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The Role of Islamic Corporate Governance and Risk toward Islamic banks Performance: Evidence from Indonesia

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Abstract:
Research aims: This study aims to analyze the role of Islamic corporate governance mechanisms on the performance of Islamic banks. Besides, it also analyzes the effect of risk profiles, especially those that are directly related to bank financing, on the performance of Islamic banks.
Design/Methodology/Approach: Islamic banks that become the objects are Sharia Commercial Banks (SCB) and Sharia Business Units of Conventional Banks (SBU). This study uses data from 20 Islamic banks (11 SCB and 9 SBU). The analytical tool used in this study is panel data regression.
Research findings: The results show that the meeting frequency of the Board of Commissioners (BC), Sharia Supervisory Board (SSB), Financing to Deposits Ratio (FDR), and bank size have a significant positive effect on the performance of Islamic banks. Non-Performing Financing (NPF) has a significant negative effect on the performance of Islamic banks.
Theoretical contribution/Originality: This study utilized Stakeholders theory, *Maqashid Sharia* concept, and corporate governance to investigate the role of Islamic corporate governance mechanisms and risk management on Islamic banks performance.
Practitioner/Policy implication: The implication of this study is that SSB activities had a direct and robust influence on Islamic banks, which have relatively larger assets. Hence, the task of the Sharia Supervisory Board should not be limited to only monitoring the conformity of transactions with sharia but also providing input so that banks can increase their profits in line with sharia.
Research limitation/Implication: The limitation in this study is the number of corporate governance variables that was limited.
Keywords: Islamic Corporate Governance; Risk Profile; Sharia Supervisory Board; Islamic bank Performance

Introduction

The development and growth of Islamic banking in Indonesia have been rapid since 2002. While it has experienced stagnation as evidenced by less than 5% of market share, since 2017, the market share of Islamic banks has passed out of “five percent traps,” which means it has increased its market share above 5% to 5.74% (OJK, 2017a). Islamic banking has a much smaller market share than conventional banking. In fact, the overall social performance of Islamic banking in Indonesia remains lower than that of neighbouring country Malaysia in 2010 (Sofyani et al., 2012). Although Islamic banking has a smaller market share than conventional banking, it has grown at a rapid pace (OJK, 2017a).

Regardless of the differences in the conditions outlined above, both Islamic and conventional banks face the same corporate governance issues as other businesses. The inability of large companies to operate effectively results from poor corporate governance implementation (Bonn & Fisher, 2005). Additionally, poor corporate governance necessitates the significant importance of risk management. Risk management is a critical aspect of today's business environment (Gates, Nicolas, & Walker, 2012). This research focuses on two aspects of the company's primary objective of achieving high performance.

Corporate governance entails both structure and mechanism aspects. This study aims to examine the effect of Islamic corporate governance mechanism on the performance of Islamic banks in Indonesia. In the corporate governance mechanism, the Board of Commissioners is the primary required party. Numerous research, including those by Kang and Kim (2011), Liang, Xu, and Jiraporn (2013), Al-Matari, Al-Swidi, and BtFadzil (2014), and Kakanda, Salim, and Chandren (2017) demonstrated a positive association between the frequency of Board of Commissioners meetings and bank performance. By contrast, Harvey Pamburai et al. (2015) discovered a negative association. Meanwhile, Qadorah and Fadzil (2018) found no relationship between the Board of Commissioners and company performance. Due to the inconsistency of these studies' findings, the we decided to re-examine this issue using a different set of objects in this study.

An empirical study that connected corporate governance to an Islamic perspective by incorporating the role of the Sharia Supervisory Board (in Indonesia, it is referred to as Dewan Pengawas Syariah/DPS) was conducted by Mollah and Zaman (2015). They investigated the relationship between variables associated with Sharia Supervisory Boards (SSB), concluding that the presence of SSB had a significant positive effect on company performance. The study noted, however, that the impact may be negligible if regulations or businesses limit the role to advisory only. Thus, the current study extends Mollah and Zaman's (2015) findings by focusing not only on the existence of SSB but also on its activity.

Additionally, current study examines the effect of risk profile on the performance of Islamic banks (more precisely, the risks directly related to the bank's finances). Boahene, Dashah, and Agyei (2012), Kolapo, Ayeni, and Oke (2012), and Nawaz et al. (2012) established an empirical link between high levels of bad loans and poor financial performance. In comparison, Nguyen (2020) discovered a significant effect on large banks, but not on small banks. According to Gul, Irshad, and Zaman (2011), the more credit provided, the higher the bank's performance. However, Kingu, Macha, and Gwahula (2018) stated that it would increase risk and decrease the bank's profit rate as a percentage. Therefore, we are interested in establishing and testing these linkages.

