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The Influence of Corporate Governance on the Performance of Islamic Banking Companies in Indonesia

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Abstract

The study examines the relationship between corporate governance as measured by audit committee independence, audit committee size, audit committee meetings, the board size, managerial ownership, and institutional ownership as well as control variables, namely firm size, firm age, and debt on firm performance as measured by return on asset (ROA) at the bank general sharia law in Indonesia is registered with the financial services authority for the period 2013-2020. The data were analyzed using descriptive statistics, linear regression analysis, partial test, simultaneous test, and coefficient of determination and the result show that there is a significant effect of board size, firm size, and debt on the performance of Islamic banking companies. While other variables audit committee independence, audit committee size, audit committee meetings, managerial ownership, institutional ownership, and firm age have no significant effect on the performance of Islamic banking companies in Indonesia.

Keywords: *Corporate Governance; Firm Performance; Islamic Banking*

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1. INTRODUCTION

The results achieved from all company activities and become a determinant of success are referred to as firm performance. The firm performance has an important role for internal companies as part of decision making and for investors to monitor the company's performance in returning the results of the funds invested (Apriliani & Dewayanto, 2018). Every company needs the right direction to achieve its organizational goals which can be implemented through corporate governance (Fernando & Weligamage, 2021). Good governance can minimize the possible risks that arise because the board of directors tries to benefit themselves.

Corporate governance is a process and structure for taking action whose purpose is to protect stakeholders (Kyere & Ausloos, 2021). According to Pintea *et al* (2020), governance is carried out to ensure that the company is run with responsibility and accountability to improve overall performance. Arora and Sharma (2016) there is a relationship between the company's success and the satisfaction felt by shareholders, where companies can protect wealth and maximize shareholder wealth through better performance practices. Discussions from Emmanuel and Esther (2022), Ali *et al* (2021), Balios and Zaroulea (2021), Ekadjaja *et al* (2021), and Bhatt and Bhatt (2017) show corporate governance as a protector for shareholders in strategic decisions in companies like investment, financing, and dividends.

Ardhanareswari (2017) argued that the implementation of corporate governance in Indonesia has not been carried out comprehensively. This can be seen during the banking crisis in Indonesia, which was caused by the implementation of poor governance. Governance has a great influence on banking performance because banks are considered to have the ability to adapt to various problems and have a high level of bank soundness. The object of the research on the application of governance is Islamic commercial banks.

Islamic commercial banks are financial institutions that follow sharia principles in banking operations and prohibit usury and illegal investments (Khan & Zahid, 2020). Islamic banks have a goal to maximize shareholder value by following sharia law, prohibition collecting interest, engaging in excessive risk, and using derivative instruments (Basiruddin & Ahmed, 2020). Islamic banks have a different application of governance from conventional banks, where Islamic banks have a sharia supervisory board whose function is to be the second group in the governance mechanism to prevent the board of directors and top management from deciding on an investment activity with a high level of risk.

During the global financial crisis, the growth of Islamic credit and financial assets was twice as high as that of conventional banks. Islamic banking helps to overcome the adverse impact on profitability and market valuation, as Islamic financial institutions have a clear difference in funding structure compared to conventional banks. This financial crisis shows the resilience of Islamic banks in experiencing a challenge and it is hoped that in the future it will be more efficient in creating value for stakeholders (Nawaz, 2017). According to the report of the global Islamic finance forum, the Islamic banking industry has a remarkable development with total assets of around US$1.3 trillion worldwide in 2011 and is projected to exceed $6.5 trillion by 2020. Meanwhile, according to Aslam and Haron (2020) Islamic banking has the fastest growth in the global financial industry based on the Islamic finance country index report in 2019, Islamic banking grew 12.46% per year with total assets US$2.591 trillion at the end of 2018.

