

DOES GCG INCREASE FINANCIAL PERFORMANCE? A STUDY IN INDONESIAN SHARIA BANKS.

Devi Novianti¹, Tri Gunarsih^{2*}, Ralina Transistari³

¹Universitas Teknologi Yogyakarta,
Siliwangi Street, North RingRoad, Sleman, D.I.Y, Indonesia. 55285

²Universitas Teknologi Yogyakarta,
Siliwangi Street, North RingRoad, Sleman, D.I.Y, Indonesia. 55285

² STIM YKPN
Palagan Tentara Pelajar Street Km. 7, Sleman, D.I.Y, Indonesia. 55581

Abstract

This study aimed to analyze the impact of Good Corporate Governance (GCG) on the financial performance of Sharia Banks in Indonesia. The sharia banking in Indonesia comprises of Sharia Commercial Bank and Sharia Rural Bank (BUS) and Sharia Business Unit (UUS) as seen to in Act Number 21 of 2008 concerning Sharia Banking. The population in this study are BUS and UUS in Indonesia, which registered in the Financial Services Authority (FSA) in the period 2010-2017. The samples are 240 BUS and UUS, which are selected based on purposive sampling method. This study implements a regression analysis to test the hypotheses. The proxy of GCG is GCG index as referred to Bank Indonesia Regulation Number 11/33/PBI/2009 Concerning The Implementation of Good Corporate Governance by Islamic Commercial Banks and Islamic Business Units. The GCG index ranges from 1 to 5, meaning the best to the worst; the smaller the index number, the better the GCG index. The Return on Assets (ROA) measures financial performance. Other independent variables instead of GCG are sharia bank type (BUS/UUS) and income. The regression results show that there is a negative impact of GCG on ROA. The negative sign of GCG means that the better the GCG index, the higher the ROA. This result suggests that GCG increases financial performance as expected.

Keywords: Index Good Corporate Governance, Return On Assets, Distribution Income Fund.

1. Introduction

There is numerous study of sharia banking performance. Some studies examine the impact of a spin-off to financial performance (Naomi (2017), Al Arif (2018), Hilman (2018), Hamid (2015), Haryanto and Gunarsih (2020)). Other studies analyzed macroeconomic factors and internal factors to sharia bank performance (Istan and Fahlevi, 2020). Some research compares the financial performance in sharia banks is also compared to conventional banks' financial performance (Hazzi and Al Kilani (2013) and Salman and Nawaz (2018)). Hazzi and Al Kilani (2013) found significant differences between such banks concerning profitability, liquidity, and risk performance. Salman and Nawaz (2018) find out the difference between the two areas of banking, that is, Islamic and conventional banking concerning profitability, efficiency, and liquidity.

Corporate Governance (CG) is another variable that considered to influence financial performance is. Major failures in the business world, from Enron to Lehman Brothers, have been

characterized as, among other things, failures of corporate governance. As a result, for a financial institution to compete on a global scale, investors, regulators, and consumers must have faith that the solid corporate governance principles embedded in the institution's core (Samra, 2016). Another study found that GCG enhances the relationship between Sustainability Reporting to firm performance (Gunarsih *et al.*,2020). The result suggests that the better the GCG, the stronger the relationship.

The CG in sharia bank is suspected to be different between countries. Maspupah and Hasnah (2018), Helmi and Mulyany (2019) compare sharia banks CGC in Malaysia and Indonesia, while Khandelwal and Aljifri (2016) compare GCC, Yemen, Egypt, Sudan, Tunisia, Syria, Turkey, Indonesia, Malaysia, Pakistan, Bangladesh, the UK, and South Africa.

Many studies analyzed the impact of sharia banks corporate governance to financial performance, both in term of the structure of corporate governance (Bukhari (2012), Widagdo (2014), Violita (2014), Kusuma and Rosadi (2018) and index of corporate governance (Wahyuni *et al.* (2020), Helmi and Mulyany (2019), Lidyah (2018) and Mukhibad and Khafid (2018).