Banks with substantial assets are more efficient (Ajlouni, Hmedat, & Hmedat, 2011), which has an impact on the performance. However, as Fiordelisi and Marqués-Ibañez argue, the larger the bank, the greater the systemic and systematic risk (2013). Adelopo, Lloydking, and Tauringana (2018), Al-Homaidi, Tabash, Farhan, and Almaqtari (2018), Batten and Vo (2019), Bolarinwa, Obembe, and Olaniyi (2019), and Bono (2019) all conducted research that demonstrated a positive effect of size on performance. However, Bouaziz and Triki (2012), as well as Tariq Bhutta and Hasan, revealed the opposite results (2013). Nguyen's (2020) findings indicated that the influence was insignificant on both small and large institutions. Thus, we are interested in re-examining different objects due to the variance of prior studies' findings.

Based on the background, the study's problem formulation is as follows: Does the Islamic corporate governance mechanism, which includes the roles of the Board of Commissioners, and sharia supervisory board, affect the performance of the bank; and does the risk profile, which takes into account non-performing financing and the financing to deposits ratio, as well as the size of the bank, affect the performance of Islamic bank?

This research is expected to provide information, references, and comparisons of theory and practice regarding the application of Islamic financial management principles that affect bank's performance. A distinct contribution about SSB is to develop prior studies. Previously conducted research focused exclusively on the effect of SSB presence on performance. Meanwhile, to improve the accuracy of the interpretation in this study, the frequency of SSB meetings is employed as a proxy for SSB activities. Additionally, it is anticipated that empirical evidence will reveal that the size of Islamic banks' assets has a significant impact on their performance, implying that large Islamic banks will be able to compete with large conventional banks.

Literature Review and Hypothesis Development

Islamic Corporate Governance

The main theories related to corporate governance are Agency Theory, Stewardship Theory, and Stakeholder Theory. In this study, the theoretical approach for corporate governance focuses on Stakeholder Theory. This is in reference to Iqbal and Mirakhor (2004), who assert that the Islamic economic system's corporate governance model is stakeholder driven. According to Stakeholder Theory, a business does not exist for its own sake but rather for the benefit of all stakeholders (Amran, Manaf Rosli Bin, & Che Haat Mohd Hassan, 2009). Corporate governance practices and structures based on Stakeholder Theory must safeguard the interests and rights of all stakeholders (Iqbal & Mirakhor, 2004).

What has been stated thus far is consistent with Islamic economics' objective, namely the attainment of welfare for all parties based on the concept of *Maqoshid Sharia* (sharia goals). In the context of sharia, there is an aspect of *Maqoshid Sharia*, which is to attain benefits both in this world and in the hereafter. Benefits can be achieved by maintaining five necessities: faith, life, intellect, lineage/honor, and property. Chapra (2008) considers aspects of good governance as part of the process of achieving *falah* (well-being) in one component of *Maqoshid Sharia*, namely the aspect of property protection. The concept of *Maqoshid Sharia* can serve as a foundation for Islamic economics in an effort to benefit humans, and it is viewed as capable of resolving economic problems faced by people today (Chapra, 2008).

The Islamic economic system (including one of its manifestations in the form of Islamic banking) is a part of *muamalah*. *Muamalah* is a subset of Islamic law which is an integral part of a perfect Islamic system and cannot exist independently of other Islamic rule systems governing *aqidah* (faith), *ibadah* (worship), and *akhlaq* (ethics) (Habibullah, 2018). Additionally*, fiqh* can be defined as the product of Islamic scholars' interpretations of sharia. The fundamental rule in *fiqh muamalah* (Djazuli, 2006) is "*Al ashlu fil asyyaail ibaahatu hatta yadullad daliilu tahriimi*," that means the law of origin of everything is permissible until there is a law that shows its prohibition. As a result, the Sharia Supervisory Board's actions in Islamic banking are critical.

Corporate governance, from an Islamic perspective, is a system that guides and governs businesses to achieve their objectives while preserving the interests and rights of all stakeholders. It is based on the Islamic socio-scientific epistemology of Allah's oneness (Sodiq, 2019). From an Islamic perspective, company management is responsible not only to investors but also to God (Putra & Wijayanti, 2020). According to Bhatti and Bhatti (2010), Islamic corporate governance is an attempt to construct a system in which economic agents, legal systems, and corporate governance can be directed by sharia-based moral and social values. Islamic banking is an example of a business that adheres to Islamic corporate governance. Bank Indonesia (2009) controls corporate governance for Sharia Commercial Banks and Sharia Business Units under PBI regulation Number 11/33/PBI/2009.

The conventional corporate governance concepts have been included in the Islamic corporate governance principles (Endraswati, 2015). Corporate governance in the conventional sense is guided by several principles, including transparency, accountability, responsibility, independence/professionalism, and fairness (OJK, 2017b). Transparency represents *shiddiq* (honest), accountability is consistent with *shiddiq* and *amanah* (trustworthy), responsibility is associated with *amanah* and *tabligh* (delivering the truth), independence/professionalism is associated with *amanah* and *fathanah* (intelligent), and fairness is consistent with *shiddiq* and *amanah.*

It can be said that Islamic corporate governance is a derivative concept of corporate governance with the distinction that it complies with Islamic laws. Conceptually, according to the we, there is a solid junction between *Maqoshid Sharia*, stakeholder theory, and corporate governance. These three points serve as the primary theoretical basis for this research.