Indonesia is a country with a large muslim population, so there is a high need for funding activities according to Islamic principles. According to the financial services authority, every six months third-party funds by Islamic commercial banks and their units always grow to one million new accounts. Islamic commercial banks and their units disbursing financing grew 10.83% per year to Rp 337.6 trillion at the end of August 2019. The market share of Islamic banking tends to grow more slowly, but the increase in funding is consistent (Syarif, 2020). Indonesia is ranked 5th in the world as the largest Islamic economic country in 2019, then ranked 4th in the world in 2020. The growth of third-party funds increased by 70.67% in 2014-2018 to reach 371.38 trillion rupiahs and in 2020, third-party funds reached 425 trillion rupiah (Syahputra, 2021).

Over the past 5 years, islamic commercial banks have experienced rapid growth based on total assets, total financing, and total third-party funds. The development of islamic commercial banks is an advantage in increasing the stability of the national financial system in Indonesia. Banking is part of the real sector which is national. In finance, the bank is considered a third party, a party that has more funds and brings it together with parties who need funds (Hapsari, 2017). According to Novitasari *et al* (2019), the rapid circulation of money in banks has required an orderly mechanism regarding corporate governance. The goal is that the trust of the various parties involved can remain solid and built.

Firm Performance

According to Iin and Anik (2020) firm performance is a condition in describing the achievements of the company in a certain period. The achievement in question comes from operational activities, where the company optimizes its resource ownership to realize a change. firm performance can be measured by analyzing the company's financial statements to determine whether the company is in good or bad condition. A company should disclose its financial statements which are presented by including information and conditions of the company's performance in a certain period in a transparent manner. Financial reports are prepared for shareholders, consumers, the public, suppliers, creditors, government, and other parties to see the financial condition and development of the company (Agatha *et al*., 2020)

Audit Committee Independence

The audit committee’s independent is an independent committee member who oversees the quality of financial reporting. An independent audit committee increase oversight of financial statements because there’s no interference. Meanwhile, according to Budiyono *et al* (2021), audit committees can reduce agency problems and the possibility of takeovers from insiders. Committee audit’s independence is important determining the integrity of financial statements, because management may manipulate the calculation of its self-interest. Audit committee is complete its duties by acting independently and is not allowed to side with anyone in resolving conflicts between managers and shareholders (Kristiyanti, et al (2021). Research from

Shatnawi *et al* (2021) explains that the independence of the audit committee is significant to the performance of the company because there is no management linkage so that its management is not affected by the company's internal. The results of this study are supported by Ali *et al* (2021) and Mohammed *et al* (2019). However contrary to the research results of Ngo and Le (2021) and Sehrawat *et al* (2020)

H_1: The independence of the audit committee has a significant effect on firm performance.

Audit Committee Size

The audit committee is measured by adding up the number of audit committee members owned by the company. According to OJK Regulation No. 55/POJK.04/2015, a minimum of three members of the audit committee is set. Members consist of one chairman from an independent commissioner and two members from external parties (Wibawaningsih & Surbakti, 2020). Bagais and Aljaaidi (2020) shows a positive relationship between the size of the audit committee on firm performance. According to him, a large audit committee within the company will show a more regular performance. This provides evidence that the appropriate number of audit committees is effective in increasing the value of the company by increasing efficiency, reducing company risk, reducing the incidence of crime or fraud, and increasing available resources. The resulting research is consistent with Al-Okaily and Naueihed (2020), Rahman *et al* (2019) and Alqatamin (2018). However, this contradicts the results of research by Azizah and Diana (2020) and Fariha *et al* (2022).

H_2: The size of the audit committee has a significant effect on firm performance.