The studies in Index CG show mixed results. Wahyuni *et al.* (2020) found that the Islamic Corporate Governance Index enhances the value of Sharia commercial banks, and Helmi and Mulyany (2019) Islamic Corporate Governance influenced the performance of Islamic Banks. But, other studies find different results. Lidyah (2018) found that Islamic Corporate Governance does not affect the Islamicity Performance Index, Islamic Income Ratio, Profit Sharing Ratio. Part of the result in Mukhibad and Khafid (2018) supports Lidyah (2018) that empirically found that GCG disclosure did not affect non-performance financing but influenced profitability.

The latest regulation of GCG sharia banking implementation in Indonesia is Bank Indonesia Regulation Number 11/33/PBI/2009 Concerning The Implementation of Good Corporate Governance by Islamic Commercial Banks and Islamic Business Units. The first consideration that regulation is that to build a sound and robust Islamic banking industry, it is necessary to implement Good Corporate Governance in Islamic Commercial Banks and Islamic business units effectively. If the implementation of GCG is sufficient, then the Islamic banking industry will robust, and the financial performance increases.

The mixed results of GCG and financial performance studies and the considerations of the regulation of GCG sharia banking motivates this study, whether the GCG implementation increases financial performance or not. This study analyzes the impact of Islamic GCG implementation on performance in Indonesian sharia banking.

2. Literature Review and Hypotheses Development

2.1. GCG in Indonesian Sharia Banking

In Indonesia, the regulation in Sharia Banking is as in Act Number 21 of 2008 concerning Sharia Banking. The sharia banking comprises of Sharia Commercial Bank and Sharia Rural Bank (from now on shall be referred to as BUS), and Sharia Business Unit (from now on shall be referred to as UUS). The regulation of GCG implementation in Indonesian Sharia Banking is as in Bank Indonesia Regulation Number 11/33/PBI/2009. There are three considerations of the Good Corporate Governance implementation in Islamic Commercial Banks and Islamic Business

Units, as mention in Bank Indonesia Regulation Number 11/33/PBI/2009. The first is that to build a sound and robust Islamic banking industry; it is necessary to implement Good Corporate Governance in Islamic Commercial Banks and Islamic business units effectively. Second, the implementation of Good Corporate Governance in Islamic banking industry shall comply with the Sharia principles. Third, the performance of Good Corporate Governance is one of the efforts to protect the interests of the stakeholders and to improve compliance with the prevailing laws and regulations and values of ethics, which are generally applicable to the Islamic banking industry.

The BUS and UUS should prepare the GCG implementation, as referred to as the regulation. Good Corporate Governance, from now on, referred to as GCG, is banking governance, which applies the principles of transparency, accountability, responsibility, professionalism, and fairness. A BUS shall conduct a self-assessment of the GCG implementation as referred to Article 66 (1) while the procedure outlined in a Bank Indonesia Circular Letter. A UUS shall prepare a report on the GCG implementation at the end of each financial year as referred to Article 76 (1), and the information on the GCG implementation shall include a general conclusion of the self-assessment of the GCG implementation by the UUS.

One of the objectives of GCG implementation is to maintain and improve sharia banks' healthiness and as of the issuance of the Financial Services Authority regulation number 8/POJK.03/2014 and Circular of the Financial Services Authority (SEOJK) number 10/SEOJK.03/2014 concerning Health Level Assessment of BUS and UUS. The self-assessment of GCG is one of the bank healthiness as referred to Risk-Based Bank Rating. The GCG rating consists of 5 ratings, form 1 as the best rating to 5 as the worst rating.

2.2. GCG and Sharia Banking Financial Performance

Some studies support the argument that GCG implementation increases sharia bank performance (Wahyuni et al. (2020), Helmi and Mulyany (2019), and Hisamuddin and Tirta (2013). Other study does not support the argument that GCG implementation increases sharia bank performance (Lidyah (2018). Other studies show the mixed results, some variable support the view that GCG implementation improves sharia bank performance and other do not support (Kusuma and Rosadi (2018), Mukhibad and Khafid (2018), Budiman (2017), Sunarwan (2015), Violita (2014) and Prasinta (2012).