Bank's Risk Profile

Risk management is also a company's responsibility to its stakeholders. In the banking context, the risk is a potential occurrence, anticipated or unanticipated, that has a detrimental effect on the bank's income and capital (Karim, 2004). Bank Indonesia (2003) in PBI regulation Number 5/8/2003, defines risk as the potential occurrence of events that could result in a loss to the bank. Banking is a risk management business (Rosly & Zaini, 2008). Bank risk can be defined as the compilation of probability levels for an event and the resulting consequences to occur in the bank, where each operation has the potential to generate profits or losses or threaten success. The rule of *al-ghunm bil-ghurm* states that *ghurm* or risk in Islamic law is complemented by the possibility of profit.

The risks faced by financial institutions can be generally divided into financial risks and non-financial risks (Khan & Ahmed, 2001). Financial risks consist of market risk, credit risk, and liquidity risk. Non-financial risks are broad in scope, not only operational risks and regulatory risks or legal aspects. In Islamic banking, there is sharia risk in the form of risks related to the structure and function of sharia supervision at the institutional and systemic levels. Islamic banks are required to employ risk management in their business (Bank Indonesia, 2011; OJK, 2016). From a financial point of view, the measurement of credit risk in Islamic banks is informed by Non-Performing Financing. The measurement of liquidity risk is known from the Financing to Deposits Ratio.

Relationship between Board of Commissioners' Meeting Frequency and Islamic Banks Performance

Bank Indonesia (2009) through PBI regulation Number. 11/33/PBI/2009 stated that the Board of Commissioners must conduct supervision on the implementation of corporate governance in every Islamic bank business activity at all levels from the highest to the lowest management. Tao and Hutchinson (2013) explained that the characteristics of the board (or the committees below) include elements of size, composition, meeting, and expertise. These characteristics (size, composition, meeting, and expertise) have a significant positive relationship to the company's performance (Kakanda et al., 2017).

The board's meeting frequency can be viewed as one of the key elements of the board's effectiveness (Bouaziz & Triki, 2012). The board meeting functions as a means or approach for establishing effective decisions for a company (Kakanda, Salim, & Chandren, 2016). The amount of the board's meeting frequency indicates significant capability in counselling, supervising, and aligning management conduct to encourage the firm's performance.

Some research found a positive and significant relationship between Board of Commissioners and company's performance, for instance, Kang and Kim (2011), Liang et al. (2013), Al-Matari et al. (2014), and Kakanda et al. (2017). On the other hand, research by Harvey Pamburai et al. (2015) found that the meeting frequency of the Board of Commissioners was negatively related to the performance. In comparison, Qadorah and

Fadzil (2018) did not find any significant relationship between the Board of Commissioner's meeting frequency and the performance. Based on the explanation, the first formulation of the hypothesis proposed in this research is below.

***H_1**: Meeting frequency of the Board of Commissioners positively affect Islamic bank's performance.*

Relationship between Sharia Supervisory Board's Meeting Frequency and Islamic Banks Performance

Stakeholders-modelled Islamic corporate governance is based on two fundamental concepts of sharia principles, such as ownership rights and the framework of contracts (Hasan, 2009). In Islamic financial institutions, all stakeholders must comply with sharia provisions. On a practical level, this model requires a Sharia Supervisory Board (SSB), whose role is to provide advice and supervise the company's operations to ensure compliance with sharia principles.

The existence and operation of Islamic banks can be distinguished at least theoretically from conventional banks in terms of their commitment to social fairness (Mollah & Zaman, 2015). In order for an Islamic bank to contribute to the achievement of social fairness, it is expected to obey Islamic rules related to fair profit and loss sharing, equitable distribution, and prohibition of usury (interest). The main feature of Islamic banking is Sharia Supervisory Board (SSB) institution that helps to ensure their compliance with Sharia principles.

Board members of the Shariah Supervisory Board (SSB) have roughly equivalent status to administrators as on other boards, such as the Board of Commissioners or the Board of Directors (Neifar & Jarboui, 2018). The board members are appointed by the mechanism of the shareholders. Bank Indonesia (2009), through PBI regulation No:11/33/PBI/2009, stipulates that the appointment and/or replacement of SSB members is proposed to the general meeting of shareholders and is conducted by taking into account the recommendations of the Remuneration and Nomination Committee.

The roles of SSB will also have an impact on company performance, as empirical evidence obtained from research by Mollah and Zaman (2015). Research on the relationship of SSB with performance is still rare. The research results by Mollah and Zaman (2015) showed that SSB had a significant positive effect on company performance. However, the impact can be ignored when SSB role was restricted only as an advisory by the regulations or companies.

The roles of SSB in Islamic banks lead to the emergence of activities in SSB itself. These activities can be proxied by the frequency of meetings (Xie, Davidson, & DaDalt, 2003). Meeting frequency is considered an important attribute of monitoring effectiveness (Lin, Li, & Yang, 2006). Therefore, the intensity in the frequency of meetings of the Sharia

Supervisory Board is expected to influence the disclosure of Islamic bank's performance. The proposed hypothesis is as follows.