Audit Committee Meeting

According to Marsha and Ghozali (2017), the number of meetings between audit committees is how many meetings are held in a year. The increasing number of meetings will encourage the audit committee to be more active because it evaluates the company more often. Buallay and Al-Ajmi (2020) stated that to monitor effective corporate reporting and responsibilities, time is needed for frequent meetings. Research by Farooque *et al* (2019), explains that more meetings will help committees to produce better monitoring mechanisms and motivate top-level executives to apply tasks well as well. Thus, the high frequency of meetings leads to increased firm performance and a higher quality of auditors to protect the interests of shareholders. The results of this study are supported by Ashari and Krismiaji (2020), Al-Okaily and Naueihed (2020) and Oroud (2019) which show similar results. However, this is in contrast to research by Anaima and Trisnaningsih (2021) and Rahman *et al* (2019).

H_3: Audit committee meetings have a significant effect on firm performance.

Board Size

The size of the board is the total number of existing members. A board with the right number of members will encourage increased performance (Wikan, 2021). The larger the size of the board, which is accompanied by experience and knowledge, will lead to firm performance (Sehrawat *et al.*, 2020). With a large number of meetings, the more different opinions from members with different bases and experiences. So that the increase in decision-making strategies is higher (Koji *et al.*, 2020). According to Queiri *et al* (2021), large board size is likely to diversify abilities and skills to provide different voices and points of view. This diversity can focus on improving firmperformance and reducing agency problems and financial fraud activities. This opinion is also supported by Fernando and Weligamage (2021), Khatib and Nour (2021) and Sobhan (2021). But contrary to Shao (2018), Arora and Sharma (2016), Malik and Makhdoom (2016).

H_4: Board size has a significant effect on firmperformance.

Managerial Ownership

Fujianti *et al* (2020) describe their study on managerial ownership as shareholders who are people internally in companies that are actively involved in company activities, such as boards of directors and managers. In the financial statements, this variable is indicated by the percentage of the manager's ownership. Agatha *et al* (2020) in their research revealed that based on stakeholder theory, managers and shareholders have a strong relationship because managers are not only shareholders but also responsible for the company. Therefore, the greater the ownership of people in the company, it will encourage the motivation of managers to strive for the achievements (performance) achieved. The results of this study are in line with those of Kanakriyah (2021) and Sehrawat *et al* (2020). But contrary to Harahap (2021), Shao (2018), Hermiyetti and Erlinda (2016).

H_5: Managerial ownership has a significant effect on firm performance.

Institutional Ownership

Institutional ownership is shares owned by outside or external parties such as banks, insurance entities, or other institutions. The shares owned are measured by calculating the percentage of the company's ownership of the number of shares already outstanding (Wardhan & Samrotun, 2020). According to research by Kao *et al* (2018), institutional ownership can assist directors in the monitoring function to contribute to firm performance. Ownership owned by external parties has a role in ensuring the right decisions by the company's management to improve the welfare of shareholders. The large number of shares owned by institutions will increase shareholder cash flow thereby encouraging a positive impact on the value of the shares themselves. Institutional ownership is better in terms of monitoring the activities of managers and has a prominent role as it is tasked with ensuring that decision-making is in line with all shareholders. Research by Hartati (2020) and Hasanudin *et al* (2020) support this statement. However, contrary to the results of research by Harahap (2021), Nilayanti and Suaryana (2019)

H_6: Institutional ownership has a significant effect on firm performance.

2. RESEARCH METHODS

Research is designed with deductive nature because the aim is to test hypotheses about a significant and positive relationship between three variables, namely the independent, dependent, and control variables. judging from the characteristics of the problem, research is classified as causal comparative which indicates a causal relationship between variables (Cooper & Schindler, 2014).

This study uses the object of the annual report of Islamic commercial banks which have been officially registered with the Financial Services Authority. The sampling method uses purposive sampling with the criteria that Islamic commercial banks have official registration at the OJK institution, publish annual reports and corporate governance reports for 8 years from 2013 to 2020 and have the necessary variable data complete. There are 14 banks as research samples that meet the criteria with a total of 112 data. From the results of outlier testing using the z score method, 9 samples were not normal so the total sample in the test was 103 samples.