Wahyuni et al. (2020) examine which Islamic Corporate Governance Index can enhance the firm's value for Islamic banking in Indonesia. The Islamic Corporate Governance Index was determined based on the composite value of the results of the Sharia Bank self-assessment. The Islamic Governance Score determined by content analysis of the characteristics of the Sharia supervisory board as measured by the number of Sharia supervisory boards, cross membership; educational background; and experience or reputation of the Sharia supervisory board. ROE is the firm's value indicator. The results of this study indicated that the Islamic Corporate Governance Index could enhance the value of the Sharia Commercial Banks, while the Islamic Social Reporting Disclosure does not. Helmi and Mulyany (2019) support Wahyuni et al. (2020). Helmi and Mulyany (2019) investigate the influence of Islamic Corporate Governance (ICG) on the performance of Islamic Banks (IBs) in two major Islamic financial hubs in Southeast Asia, i.e., Indonesia and Malaysia during the period of 2015-2017. The Islamic Supervisory Board and

Board of Directors represents ICG variable. The indicator of Islamic Banks' performance is the Zakat performance ratio and equitable distribution ratio. This study revealed that ICG indicators influenced the performance of IBs and imply that there is an urgent need to strengthen the ICG mechanism in the Islamic banking industry. The study of Hisamuddin and Tirta (2013) to the BUS 2008-2010 with a sample of 17 sharia banks, showed that GCG affects the financial performance proxied by the ROA and ROE. This study suggests that the implementation of GCG by sharia banks can reduce the conflict of interest and foster Islamic banking performance.

Lidyah (2018) gives empirical evidence that Islamic CG has no impact on sharia banks' performance. In her study, Lidyah (2018) found that Islamic Corporate Governance does not affect the Islamicity Performance Index, Islamic Income Ratio, Profit Sharing Ratio. Other results are that Islamic Investment Ratio (Islamicity Financial Performance Index) influence to Fraud; Islamic Corporate Governance does not affect Fraud and Islamic Income Ratio. Lidyah (2018) analyzed further the Islamic Investment Ratio (Islamicity Financial Performance Index) as mediation variables and found that Islamic Investment Ratio (Islamicity Financial Performance Index) does not mediate the influence of Islamic Corporate Governance to Fraud on Islamic Bank.

The studies of Kusuma and Rosadi (2018), Mukhibad and Khafid (2018), Budiman (2017), (Pratama (2016), Sunarwan (2015), and Violita (2014) show the mixed results in explaining the impact of GCG implementation to performance. Some of the variables in their study support the argument that GCG implementation affects sharia banking performance, while some others do not support it. Kusuma and Rosadi (2018) examine the effect of Islamic Corporate Governance on the financial performance of Islamic banks in 2012-2016. The indicators of the Islamic Corporate Governance comprise the board of commissioners size, Audit Committee Size, Sharia Supervisory Board Size, and frequency of Sharia Supervisory Board meetings. The financial performance' indicator is ROA. The results show that the frequency of sharia supervisory board meetings and the size of the audit committee positively influences the financial performance of Islamic banks. Mukhibad and Khafid (2018) analyze good corporate governance (GCG) and performance in Islamic Banking. GCG is measured based on the disclosure index value in the bank GCG report. The index is calculated by the formula the number of GCG's score divided by maximum score. The study proved that empirically that GCG disclosure did not affect non-performance financing but influenced profitability. Budiman (2017) examined the effect of corporate governance on the financial performance of Islamic banks registered in the FSA from the period 2011 to 2015. The samples consisted of 55 Islamic banks. The results showed that the variables of the board of directors, independent directors and the supervisory board of sharia affect the financial performance. In contrast, commissioners did not affect financial performance.

