
The Impact of Good Corporate Governance Implementation on the Financial Performance of Islamic Banking in Indonesia

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Abstract

This study aims to analyze the impact of Good Corporate Governance (GCG) implementation on the financial performance of Islamic banks in Indonesia. This study uses panel data covering a five-year period, namely from 2019 to 2023, and involves a sample of 17 Islamic banks that meet the selection criteria, with a quantitative approach with descriptive and analytical methods. Data analysis was conducted using panel data regression with the help of EViews 13 processing software. The results show that GCG implementation, the existence of an audit committee, and managerial ownership simultaneously have a significant effect on the financial performance of Islamic banks as measured by the Return on Assets (ROA) ratio. Partially, GCG has a significant negative effect, the audit committee has no significant effect, while managerial ownership has a significant positive effect on ROA. These findings provide important implications for strengthening governance structures to encourage more optimal financial performance of Islamic banks.

Keywords: corporate governance index, profitability, audit committee, management ownership

1. Introduction

Financial performance is a crucial indicator in assessing the health and sustainability of Islamic banks. In Indonesia, the Islamic banking sector has experienced significant growth as public awareness of Islamic financial principles, which prioritize profit-sharing and prohibit usury (Hidayat et al., 2023).

Good Corporate Governance (GCG) plays a crucial role in regulating and overseeing company operations to ensure transparency, accountability, and fairness. Effective implementation of GCG principles has the potential to improve company performance, including in the banking sector, such as at Bank Syariah Indonesia. In the context of Islamic banking, GCG implementation can strengthen Sharia-compliant governance, increase efficiency, and prevent abuse of power (Safitri & Mukhibad, 2020).

According to Kolid & Bachtiar, (2014; and Sulaiman et al., (2015) financial performance and company value factors cannot be separated from the importance of implementing Good Corporate Governance in companies. GCG is one of the non-financial components that is an important issue and needs to be considered by companies in an effort to increase profits and company performance (Mukhibad & Khafid, 2018). Good corporate governance in Indonesia can be reviewed through the CG Watch report. The report relates to the results of a study on the implementation of Good Corporate Governance (GCG) in Asia which includes aspects of assessing corporate governance rules and practices such as social, environmental, fairness, accountability, transparency, discipline, independence, law enforcement, regulatory issues, politics, as well as accounting and auditing (Laksono, 2021)

The Audit Committee functions to ensure that the internal control system runs smoothly and to supervise the audit process and financial reports produced by the bank (Wijoyo et al., 2024). With an effective audit committee, errors and irregularities in financial reports can be minimized, which will certainly contribute to improving the bank's financial performance. The audit committee is a committee established by the board of directors and can be relied upon by the leadership group to assist in fulfilling the obligations and elements of the Judicial Institution leadership (Bapepam-LK Regulation Number IX.I.05). The audit committee and independent auditors have interrelated responsibilities related to financial reporting. The independent auditor is responsible for monitoring management in the financial reporting process, and the independent auditor is responsible for the opinion on the fairness of the financial statements (Tessema, 2019). According to (Yacob et al., 2019), the audit committee is also formed to assist in supervising the board of directors and the management team, as well as ensuring the implementation of good corporate governance principles. The Audit Committee plays a crucial role in ensuring that the financial reports presented by Islamic banks are accurate and reliable. They are responsible for reviewing the effectiveness of internal control systems, identifying potential non-conformities, and ensuring that financial reports comply with applicable accounting standards. Oversight by the Audit Committee can reduce the likelihood of fraud or errors in financial reporting, which in turn can increase transparency and investor confidence. With strong controls, banks can manage assets and liabilities more efficiently, which directly impacts financial performance (Mahrani & Soewarno, 2018). Therefore, a better quality audit committee can improve a bank's financial performance (Alsagr et al., 2018; Nuswantara et al., 2020).