***H_2**: The frequency of meetings of the Sharia Supervisory Board has a positive effect on the performance of Islamic banks.*

Relationship between Non-Performing Financing and Islamic Banks Performance

High non-performing loans will harm the bank's net profit. Banks must provide items for bad debts and write-off of bad debts, which will affect profitability and capital levels (Ombaba, 2013). Furthermore, when bad loans exceed the bank's capital in a relatively large amount, it will become a bank crisis. It will eventually turn into a financial crisis (Karim, Chan, & Hassan, 2010).

If the bank is not precise in providing credit or financing, then high-quality financing will be replaced by low-quality financing. In the long term, this causes a decrease in the quality of the bank's overall financing portfolio. This also leads to the accumulation of bad loans, reduction in profitability, and capital erosion (Makri, Tsagkanos, & Bellas, 2014). The high financing risk is a sign of the bank's fragility in guaranteeing, monitoring, and controlling the financing portfolio (Vardar & Özgüler, 2015).

Research by Boahene et al. (2012), Kolapo et al. (2012), and Nawaz et al. (2012) produced empirical evidence of the relationship between high levels of bad loans and low financial performance. Similarly, Laryea, Ntow-Gyamfi, and Alu (2016), Akter and Roy (2017), and Kingu et al. (2018) revealed a negative relationship between financing risk and financial performance. While in the latest research from Nguyen (2020), the effect was significant on large banks and not significant on small banks. From the description, the formulation of the proposed hypothesis is as follows.

***H_3**: Non-Performing Financing has a negative effect on the performance of Islamic banks.*

Relationship between Financing to Deposits Ratio and Islamic Banks Performance

An efficient financial system in banking is indicated by a continuous increase in profitability and a gradual increase in the volume of funds flowing from savers to borrowers (the parties who take advantage of financing), as well as better service quality for customers (Hoffmann, 2011). The bank's profitable business will be able to withstand negative shocks in the banking system and will contribute to financial system stability. This will accelerate the economic growth of a country (Elbannan, 2017). The increase in third-party funds disbursed in rising financing is expected to boost the bank's profitability.

One of the ratios in measuring financing activities is the FDR (Financing to Deposits Ratio) or LDR at conventional banks. This financing ratio can also be used as a measure of liquidity risk. The lower this ratio, the more liquid the bank is, and vice versa; the greater this ratio, the more illiquid the bank, even though the profit opportunity is higher (Gul et al., 2011).

The higher the funds given to third parties, the higher the financial performance in the form of profitability, namely ROA (Return on Assets). Research by Gul et al. (2011) showed that the greater the credit or financing provided, the greater the ROA. Lee and Hsieh (2013), Vo and Nguyen (2018), Batten and Vo (2019) also found that profitability was an essential indicator for predicting financial difficulties and bank crises. Research by Adelopo et al. (2018) and Hasanov, Bayramli, and Al-Musehel (2018) exhibited the effect of financing on performance, especially profitability.

In contrast to these arguments, Kingu et al. (2018) stated that a high LDR caused risk to increase because the amount of funds needed for credit financing is getting bigger. They showed that the percentage of bank profits decreased with the increase in the ratio of financing to deposits. This implies that the bank is increasingly vulnerable to liquidity risk and experiences financial distress when liquidity risk increases. Increasingly higher ratios indicate that the bank has reached the limit of its financing capability beyond its deposits. In the end, the bank will apply more expensive schemes such as expensive deposits, debt, and equity to fund its financing. This will reduce the level of profitability. The results of the research by Kingu et al. (2018) are in line with Kolapo et al. (2012). The formulation of the proposed hypothesis is as follows.

***H_4**: Financing to Deposits Ratio has a positive effect on the performance of Islamic banks.*

Relationship between Company Size and Islamic Banks Performance

The size of a company or bank is one of the important variables of the company's characteristics. The greater the company's assets, the more likely it is to have greater economic resources. The company will have more ability to reduce transaction costs; hence, its efficiency will be higher. The company's fixed costs tend to reduce as the company grows (increasing return to scale). Large banks will have a network and access to funding as well as a more significant number of customers so that they will get a more considerable fee-based income. Therefore, large banks tend to be more efficient (Ajlouni et al., 2011).

In addition to the statements above, a larger size of the bank will hold a greater impact on the financial system and the wider economy. This occurs especially when the interconnection between banks is very close, and the economy still relies more on bank credit. Default risk from the bank will be likely to simultaneously affect its relationship with systemic risk (banking industry risks) and systematic risk (market wide risks), as stated by Fiordelisi and Marqués-Ibañez (2013).

Large companies cause business activities to be carried out more complex so that they will involve more stakeholders. The larger the size of the company, the number of stakeholders involved in the company will increase. Disclosure made by the company is a form of corporate responsibility to the public. Based on stakeholder theory, the increasing number of stakeholders are involved in the company, the greater the obligation to disclose financial risk (Amran et al., 2009).