Sunarwan (2015) examine the effect of corporate governance on the financial performance of Islamic banking as measured by Return on Assets (ROA). The sample in this study is BUS and UUS. The results indicate that the board of commissioners and board of sharia supervisory significantly affect financial performance. While the board of directors, independent board, and audit committee do not significantly influence financial performance as measured by ROA. Violita (2014) also analyzed the influence of corporate governance on financial performance in Islamic Banks in 2010-2013. The results of the analysis variable board size have no effect on financial performance. A variable audit committee has a negative impact on financial

performance. Variable institutional ownership has no effect on financial performance. The managerial ownership variable has an effect on financial performance.

The literature review in this section explains the importance of GCG implementation as referred to Bank Indonesia Regulation Number 11/33/PBI/2009 and Financial Services Authority regulation number 8/ POJK.03/2014 and Circular of the Financial Services Authority (SEOJK) number 10/ SEOJK.03/2014 as well. While there are mixed results of GCG implementation and financial performance results, it is hypothesized in this study that the GCG index influence the financial performance of sharia banking; the better the index, the higher the financial performance.

3. Research Methods

3.1. Population and Sample

The population in this study is BUS and UUS, which are listed in the FSA on 2010-2017. The samples comprise 10 BUS and 20 UUS that published the GCG report and financial report.

3.2. Variables

The dependent variable in this study is ROA (Return On Asset). ROA is one of the profitability measurement and asset turnover measurement, as well. The independent variable is the GCG index of BUS and UUS based on the self-assessment GCG report annually. Other variables are the control variable and dummy variable of BUS and UUS. The control variable is the revenue distribution of funds. The dummy variable is 1 for BUS and 0 for UUS. This variable will capture the profitability difference between BUS and UUS.

3.3. Regression Model

The multiple regression model to test the hypotheses is implemented in this study as follows.

$$Y = \alpha + b_1X_1 + b_2X_2 + b_3X_3 + e$$

Where :

- Y = ROA (Return on Assets)
- X₁ = IGCG (Index of Good Corporate Governance)
- X₂ = Revenue distribution of funds
- X₃ = Dummy (1 for BUS and 0 for UUS)

4. Results

4.1. Descriptive Statistics

Table 1 shows the descriptive statistic. The number of samples is 240 sharia banks. The GCG index as referred to as Bank Indonesia Regulation Number 11/33/PBI/2009 Concerning The Implementation of Good Corporate Governance by Islamic Commercial Banks and Islamic Business Units. The index ranges from 1 to 5, mean the best to the worst; the smaller the index number, the better the GCG index. The minimum ROA is -17.22; the number suggests that there are sample firms that report the loss during the sample period.

Table 1. Descriptive statistics

| | N | Minimum | Maximum | mean | Std. deviation |
|-------------------------------|-----|---------|---------|--------|----------------|
| Index GCG | 240 | 1.00 | 3.42 | 1.8160 | 0.48602 |
| Revenue distribution of funds | 240 | 2.70 | 6.87 | 5.2431 | 0.82162 |
| Dummy | 240 | 0.00 | 1.00 | 0.4333 | 0.49657 |
| ROA | 240 | -17.22 | 23.53 | 2.1328 | 3.77609 |

4.2. Regression Result

Table 2 describes the regression result. The F value is 3.152, statistically significant at $\alpha 5\%$, suggests that the regression model is fit. The R^2 and Adjusted R^2 are relatively low. The low number indicates that many other variables explain ROA instead of the independent variables in the model. The t value of X_1 (Index GCG) is -1.744, statistically significant at $\alpha 10\%$. The negative sign suggests that there is a negative influence between Index GCG to ROA. Since the best index is 1, the lower the index, the better the GCG implementation, then the result suggests that the better the GCG implementation, the better the ROA. The t value of X_2 (Revenue distribution of funds) is 1.257, statistically, not significant. This result suggests that the X_2 (Revenue distribution of funds) has no impact on ROA. The t value of X_3 (Dummy) is -2.612, statistically significant at $\alpha 5\%$. This number suggests that the sharia bank type affects the ROA. Since the dummy variable is 1 for BUS and 0 for UUS, then the negative sign indicates that the BUS has a lower ROA than UUS.