Managerial Ownership refers to the extent to which shares are owned by managers or other parties involved in bank management. Several studies have considered managerial ownership as a mechanism that can mitigate agency problems, as managers with shareholdings tend to prioritize company performance (Molla et al., 2021). In the context of Islamic banks, managerial ownership can increase motivation to operate efficiently and in accordance with Sharia principles, potentially improving the bank's financial performance (Nuswantara et al., 2020). Managerial ownership represents the proportion of share ownership held by management. Managers who own shares will naturally align their interests with those of shareholders to avoid conflicts. Therefore, the principles of transparency, fairness, and equality are essential for

companies to ensure managers are diligent in ensuring the company's proper operation and maintaining expected financial performance (Molla et al., 2021).

Effective implementation of Good Corporate Governance (GCG) in Indonesian Islamic Banks is crucial for enhancing credibility and transparency, but its impact on financial performance requires further analysis (El-Chaarani et al., 2022 and Nuswantara et al., 2020). Overall, the implementation of Good Corporate Governance, involving the Audit Committee and Managerial Ownership, is believed to have a significant impact on the financial performance of Islamic banks in the Middle East and North Africa (El-Chaarani et al., 2022). This study will explore the relationship between these variables to provide further understanding of how good governance can contribute to the financial performance of Islamic banks in Indonesia.

2. Theoretical Review and Hypothesis

Islamic Bank: Definition and Characteristics

Islamic banking is a banking system whose operations are based on sharia principles, namely Islamic law derived from the Quran, Hadith, and fatwas from Islamic scholars and authoritative institutions such as the National Sharia Council (DSN) (Mulya & Ansari, 2024). Fundamentally, Islamic banks differ from conventional banks because they reject practices involving riba (interest), gharar (excessive uncertainty), and maysir (gambling/speculation), which are prohibited in Islamic teachings (Suliyono & Risfandy, 2021). Islamic banking business activities and products must be free from these elements. Its main characteristic lies in the principles of fairness and transparency between the bank and its customers, emphasizing the concept of profit and loss sharing. An example of this implementation is the mudharabah contract, where the customer, as the fund owner (shahibul maal) and the bank, as the manager (mudharib), share the business profits according to an initial agreement (Suciningtias & Astuti, 2020).

Another distinctive feature is the Sharia Supervisory Board (SSB), tasked with overseeing all bank operational activities and products to ensure they comply with sharia principles. The SSB consists of Islamic legal experts who independently issue fatwas and sharia opinions on the bank's products, services, and management policies (Ben Bouheni et al., 2016). Sharia compliance is a key parameter in maintaining the trust and integrity of Islamic banking. Products offered include wadiah savings, mudharabah deposits, murabahah financing, musyarakah, ijarah, and sharia-based financial services. All products are aimed at supporting halal economic activities and avoiding investments in prohibited sectors such as alcohol, gambling, or environmentally harmful businesses (Arafah et al., 2023).

Regulation and Governance of Islamic Banking in Indonesia

The Islamic banking industry is regulated by government regulations and independent authorities, with Law No. 21 of 2008 as the primary legal basis. The Financial Services Authority (OJK) has played a strategic role in supervision, compliance enforcement, and consumer protection since 2008 (Anonymous, 2022). In governance, Islamic banks are required to implement good corporate governance (GCG) principles, including transparency,

accountability, responsibility, independence, and fairness. They also have a Supervisory Board (SSB) to ensure policies and products comply with Islamic principles (Muhammad et al., 2021).

The OJK also promotes public education, transparency, and accountability through regular Islamic reporting and audits. In recent years, the OJK and the National Sharia Council (DSN-MUI) have tightened regulations regarding innovation in Islamic digital financial products to ensure they comply with Islamic principles, given the rapid technological developments in the banking sector (Riyadi et al., 2021).