Company size has a vital role in determining financial performance or profitability (Salman & Yazdanfar, 2012). Some research that produces a positive effect of size on performance are from Gul et al. (2011), Singapurwoko and El-Wahid (2011), Salman and Yazfandar (2012), Pervan and Visic (2012), Dogan (2013), Babalola (2013), Adelopo et al. (2018), Al-Homaidi et al. (2018), Batten and Vo (2019), Bolarinwa et al. (2019), and Bono (2019).

However, the negative relationship between size and performance was shown by the research of Tariq Bhutta and Hasan (2013). The argument for the negative influence of company size according to Bouaziz and Triki (2012) was because large companies tend to have difficulty controlling it and the problem of free cash flow (the use of remaining cash from operational activities that can be used for dividend payments, expansion, or settlement of obligations). Meanwhile, in the latest research from Nguyen (2020), the effect was not significant for both small and large banks. From the description above, the formulation of the proposed hypothesis is as follows.

H$_5$: *Bank size has a positive effect on the performance of Islamic banks.*

Research Method

This research is the type of field research that using a quantitative approach. The data used are secondary data (archives) obtained from the financial statement and annual report of each Islamic bank. The population in this study is Islamic banks in Indonesia. The sampling technique applied is purposive sampling with the criteria: (1) Islamic banks in Indonesia with the status of Sharia Commercial Banks (SCB) and Sharia Business Units (SBU) of conventional banks; (2) Quarterly financial statements and annual reports of SCB and SBU; and (3) Reporting period of Islamic banks consecutively from 2014 to 2019. Based on the criteria, the sample size is 20 Islamic banks, consisting of 11 SCBs and 9 SBUs. From the 20 banks within 24 time-series, the number of observations is 480 panel data.

The variable of meeting frequency of the Board of Commissioners (MFBC) is measured from the total meetings within a period (Al-Matari et al., 2014). The meeting frequency of Sharia Supervisory Board (MFSSB) is obtained from the total meetings in a period (Mollah & Zaman, 2015; Xie, Davidson, & DaDalt, 2003). The variable of Non-Performing Financing (NPF) refers to a ratio of customers unrepaid financing to the total financing channeled by Islamic banks to society (Kingu et al., 2018). The variable of Financing to Deposits Ratio (FDR) is a ratio of total financing volume to the total receipts of funds (Gul et al., 2011). The variable of Islamic bank’s size (SIZE) is measured by using a proxy of total assets in the financial statement of Islamic bank (Salman & Yazdanfar, 2012; Wahyono, Putri, & Cahya, 2020).

The dependent variable of Islamic bank's performance is measured by using the profitability ratio (Ongore & Kusa, 2013; Farida & Sofyani, 2018). According to Ongore and Kusa (2013), Return on Asset (ROA) is one of the main ratios that exhibits profitability or financial performance. Financial performance is a representation of banking performance (Kakanda, Salim, & Chandren, 2018). Therefore, hypothesis testing is conducted by employing the dependent variable ROA to the overall banks. Nevertheless, a specific analysis is added for Sharia Commercial Banks (SCB) in the form of regression with the dependent variable ROA and ROE (Return on Equity). Regression on ROE only applies for SCB since ROE is not proper to Sharia Business Unit (SBU). ROE is useful to perceive financial performance from the contribution of equity; however, equities in SBU are still mixed with its conventional bank.

This study uses analysis of panel data regression as follows. General equation for the overall Islamic banks (hypothesis testing):

$$ROA_{it} = b_{10} + b_{11}MFBC_{it} + b_{12}MFSSB_{it} + b_{13}NPF_{it} + b_{14}FDR_{it} + b_{15}SIZE_{it} + e_1 \quad (1)$$

General equation for SCB (additional testing):

$$ROA_{it} = b_{20} + b_{21}MFBC_{it} + b_{22}MFSSB_{it} + b_{23}NPF_{it} + b_{24}FDR_{it} + b_{25}SIZE_{it} + e_2 \quad (2)$$

$$ROE_{it} = b_{30} + b_{31}MFBC_{it} + b_{32}MFSSB_{it} + b_{33}NPF_{it} + b_{34}FDR_{it} + b_{35}SIZE_{it} + e_1 \quad (3)$$

The acronyms at the formulas above refer to meeting frequency of the Board of Commissioners (MFBC), meeting frequency of Sharia Supervisory Board (MFSSB), Non-Performing Financing (NPF), Financing to Deposits Ratio (FDR), and bank's size (SIZE). Data processing as well as panel data regression analysis is established by using EViews software 11th version.

Result and Discussion

In this study, the analysis of descriptive statistics is used to explain the condition of the data. The following table summarizes the output of descriptive statistics.

Table 1 Descriptive Statistics

	ROA	MFBC	MFSSB	NPF	FDR	LOGSIZE
Mean	1.767375	5.283333	3.695833	2.304917	104.9708	12.75563
Median	1.175000	5.000000	3.000000	1.720000	96.00000	12.71305
Maximum	13.58000	14.00000	14.00000	16.86000	338.5200	14.05035
Minimum	-10.77000	0.000000	0.000000	0.000000	4.500000	11.53543
Std. Dev.	2.559911	2.481441	1.515123	2.046253	30.75245	0.579683

This study applies panel data analysis. Therefore, the selection of a model is made prior to hypothesis testing. In panel data regression, Fixed Effect Model (FEM) is chosen for ROA of all Islamic banks and SCB. While Random Effect Model (REM) is selected for ROE of SCB. There is no analysis using Common Effect Model (CEM). Here below is the summary for the selection of the best model that fits each panel data regression.