Table 2. Regression Result

| Model | Unstandardized coefficients | T | Sig. |
|---------------------------------------|-----------------------------|--------|----------------------|
| | B | | |
| Constants | 2.073 | 1.070 | 0.286 |
| X_1 (Index GCG) | -0.866 | -1.744 | 0.082 ^{*)} |
| X_2 (Revenue distribution of funds) | 0.435 | 1.257 | 0.210 |
| X_3 (Dummy) | -1.499 | -2.612 | 0.010 ^{**)} |
| F statistic | 3.152 | | 0.026 ^{**)} |
| R^2 | 0.196 | | |
| Adjusted R^2 | 0.026 | | |
| N (Observation) | 240 | | |

Note: ^{**)} and ^{*)} Statistically significant $\alpha 5\%$ and $\alpha 10\%$ respectively

5. Discussion and Conclusions

The hypothesis in this study is that the GCG index influences the financial performance of sharia banking, the better the index, the higher the financial performance. The regression result shows the t value of X_1 (Index GCG) is -1.744, statistically significant at $\alpha 10\%$. The statistical work suggests that the hypothesis not rejected. The GCG index influences the financial performance, the better the index, the higher the financial performance.

The results of this study support the implementation of GCG as referred to Bank Indonesia Regulation Number 11/33/PBI/2009 and Financial Services Authority regulation number 8/POJK.03/2014 and Circular of the Financial Services Authority (SEOJK) number 10/SEOJK.03/2014 as well. The implementation of GCG in sharia banking is essential, not only to build a sound and robust Islamic banking industry but also to increase sharia bank performance.

This study supports the argument that GCG implementation increases sharia bank performance (as in Wahyuni et al. (2020), Helmi and Mulyany (2019), and Hisamuddin and Tirta (2013). This study also in line with the part of the study results in Kusuma and Rosadi (2018), Mukhibad and Khafid (2018), Budiman (2017), (Pratama (2016), Sunarwan (2015), and Violita (2014). If the index of good corporate governance increases, then the return of the sharia banking increase.

Reference

- Act of the Republic of Indonesia Number 21 of 2008 concerning Sharia Banking on July 16, (2008).
- Al Arif, M. Nur Rianto, Nachrowi D Nachrowi , Mustafa E Nasution and T.M. Zakir Mahmud. (2018). Evaluation of the Spin-offs Criteria: A Lesson from The Indonesian Islamic Banking Industry. *Iqtishadia*, 11 (1), 85-104.
- Bank Indonesia Regulation Number 11/33/PBI/2009 Concerning The Implementation of Good Corporate Governance by Islamic Commercial Banks and Islamic Business Units
- Budiman, Arif. (2017). Effects of Good Corporate Governance Financial Performance Against Islamic Bank. *Thesis*, University of Muhammadiyah Surakarta.
- Bukhari, Iqbal. (2012). Effects of Good Corporate Governance and Firm Size Performance Against the Finance Company. *Diponegoro Journal of Accounting*, 1-12.
- Circular of the Financial Services Authority (SEOJK) No. 10 / SEOJK.03 / 2014 on Bank Rating Sharia and Sharia.
- Financial Services Authority (SEOJK) number 10/ SEOJK.03/2014 concerning Health Level Assessment of BUS and UUS.
- Gunarsih, Tri, Ralina Transistari, Ari Rudatin. (2020). Is GCG Strengthening the Influence Between Sustainability Reporting to Financial Performance? (A study in IDX companies). Proceedings of the International Conference on Management, Accounting, and Economy (ICMAE 2020). *Advances in Economics, Business and Management Research* (151), 124-129. <https://doi.org/10.2991/aebmr.k.200915.029>
- Hamid, Abdul. (2015). The Impact of Spin-off Policy to Profitability on Indonesian Islamic Banking Industry. *Al-Iqtishad* 7(1), 117-126.
- Haryanto, Feri Dwi and Tri Gunarsih. (2020). Does Spin-Off Increase Profitability? A Study in 8 Indonesian Sharia Banks. *International Journal of Economics, Business and Management Research* 4 (08), pp.118-130.
- Hazzi, Osama A. and Mohamad Ihsan AL Kilani. (2013). The Financial Performance Analysis of Islamic and Traditional Banks: Evidence from Malaysia, *European Journal of Economics, Finance and Administrative Sciences*, 57, 133-144.