Financial Performance

In addition to operating within Sharia principles, Islamic banking is also required to maintain strong financial performance. Financial performance for banks is measured by various indicators, such as capital adequacy ratio (capital adequacy ratio), liquidity (financing to deposit ratio), and profitability. Profitability is the primary indicator of banking performance (Hidayat et al., 2023). Therefore, Islamic banks must balance Sharia compliance with profitability (Muda et al., 2013). Profitability is a bank's ability to generate profits, as measured by return on assets (ROA) and return on equity (ROE) (Zakaria et al., 2022). High profitability indicates a company's ability to manage resources effectively and maintain long-term financial health.

Good Corporate Governance

According to Candra (2021), Good Corporate Governance (GCG) is a system and structure for managing a company to increase shareholder value and protect the interests of all stakeholders. Kakar et al. (2021) cited GCG as a topic of ongoing discussion in the business world, while Badrul Muttakin & Shahid Ullah (2012) emphasized the importance of implementing GCG in Islamic banking, in accordance with Bank Indonesia Regulation No. 11/33/PBI/2009, which adheres to sharia principles.

The success of GCG is influenced by external factors such as a consistent legal system, support from public institutions, examples of effective implementation, supportive social values, community participation, an anti-corruption spirit, and improved human resource quality. Good GCG implementation is expected to create transparency, accountability, and business sustainability.

The Effect of Good Corporate Governance on Financial Performance

The Indonesian Institute for Corporate Governance (2016) defines GCG as the systems and procedures that govern company activities to maximize value without neglecting stakeholder interests. The FCGI defines GCG as a set of rules governing the relationship between shareholders, management, creditors, the government, and other related parties.

With GCG, companies are able to control operations transparently and accountably, thereby minimizing risk and increasing investor confidence. Asare et al. (2022) and Kakar et al. (2021)

found a positive and significant effect between corporate governance and banking financial performance. Therefore, the proposed hypothesis is:

H1: GCG has a significant positive effect on financial performance.

The Influence of the Audit Committee on Financial Performance

According to Indriyani & Asytuti (2019), the audit committee is formed by the board of commissioners and consists of at least an independent commissioner, an accounting expert, and an Islamic banking expert. This committee oversees audits, risk management, financial reporting, and the implementation of GCG. Yunina & Nisa (2019) emphasize its role in monitoring internal controls, while Bank Indonesia Regulation No. 8/14/PBI/2006 stipulates a minimum of three members.

The audit committee maintains independent oversight, acts as a liaison between external and internal auditors, and the board of commissioners, and ensures the quality of financial reporting. The more optimal its role, the better the company's financial performance because the oversight process is more effective and accountable (Wijoyo et al., 2024). Nuswantara et al. (2020) stated that the audit committee helps the board of commissioners ensure sound internal controls, valid financial reports, and legal compliance. Syafruddin (2020) added that Islamic banks have dedicated committees, including audit committees, to maintain the quality of financial report disclosures.

A professional and independent audit committee enhances the credibility of financial reports and enhances the effectiveness of oversight. Alsagr et al. (2018) and Nuryana & Dwi Surjandari (2019) found that the number of audit committees has a positive and significant effect on financial performance, thus hypothesizing:

H2: The number of audit committees has a positive effect on financial performance.

The Effect of Managerial Ownership on Financial Performance

Molla et al., (2021) define managerial ownership as the portion of shares owned by management, who actively make company decisions. The goal is to align the interests of managers and shareholders, encouraging managers to maximize profits. Indriastuti et al. (2020) emphasized that shareholder managers will be oriented towards increasing company value. The greater managerial ownership, the greater the manager's motivation to operate prudently, transparently, and avoid financial manipulation. This can improve company performance, increase ROA, and create sound governance.

Managerial ownership minimizes conflicts of interest between managers and shareholders because managers directly experience the impact of business decisions. According to Al-Janadi (2021) and Basyith et al. (2015), this ownership drives increased ROA through the motivation to maximize profits. By increasing the proportion of shares owned by management, the opportunity

for financial manipulation is reduced, transparency is increased, and company performance is optimized. Basyith et al. (2015) found that managerial ownership has a positive and significant effect on financial performance. Therefore, the proposed hypothesis is:

H3: Managerial ownership has a positive effect on financial performance.