Table 2 Summary of Determination of Panel Data Regression

Dependent Variable	Sample	Chow Test	Hausman Test	Lagrange Multiplier Test	Decision on Model Selection
ROA	All Banks	0.0000	0.0001	--	Fixed Effect Model (FEM)
ROA	SCB	0.0000	0.0013	--	Fixed Effect Model (FEM)
ROE	SCB	0.0000	0.4045	0.0000	Random Effect Model (REM)

The following step is to validate the prerequisite assumptions. Following the prerequisite assumptions testing, the hypothesis is tested. Because the regression model for the sample of all banks is a Fixed Effect Model, the slope and intercept of the regression equation can be estimated using an assumption model approach. The regression produces the following results when the slope and intercept are assumed as follows.

Table 3 Summary of Regression Results for ROA based on Slope and Intercept Assumptions

	Assumption of Constant Slope, Intercepts Vary among Individuals		Assumption of Constant Slope, Intercepts Vary among Individuals and Time	
	Coefficients	**Prob.**	**Coefficients**	**Prob.**
C	-44.33008***	0.0000	-56.41405***	0.0000
MFBC	0.090088**	0.0119	0.087519**	0.0151
MFSSB	0.132644***	0.0015	0.151367***	0.0008
NPF	-0.143741**	0.0057	-0.168187***	0.0031
FDR	0.011801***	0.0000	0.012424***	0.0001
LOG(SIZE)	1.508140***	0.0000	1.918717***	0.0000
F-statistic	41.08491***	0.0000	21.53940***	0.0000
R-squared	0.693476		0.705780	

significant at α 1%***; 5%**; 10%

Regression using the two assumptions shows a relatively indifferent result. It slightly differs in terms that variable of NPF is significant at level α = 5% by using the assumption of constant slope and intercepts vary among individuals, but significant at level α = 1% with the assumption of constant slope and intercepts vary among individuals and time. However, the results of both assumptions are statistically significant. The following table summarizes the results of the hypothesis test.

Table 4 Summary of Regression Results for ROA of All Banks (Hypothesis Testing)

	Coefficients	Prob.	Decisions
MFBC	0.087519**	0,0151	H_1 is Accepted
MFSSB	0.151367***	0,0008	H_2 is Accepted
NPF	-0.168187***	0,0031	H_3 is Accepted
FDR	0.012424***	0,0001	H_4 is Accepted
LOG(SIZE)	1.918717***	0,0000	H_5 is Accepted

Significant at level α 1%***; 5%**; 10%*

As a supplementary analysis, the following table presents the regression results for the dependent variables ROA and ROE of SCB.

Table 5 Summary of Regression Results for ROA and ROE of SCB

	Dependent Variable ROA		Dependent Variable ROE	
	Coefficients	**Prob.**	**Coefficients**	**Prob.**
C	-27.87683***	0.0000	-143.1375***	0.0020
MFBC	0.028120**	0.0238	0.347149	0.1951
MFSSB	0.052402**	0.0165	1.301018**	0.0107
NPF	-0.158165***	0.0000	-2.520177***	0.0000
FDR	0.013277***	0.0049	0.057841	0.2243
LOG(SIZE)	0.929449***	0.0000	4.804134***	0.0012
F-statistic	36.48215***	0.0000	5.511488***	0.0000
R-squared	0.718142		0.114004	

Discussions

The first hypothesis (H_1), which states that the meeting frequency of the Board of Commissioners (MFBC) positively affect Islamic bank performance (ROA), is accepted. This result indicates the powerful influence between those variables. This also informs the effectiveness of meetings held by the Board of Commissioners in companies. If the findings are sorted into overall banks and SCB, both displays equal significances at level α = 5%.

The results of the regression above show in general that there is a strong impact in each type of bank regarding the role of meetings frequency of the Board of Commissioners, particularly if it is measured by using ROA. The result remains insignificant for additional analysis with performance measured by ROE, especially in sharia commercial banks. According to Ongore dan Kusa (2013), Return on Asset (ROA) is one of the major ratios representing a company's profitability or performance. The comparison of how much return is earned to the asset's contribution will be more appropriate instead of equity contribution. R-squared from regression with ROE as the dependent variable is much lower than ROA as the dependent variable.

The role or composition of the Board of Commissioners has a positive impact on the performance, as what has been discovered by some studies earlier. The studies are conducted by Kang and Kim (2011), Liang et al. (2013), as well as Al-Matari et al. (2014). More precisely, the findings of this study support those of Kakanda et al. (2017), which reveals that meeting intensity, as measured by the number of meetings, has a positive effect on performance. However, the findings of this study contradict Harvey Pamburai et al. (2015), who discovered that performance was negatively impacted. Similarly, it contradicts Qadorah and Fadzil (2018), who reported no significant relationship between the frequency of Board of Commissioners meetings and performance. This was suspected to be connected to issues of efficiency and disagreements between commissioners and directors.

