", The results show *Islamic corporate governance* has no effect on the financial performance of Islamic commercial banks in Indonesia for the period 2012-2016 . Cahayanti's research (2021) entitled "The Influence of *Islamic Corporate Governance* (ICG) on the Financial Performance of Islamic Commercial Banks", the results of this study indicate that ICG has no effect on the financial performance of Islamic Commercial Banks. Furthermore, the research by Mardiani, Yadiati, & Jaenudin, (2019) entitled "Islamic Corporate Governance and Financial Performance of Sharia Business Units (UUS)", the results of this study show *Islamic Corporate Governance* and have no effect on Financial Performance of Sharia Business Units (UUS).

Based on the background and research gap above where there are inconsistent results on the influence of

ICG on bank financial performance, the authors are interested in researching the Effect of *Islamic Corporate Governance on Islamic* Banking Financial Performance in Indonesia. However, this research has a newness compared to previous studies, namely this research has a different research time period from previous research, namely data from 2016-2020, so the data processed is data with a fairly long period and is the latest data. This study aims to analyze the influence of *Islamic corporate governance* on the financial performance of Islamic banking in Indonesia.

2. RESEARCH METHODS

This research is included in quantitative research. This study uses panel data regression analysis method and is processed using Eviews 9. The independent variable used is *Islamic Corporate Governance* (ICG). While the dependent variable used is financial performance which is measured using *Return On Assets* (ROA). The population in this study were all Islamic Commercial Banks (BUS) registered at Bank Indonesia from 2016 to 2020. The sample selection method used in this study was purposive sampling. Based on the *purposive sampling method* , the samples obtained were 8 Islamic banks that met the criteria. The data in this study are secondary data in the form of time series and *cross section data* with an annual (annual) scale taken from financial report data and the Annual ICG report of Islamic Commercial Banks which are the research samples with a time span of 2016 – 2020. This study uses the 44 method. panel data regression analysis using the computer program EViews Version 9.0 and Microsoft Excel 2007.

3. RESULTS AND DISCUSSION

3.1. Research result

Hypothesis test

The Influence of *Islamic Corporate Governance* on the Financial Performance of Islamic Banks

Table 1. T. test

Variable	Coefficient	Std. Error	t-Statistic	Prob.
ICG	0.570434	0.227972	2.2093970	0.0412

Source: Data Processing Results

The explanation of the table above is as follows:

The test results with panel data regression analysis show that the ICG value is 0.0228 which is smaller than 0.05 so H0 is rejected. This means that ICG has an influence significant to Financial Performance (ROA).

Regression Model Equation

Table 2. Regression Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
ICG	0.570434	0.227972	2.2093970	0.0412

Source: Data Processing Results

Financial Performance = 1.094078 + 0.570434 ICGit

From the above equation it can be explained that:

a. The constant of 1.094078 indicates that if the independent variable (ICG) in observation i and period t is constant, then the financial performance (ROA) is 1.094078.
b. If the ICG value in the i observation and t period is 1%, it will increase the financial performance (ROA) in the first observation and t period by 0.570434 if the value of other independent variables is considered constant.

3.2. Discussion

Based on the results of data processing above, it shows that *Islamic Corporate Governance* has a positive effect on the Financial Performance of Islamic Banking in Indonesia. This is evidenced by the results of hypothesis testing where *Islamic Corporate Governance* has a value of 0.0228 which is smaller than 0.05 so that H0 is rejected , it can be concluded that *Islamic Corporate Governance* has an effect on the financial performance of Islamic banking in Indonesia. This means that the better the level of *Islamic Corporate Governance* in Islamic banking, the better the level of financial performance of Islamic banking.

Financial performance analysis is an analysis used to assess the level of success of the Bank in a certain period based on work plans, work plan realization reports, and Bank periodic reports, the aspects assessed mainly include capital, assets, management, earnings, liquidity, abbreviated CAMEL, compliance with provisions, and other aspects. Analysis of the performance of Banks in Indonesia is basically carried out by Bank Indonesia as the central bank. Performance analysis can also be done by other parties for various purposes. Financial performance can be known based on the analysis of financial statements. The information in the financial statements shows the company's performance which is used as a basis for determining decision making, both for the company itself, investors, and interested parties (Raharjo, 2014).

Ratio calculation is very important for outsiders who want to assess the financial statements of a company. The assessment focuses on the company's ability to meet short-term obligations on liquidity, solvency, profitability, and the company's prospects in the future. This ratio analysis is also useful for the company to assist managers in making evaluations of operating results, correcting errors that occur due to deviations from the plans that have been prepared and avoiding other things that are detrimental to the company. The types of financial performance are ROA (Return On Assets), CAR (Capital Adequacy Ratio), NIM (Net Inters Margin), and ROE (Return On Equity). One type of bank financial performance is ROA, which is a profitability ratio that shows the percentage of profit (net income) obtained by the company in relation to overall resources or the average number of assets (Pongoh, 2013).