3. Method

This study uses a quantitative approach with descriptive and analytical methods to analyze the effect of Good Corporate Governance (GCG), the Audit Committee (AC), and Managerial Ownership (MOWN) on the financial performance of Indonesian Sharia Banks. Secondary data was collected from the annual reports and official publications of 17 Islamic banks and Islamic business units for the 2019–2023 period. They were selected using purposive sampling based on criteria for data completeness and suitability of the research variables. The dependent variable was financial performance (ROA), while the independent variables included the GCG index, the number of audit committee members, and the percentage of managerial ownership.

Data processing was carried out through document review and annual report analysis, followed by analysis using panel data regression. There are three models in panel data regression: the common effects model (CEM), the fixed effects model (FEM), and the random effects model (REM). To select the best model, it was first tested using the Chow test, the Hmsan test, and the Lagrange Multiplier test. The panel data regression model used is:

$$ROA = \beta_0 + \beta_1GCG + \beta_2AC + \beta_3MOWN = \varepsilon$$

From this research model, it can be explained that ROA is the return on assets used to measure financial performance, GCG (Good Corporate Governance) is measured by the governance index, and AC (audit committee) is measured by the number of audit committee members, while MOWN (managerial ownership) is measured by the number of shares owned by management divided by the total shares outstanding.

4. Results and Discussion

Descriptive

Descriptive statistical testing was conducted to provide a general overview of the object being studied. This can provide initial information about the problem being investigated. The results of the descriptive statistical testing in this study can be seen in the following table:

Table 1: Descriptive Statistics

	ROA	GCG	AC	MOWN
Mean	0.014905	79.47049	2.423529	0.371882
Median	0.014621	78.88889	2.000000	0.320000
Maximum	0.021731	86.73469	3.000000	0.700000
Minimum	0.012063	76.54321	2.000000	0.220000
Std. Dev.	0.001918	2.296237	0.497050	0.125864
Skewness	1.489509	1.326604	0.309524	1.037781
Kurtosis	5.847408	4.324026	1.095805	3.056129
Observations	85	85	85	85

Source: Data processed

Overall, the descriptive analysis results indicate that all study variables tend not to be normally distributed based on the Jarque-Bera test, although the data variation is relatively small to moderate. Therefore, in the panel regression analysis stage, the use of a method with robust standard errors is recommended to ensure reliable estimation results even if the residual normality assumption is not met.

Model Testing

The Chow test was used to compare the Common Effects Model (CEM) with the Fixed Effects Model (FEM). The Chow test results showed an F-statistic of 116.494284 with a p-value of 0.0000. Thus, the Fixed Effects Model is more appropriate than the Common Effects Model.

The Hausman test was used to determine the best model between the Fixed Effects Model and the Random Effects Model. The test results showed a Chi-Square value of 239.605732 with a p-value of 0.0000. Therefore, it can be concluded that the Fixed Effects Model is more appropriate than the Random Effects Model. In this study, the LM test was not performed. This is because the results of the Chow and Hausman tests consistently indicate that the best model is the Fixed Effect Model (FEM). The LM test is essentially only necessary to compare the CEM and REM, so it is no longer relevant after the FEM is selected as the most appropriate estimation model.

Hypothesis Testing

Based on the model testing results, the best model is the Fixed Effect Model. The following are the results of the hypothesis test using e-views with the fixed effect model:

Table 2: Hypthesis Result With Fixed Effect Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.01726	0.007711	2.238403	0.0286
GCG	-0.000363	9.98E-05	-3.636623	0.0005
AC	1.39E-07	7.81E-05	0.001778	0.9986
MOWN	0.071209	0.002591	27.48212	0.0000

Source: Data processed

Corporate Governance and Financial Performance

The results of this study indicate that the Good Corporate Governance (GCG) Index has a negative and significant effect on Return on Assets (ROA) in Islamic banks in Indonesia. The regression coefficient of -0.000363 with a significance level of 5% ($p < 0.05$) indicates that an increase in the GCG score actually decreases bank profitability.