The Board of Commissioners' meeting frequency relates positively with performance, presumably because the Board of Commissioners has media in the form of internal meetings and Rakomdir (commissioners and directors' meetings). Rakomdir at the bank is a meeting convened by the Board of Commissioners with the Board of Directors' participation. The meeting evaluates the bank's business performance, work program reports, and financial performance. We hypothesize that this motivates the Board of Directors to continue improving the bank's financial performance.

In general, the bank's annual report commits the Board of Commissioners to be active. The Board of Commissioners reviews the bank's operations, oversees the work programs, and advises and assists the Board of Directors. This will help Islamic banks improve their financial performance. These findings bolster the case for applying stakeholder theory in Islamic banks by establishing a link between it and the practice of Islamic corporate governance. Additionally, the findings of this study reinforce the authority requiring Islamic banks to include the intensity of their Board of Commissioners meetings in their annual reports.

Furthermore, the second hypothesis (H_2) is accepted, stating that the frequency of Sharia Supervisory Board Meetings (MFSSB) has a positive impact on Islamic bank performance (ROA). The findings of this study reveal that there is a considerable association between the frequency of DPS meetings and the performance of Islamic banks that utilize ROA. This proves the Sharia Supervisory Board's effectiveness. Both all banks and SCB results are equally significant. If additional analysis with ROE performance measures is performed, the results remain substantial. In general, the regression results above indicate that the frequency of Sharia Supervisory Board meetings has a fairly large effect on the performance of Islamic banks.

The Sharia Supervisory Board is not to be confused with the committees whose positions are under the Board of Commissioners. SSB is roughly comparable to the Board of Commissioners in terms of authority (Neifar & Jarboui, 2018). Thus, the frequency of meetings can be used to approximate SSB activities. SSB is not viewed solely through the lens of its existence or as a sharia compliance advisor. SSB actions are not limited to these. SSB can provide alternative business policies that adhere to sharia while remaining compliant.

There is currently a dearth of research on the association between SSB and performance (Mollah & Zaman, 2015). According to Mollah and Zaman (2015), SSB has a strongly favorable effect on business performance. However, the report indicates that the impact can be disregarded when legislation or organizations limit the SSB's duty to that of an advisor.

Given the preceding context, the outcomes of this study are highly significant (α = 1%) and can be considered findings based on actions. A more thorough descriptive explanation can support the statistical evidence. SSB with a high level of activity will also contribute significantly to the performance of Islamic banks. When directors desire to boost bank profits without violating sharia, SSB can supply sharia solutions.

Not only are Islamic banks constrained by operational rules (controlled by Bank Indonesia and the OJK), but also by DSN-MUI fatwas. Islamic bank products must adhere to sharia law. According to the findings of this study, we predict that the role of SSB in Islamic banks will continue to grow in the future.

We estimate that in the future, SSB will not only conduct regular monitoring to establish whether the bank's contracts are sharia compliant. The role of SSB will be strengthened even further. Additionally, it becomes strategic if it is capable of advising the Board of Directors on how to increase financial performance without contradicting sharia. Moreover, it will be favorable if the DPS is able to demonstrate that the *syar'i* contracts are more profitable than the conventional ones.

Furthermore, hypothesis 3 (H_3), which states that Non-Performing Financing (NPF) has a negative effect on Islamic bank Performance (ROA), is accepted. The results of this study reveal that NPF has a significant negative effect on ROA. Consequently, it is critical to minimize and immediately address bad credit. When the results are separated amongst all banks and specifically SCB, they remain equally significant. In general, the regression results above indicate that NPF has a significant impact on the performance of Islamic banks. The results remained significant regardless of whether they were calculated using ROA or additional analysis of ROE (α = 1%).

The findings of this study confirm previous research indicating a negative relationship between NPF and performance. The research of Boahene et al. (2012), Kolapo et al. (2012), and Nawaz et al. (2012) establish an empirical link between high levels of non-performing loans and poor financial performance. Similarly, Laryea et al. (2016), Akter and Roy (2017), and Kingu et al. (2018) all demonstrate a negative relationship between financing risk and financial performance. Nguyen's most recent research (2020) indicates that the effect is significant for large banks but not for small banks. This study makes no distinction between large and small banks because it focuses exclusively on Islamic banks, which are significantly fewer in number than conventional banks.

The fourth hypothesis (H_4) is also accepted. It asserts that the Financing to Deposits Ratio (FDR) has a positive effect on the Islamic bank performance (ROA). The findings of this study indicate that FDR has a sizable impact on the performance of Islamic banks. When the data are split over all banks and SCB, they remain equally significant. Overall, the regression results reveal that the importance of FDR on the bank's performance has a robust influence (especially when measured using ROA). However, when additional analysis with ROE performance measures is performed, the results are not significant. The return on assets will be better than the return on equity (Ongore & Kusa, 2013).