This study observes company data so it is a study that uses time series data in the form of data from year to year and is cross-sectional which aims to determine the comparative relationship of the subjects studied. Secondary data sources are annual reports and governance reports from Islamic commercial banks registered with the OJK and obtained from the company's official website. However, it is analyzed using panel data regression to examine the effect of corporate governance on firm performance. The data analysis method used multiple linear regression analysis and performed a significant test of an individual or partial parameters (T statistic test), a simultaneous significant test (F statistic test), and a coefficient of determination test (T statistical test).R^2).

Table 1: Measurement of Research Operational Variables

Variable	Symbol	Measurement
Dependent Variable		
Return on Assets	ROA	R[illegible]A = [illegible] o [illegible] i [illegible] / X
Independent Variables		
Audit Committee Independence	ACI	Number of committees that are independent and have no internal relationship with the company.
Audit Committee Size	ACS	Number of audit membership in the company.
Audit Committee Meetings	ACM	Number of meetings held in a certain period.
Board Size	BS	Total number of board members.
Managerial Ownership	MO	Number of shares owned by management to the number of shares outstanding publicly.
Institutional Ownership	IO	Total ownership of institutional shares in the company in publicly outstanding shares.
Control Variable		
Firm Size	FS	Total assets of the company.
Firm Age	FA	Age Age of the company from the date of incorporation.
Leverage	LEV	Total debt divided by total assets.

Source: Data processed (2021)

3. RESULTS AND DISCUSSION

3.1. Research Result

Descriptive Statistics

Table 2: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	103	-0,05	0,07	0,010	0,0142
ACI	103	2,00	7,00	3,864	1,1119
ACS	103	2,00	7,00	3,854	1,0973
ACM	103	0,00	37,00	14,320	7,9115
BS	103	4,00	16,00	8,893	2,5473
MO	103	0,00	1,00	0,136	0,3444
IO	103	1,00	4,00	2,204	0,7587
FS	103	300	25,480	3,134	5,888
FA	103	3	61	26.13	18555
LEV	103	0,05	0,91	0,370	0,3194
Valid N (listwise)	103				

Source: Processed secondary data (2022)

The results show that the highest and lowest values of ROA are -0.05 and 0.07, respectively. Meanwhile, the average is 0.010 or 1%, which means that the percentage of the company's performance in generating net profit (profit) is low. A low ROA value indicates the company's lack of capability in managing its wealth in creating a profit (Rosikah *et al*., 2018).

The results of descriptive statistics on the independence of the audit committee showed the lowest result was 2 people and the highest score was 7 people, where the average independence of the audit committee was between 3 and 4 people. These results explain that the governance carried out by most Islamic banking companies has referred to and is following OJK regulations No.55/POJK.04/2015. Article 4 requires an audit committee to be formed with 3 people, in which there are commissioners and independent parties from outside the company.

According to OJK Regulation No.29/POJK.05/2020 Article 28A, the audit committee in a company must have membership of at least a chairman from an independent commissioner and a member who has the ability in the fields of finance, accounting, and auditing from outside or independent parties. . This regulation is following the statistical results above which show that the average member of the audit committee is between 3 to 4 people. This means that Islamic banking in Indonesia has implemented good governance regulations.

Average Audit committee meetings are held a year 14 times and the most are 37 meetings a year. Based on the decision of financial institutions on the form and guidelines of the audit committee No.KEP-643/BL of 2012, the audit committee meets at least 4 times a year or at least 1 time in 3 months. Based on the contents of this decision, all Islamic banking implements guidelines regarding committee meetings. In testing the data, it was found that the minimum meeting value was 0, indicating that there were companies that did not hold meetings according to the provisions.

The board size variable shows that in Islamic banking the average board is 8-9 people with the highest number being 16 people and the lowest number being 4 people. This result refers to the OJK regulation regarding the board of directors and the board of commissioners of issuers or companies No. 33 /POJK.04/2014, where article 2 paragraph (1) and Article 20 paragraph (1) state that each member of the board of directors consists of at least 2 persons.