This finding contradicts the initial hypothesis that predicted a positive relationship. Theoretically, GCG implementation should increase transparency, accountability, and management effectiveness, thereby increasing profitability. However, this negative result can be explained by the high compliance costs caused by GCG regulations, which depress profits in the short term.

These results are consistent with the findings of Badrul Muttakin & Shahid Ullah (2012) and Kakar et al. (2021), who found that GCG implementation does not always have a positive impact on profitability, particularly in the Islamic banking industry, which is heavily regulated and faces significant operational cost pressures. Thus, although GCG remains important as a governance instrument, its implementation needs to be balanced with operational efficiency to avoid compromising financial performance.

Audit Committee and Financial Performance

Based on the results of the regression analysis, the Audit Committee does not significantly influence ROA. The regression coefficient of 0.000000139 with a significance level of $p = 0.9986$ (>0.05) indicates that the existence of an audit committee has not significantly contributed to the profitability of Islamic banks. Theoretically, the audit committee's function is to oversee the financial reporting process, maintain audit quality, and reduce the risk of fraud. However, in practice, the effectiveness of the audit committee depends heavily on the competence, independence, and frequency of its members' meetings. If these factors are not optimal, the audit committee's function tends to be merely a formality. This aligns with research by Chronopoulos et al. (2023) and Pertiwi & Husaini (2021), which emphasizes that audit committee effectiveness is influenced by the quality of human resources, not simply the number of members.

Furthermore, a study by Raouf & Ahmed (2022) also stated that the role of audit committees varies depending on the institutional context and applicable regulations. Therefore, this study confirms that the existence of audit committees in Islamic banks in Indonesia is still not optimal for driving increased ROA.

Managerial Ownership and Financial Performance

The results of this study indicate that managerial ownership has a positive and significant effect on ROA. The regression coefficient of 0.071209 with a significance level of $p = 0.0000$ (<0.01) indicates that the greater the proportion of share ownership by management, the higher the level of profitability achieved by Islamic banks. This finding supports agency theory, which states that managerial ownership can align the interests of managers and shareholders. By owning shares, managers are encouraged to improve company performance because they also experience financial benefits.

These results align with research by Kakar et al. (2021) and Wahyuni & Lestari (2021), which found that proportional managerial ownership can reduce agency conflicts, encourage prudent decision-making, and improve asset management efficiency. Therefore, managerial ownership has been proven to be an effective governance mechanism in increasing the profitability of Islamic banks in Indonesia.

5. Conclusions and Recommendations

This study analyzes the influence of Good Corporate Governance (GCG), Audit Committees, and Managerial Ownership on the financial performance of Islamic banks in Indonesia (2019–2023), as measured by ROA. The results show that GCG has a significant negative effect, the Audit Committee has no significant effect, and Managerial Ownership has a significant positive effect on ROA. Simultaneously, all three variables significantly influence financial performance. This study strengthens agency theory and emphasizes the importance of effective GCG implementation and managerial ownership management to avoid new conflicts of interest.

Limitations of the study include the data coverage of only five years, the focus on Islamic banks with complete financial statements, and the use of a quantitative approach based on secondary data with limited variables. It is recommended that Islamic banks improve the quality of GCG implementation, regulate managerial ownership, and optimize the role of audit committees. Future research could add variables such as company size, liquidity, leverage, or macroeconomic factors, use alternative analysis methods (e.g., GMM or SEM) to minimize estimation bias, and combine secondary data with qualitative data, such as interviews, to enrich the analysis.

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