- Helmi, Intan Destia and Ratna Mulyany. (2019). Does Islamic Corporate Governance Contribute to the Performance of Islamic Banks? Evidence from Indonesia and Malaysia. *Proceedings of the 2nd Aceh Global Conference on Business Economic and Sustainable Development Trends (AGC-BEST) 2019*, October 17-18, 2019, Banda Aceh, Indonesia.
- Hilman, Iim. (2018). Sharia Business Unit Spin-off: Strategic Development Model of Sharia Banking in Indonesia. *International Journal of Islamic Banking and Finance Research*, 2 (2), 1-15.
- Hisamuddin, Nur and K M Yayang Tirta. (2013). Effects of Good Corporate Governance to Financial Performance in Islamic Banks.
https://www.BRISyariah.co.id/tentang_hubInvestor.php?f=gcg
- Istan, M. and Fahlevi, M. (2020). The Effect of External and Internal Factors on Financial Performance of Islamic Banking. *Jurnal Ekonomi & Studi Pembangunan*, 21(1), 137-145.
- Khandelwal, Sunil Kumar and Khaled Aljifri. (2016). Corporate Governance in Islamic Banks: a Comparative Study of Conservatives, Moderates, and Liberals. *Corporate Ownership & Control*, 13 (4), 566-574.
- Kusuma, Melia and Samsul Rosadi. (2018). Islamic Corporate Governance and Islamic Banking Financial Performance. *Journal of Finance and Islamic Banking* Vol. 1 No. 2, 164-179
- Lidyah, Rika. (2018). Islamic Corporate Governance, Islamicity financial Performance Index And Fraudat Islamic Bank. *Jurnal Akuntansi*, 22 (03), 437-453.
- Maspupah, Ima and Shofia Mauizotun Hasanah. (2018). Comparison of Good Corporate Governance Disclosure and Achievement of the Maqashid Shariah between Indonesian and Malaysian Islamic Banks. *AFEBI Islamic Finance and Economic Review (AIFER)* 03(01), 63-80.
- Mukhibad, Hasan and Muhammad Khafid. (2018). Financial Performance Determinant of Islamic Banking in Indonesia, *Jurnal Keuangan dan Perbankan*, 22(3):506–517.
- Naomi, Prima. 2017. Financial Performance of Sharia Banks Before and After Spin-Off. *Journal of Innovation in Business and Economics*, 01 (02), 83-92.
- Prasinta, Dian. (2012). Effects of Good Corporate Governance Financial Performance Against. Accounting. *Analysis Journal* 1 (2),1-7.
- Salman, Asma and Huma Nawaz. (2018). Islamic financial system and conventional banking: A comparison. *Arab Economic and Business Journal* 13, 155-167.
<http://dx.doi.org/10.1016/j.aebj.2018.09.003>
- Samra, Emily. (2016). Corporate governance in Islamic financial institutions, *Law School International Immersion Program Papers*, No. 22.
- Sunarwan, Eko. (2015). Effects of Good Corporate Governance Financial Performance Against Islamic Banking. *Essay. UIN Syarif Hidayatullah*. Jakarta.

- Violita Frida. (2014). Effects of Good Corporate Governance Financial Performance Against Islamic Bank. *Journal publication. Muhammadiyah Surakarta University.*
- Wahyuni , Sri, Pujihartob , Dwi Rahmawati Rahayu. (2020). Islamic Corporate Governance Index and Islamic Social Reporting Disclosure Index for Enhancing Firm Value: An Empirical Study of Islamic Banking in Indonesia. *International Journal of Innovation, Creativity and Change.* www.ijicc.net Volume 12, Issue 1. 511-520.
- Widagdo, Dominic Oktavianto Kresno. (2014). Effects of Good Corporate Governance of the Company's performance. *Diponegoro Journal volume 3.*