Corporate governance is basically a system that includes inputs, processes and outputs and a set of rules that regulate the relationship between stakeholders, especially in the narrow sense of the relationship between shareholders, the board of commissioners and the board of directors in order to achieve company goals. Corporate governance is intended to regulate these relationships and prevent deviations from implementing corporate strategy and to ensure that if errors occur, they can be corrected immediately (Faozan, 2013).

The National Committee on *Governance Policy* (KNKG) (2012) revealed 5 principles in the implementation of corporate governance, namely: transparency, accountability, responsibility, independence, fairness. The five main principles of governance above are in accordance with Islamic norms and values in the activities and life of a Muslim. Islam is very intense in teaching the application of the principles of 'is (justice), tawazun (balance), mas'uliyah (accountability), akhlaq (morals), shiddiq (honesty), amanah (fulfillment of trust), fathanah (intelligence), tabligh (transparency, openness).), hurriyah (independence and responsible freedom), ihsan (professional), wasathan (fairness), ghirah (sharia militancy, shari'ah militancy, idara (management), khilafah (leadership), aqidah (faith), ijabiyah (thinking). positive), raqabah (supervision), qira'ah and ishlah (organizations that continue to learn and always make improvements) (El Junusi, 2012).

The emergence of issues of weakness in corporate governance that threaten business continuity and the credibility of Islamic banks as Islamic financial institutions, encourages Islamic economics and finance experts to develop more Islamic Islamic bank corporate governance, in some literature known as Islamic Corporate Governance (ICG). (Lewis, 24 2005, Hasan, 2008; Abu Tapanjeh, 2009; Bhatti and Bhatti, 2010, in Asrori, 2014). (ICG) seeks to find ways in which the economy, legal system, and corporate governance can be guided by moral and social values based on sharia law. Its proponents believe that economic matters, enterprises, and business activities should be based on the ethareligiuos paradigm, with the aim of prospering individuals and society as a whole. ICG has the same goals as conventional corporate governance, but ICG is in a moral code based on Islam.

The results of this study are in line with the results of Lestari's research, (2020) entitled "The Influence of *Sharia Compliance and Islamic Corporate Governance* on the Financial Performance of Islamic Commercial Banks", The results show that *Islamic Corporate Governance* has an effect on the financial performance of Islamic banks. Trilaksono et al (2021)'s research entitled "The Influence of *Islamic Corporate Governance* and *Islamic Social Reporting* on the Financial Performance of Islamic Banks in Indonesia", the results show that *Islamic Corporate Governance* and *Islamic Social Reporting* affect the Financial Performance of Islamic Banks in Indonesia. Furthermore, Najib, & Rini, (2016) entitled *Sharia Compliance*, *Islamic Corporate Governance* and Fraud in Sharia Banks, the results of this study indicate that *Sharia Compliance*, *Islamic Corporate Governance* and Fraud in Sharia Banks affect the financial performance of Islamic banks.

But on the other hand the results of this study are not in line with the results of previous studies such as the results of Budiman's research, (2017) entitled "The influence of *sharia compliance* and *Islamic corporate governance* on the financial performance of Islamic commercial banks in Indonesia for the period 2012-2016", The results show that *Islamic corporate governance* is not has an effect on the financial performance of Islamic commercial banks in Indonesia for the period 2012-2016. Cahayanti's research (2021) entitled "The Influence of *Islamic Corporate Governance* (ICG) on the Financial Performance of Islamic Commercial Banks", the results of this study indicate that ICG has no effect on the financial performance of Islamic Commercial Banks. Furthermore, the research by Mardiani, Yadiati, & Jaenudin, (2019) entitled "Islamic Corporate Governance and Financial Performance of Sharia Business Units (UUS)", the results of this study show *Islamic Corporate Governance* and have no effect on Financial Performance of Sharia Business Units (UUS).

4. CONCLUSIONS AND RECOMMENDATIONS

Based on the results and data processing that has been described by the authors above, the authors can conclude that *Islamic Corporate Governance* has an effect on the Financial Performance of Islamic Banking in Indonesia. Thus, it means that if Islamic banking in Indonesia wants to improve its financial performance, Islamic banking must also improve *Islamic Corporate Governance*. *Islamic Corporate Governance* is one of the factors that influence the financial performance of Islamic banking in Indonesia, meaning that the better the level of *Islamic Corporate Governance* in Islamic banking, the better the level of Islamic banking financial performance.

Based on these conclusions, the authors recommend several things, namely 1) For Islamic banking, *Islamic Corporate Governance* as a form of Islamic banking social responsibility must be carried out as well as possible so that stakeholders feel the benefits of the presence of Islamic banking in Indonesia, 2) For the government it is better, urges, invites, and monitors the extent to which the realization of companies, especially Islamic banks, is related to *Islamic Corporate Governance*, and 3) For further research, it is hoped that researchers can add variables that are thought to also affect the financial performance of Islamic banking in Indonesia and the time period of the data studied is longer. so that the results really get valid results.

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