Adelopo et al. (2018) and Hasanov et al. (2018) showed that funding affects performance, particularly profitability. Increased financing will result in increased profits (Gul et al., 2011). It is necessary, however, to bear in mind the trade-off between liquidity and profitability. In contrast to the approach outlined above, Kingu et al. (2018) claimed that a high LDR (Loan to Deposits Ratio) increased risk as well. This was because the amount of capital required for credit financing continues to grow. According to Kingu et al. (2018), when the ratio of financing to deposits increased, the percentage of bank profits in percentage decreased. This implied that the bank is becoming increasingly susceptible to liquidity risk and is experiencing financial distress as a result. Kingu et al. (2018)'s findings were consistent with Kolapo et al.'s research (2012).

If the bank's channeling of funds exceeds its capacity, it is feasible to spend additional funds (e.g., capital or loans from other banks). The bank attempts to maximize profit from the massive channeling of funds, but the bank will encounter liquidity issues. The laws governing the lower and upper limits of Islamic banks' liquidity are typically safe between 78%-92%. Bank Indonesia and the Indonesian Financial Services Authority, on the other hand, adjusted the FDR range in a number of ways. This is feasible to enforce monetary stability and real sector development.

Hypothesis 5 (H_5), which states that bank size has a positive effect on Islamic bank Performance (ROA), is accepted. The findings reveal that Islamic bank size has a significant impact on its performance. When the data are divided into overall banks and SCB, they remain equally significant. When additional analysis with ROE performance measures is performed, the regression results remain significant.

The results in this study support previous research indicating a positive association between bank size and performance. The studies include Adelopo et al. (2018); Al-Homaidi et al. (2018); Batten and Vo (2019); Bolarinwa et al. (2019); and Bono (2019). Large banks will have a network and access to funding and a larger customer base, which will result in a higher fee-based revenue stream. As a result, huge banks will typically be more efficient (Ajlouni et al., 2011). Additionally, the larger the Bank, the more influence it has over the financial sector and the broader economy. However, certain research findings contradict the above. According to Fiordelisi and Marqués-Ibañez (2013), the larger the bank, the higher the risk. The bank's default risk will almost always influence its interaction with systemic risk (risks inherent in the banking industry) and systematic risk (market wide risks).

Additionally, the findings of this study contradict those of Tariq Bhutta and Hasan (2013), who demonstrated a detrimental influence on business size. Bouaziz and Triki (2012) suggested that large organizations frequently struggle with control and the issue of free cash flow (the use of remaining cash from operational activities that can be used for dividend payments, expansion, or settlement of obligations). Similarly, Nguyen (2020) indicated that the influence of bank size is negligible for both small and large banks. However, the findings of this study reveal that bank size has a significant impact on performance. As a result, the findings of this study indicate the possibility of Islamic banks merging to increase their assets. Additionally, to grow its network and business coverage for the benefit of the public in general and the Muslim people in particular. Islamic banking research is still in its development, and additional findings are possible.

Conclusion

Based on the analysis of research results and discussions on the impact of Islamic corporate governance mechanisms and bank risk profiles on the performance of Islamic banks in Indonesia, it can be concluded that the frequency of meetings of the Board of Commissioners, the Sharia Supervisory Board, the Financing to Deposits Ratio (FDR), and the bank's size all have a significant positive impact on the performance of Islamic banks. Non-Performing Financing (NPF) has a significant negative impact on Islamic banks' performance.

This study provides practical relevance because it establishes that the activities of the Board of Commissioners and Sharia Supervisory Board have a significant impact on the performance of Islamic banks. The bank can establish more precise rules regarding activity mechanisms and meeting agendas on a more continuous basis. Additionally, practical implications demonstrate that the strength of the bank's assets has a significant impact on performance. These assets enable the bank to be more proficient in developing Islamic banking products and expanding the business. The findings of this study support the idea of merging Islamic banks to improve performance and compete with conventional banks, hence increasing Islamic banks' market share.

The research's theoretical implication is that Islamic banking can benefit from the application of corporate governance and stakeholder theory. Islamic banks function not just for their own benefit but also for the benefit of their stakeholders. This is in line with *Maqoshid Sharia*. The methodological implication of this research is to prove that the frequency of meetings can approximate the Sharia Supervisory Board's actions. Meeting frequency has a significant impact on the performance of Islamic banks.

The primary contribution of this research is evidence that the Sharia Supervisory Board's actions are not restricted to delivering sharia advice or supervising contracts for sharia compliance, as was originally intended when the SSB was formed. Sharia Supervisory Board has matured to the point where it can contribute to the bank's financial performance. This is particularly obvious in Islamic banks whose greater asset. The Sharia supervisory board is expected to provide solutions and inputs to the bank without violating sharia.

The limitation of this study is about the sample size of Islamic banks and their assets, which are considerably smaller than those of conventional banks. We did not include additional variables that are assumed to play a role in the Islamic corporate governance mechanism affecting the performance of Islamic banks. Suggestions for research in the future are to increase the possible research objects, such as international Islamic banks, and comparing them. Additionally, it is expected for further studies to explore deeper into more variables that are potentially become components of the Islamic corporate governance process.

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