The descriptive analysis shows that the managerial ownership of Islamic banking is 1.3% on average. This result is following the implementation of Law Number 40 of 2007, which in Article 43 paragraph 3 states a company may offer shares to its management. This means that from the management of employees it is possible to own company shares accompanied by their respective rights and obligations. Meanwhile, the median value of institutional ownership of Islamic banking in Indonesia is 2,204 ownership by investors in the form of institutions. These results indicate that there is control by institutions that have share ownership in Islamic banking.

Test result statistics show that the control variable, namely company size, has an average value

of 3,134,036,052,705, meaning that Islamic banking in Indonesia belongs to the category of small and medium-scale companies until the period of 2020 because it has a total wealth of less than 100 billion. This provision refers to the decision of the chairman of BAPEPAM No. Kep-11/PM/1997. Meanwhile, for other control variables, namely the age of the company has a median value of 26 years and debt has an average value of 0.370.

Partial Hypothesis Test

Table 3: t test results

Variable	*Coefficient*	Prob.	Conclusion	Hypothesis
Constant	0.0481	0.0162		
IKA	-0.0028	0.7636	Not significant	H1 rejected
UKA	0.0049	0.6004	Not significant	H2 rejected
RKA	-0.0002	0.3307	Not significant	H3 rejected
UD	-0.0031	0.0001	Negative Significant	H4 accepted
KM	0.0006	0.9144	Not significant	H5 rejected
KI	0.0004	0.9343	Not significant	H6 rejected
UKP	-0.0037	0.0287	Negative Significant	
USP	0.0117	0.1342	Not significant	
HTG	0.0120	0.0072	Significantly Positive	

Source: Processed secondary data (2022)

The results of the t-test show that the size of the board has a probability value of 0.0001 which has a significant influence on the company's performance, and the probability value of the control variables, namely company size, and debt, also has a significant influence. Meanwhile, other variables, namely audit committee independence, audit committee size, audit committee meetings, managerial ownership, institutional ownership, and company age do not affect firm performance assessed from the probability value above 0.05.

Simultaneous Hypothesis Test

Table 4: F Test Results

Dependent Variable	Prob. (F-statistics)
ROA	0.000407

Source: Processed secondary data (2022)

From the F test results, obtained F value is equal to 0.000407 which corresponds to the level of testing the value is less than 0.05. This means that the variables of independence, audit committee size and meetings, board size, managerial and institutional ownership, firm size, firm age, and debt have significance on ROA as the dependent variable.

Coefficient of Determination Test

Tests are carried out to explain how the influence is given by one variable to another. The test shown in the table below shows R square is 0.268943 which explains the relationship between variables is 26%. While the value of Adjusted $R^2$is 0.198195 or 19.81% explaining the company's performance can be proven by independent variables, the remaining 80.19% is explained by other factors.

Table 5: Coefficient of Determination Test Results

R Square	*Adjusted* R Square)
0.268943	0.198195

Source: Processed secondary data (2022)

3.2. Discussion

Based on the examination of the audit committee's independence variable, it is concluded that it does not have a significant effect on the company's performance so that H_1 is rejected. According to Juhmani (2017), the independence of the audit committee has no relationship with increasing firm performance because the audit committee from outside the company only performs its function as an operational supervisor and is not tasked with developing the company to increase profitability. The results of this study are in line with Ngo and Le (2021), Sehrawat *et al* (2020) and Mohammed *et al* (2019). But in contrast to Bansal and Sharma (2016).

Test results concluded that testing the audit committee size variable did not have a significant effect on the dependent variable so that H_2 rejected. According to Irma (2019), a large committee size allows a decrease in firm performance because a large audit committee size will lead to more supervision and

control of company activities to encourage ineffective firm performance. A large audit committee indicates that there will be more consideration in making important decisions because of the different education and abilities of members. These results support research by Fariha *et al* (2022), Azizah and Diana (2020), Prayanthi and Laurens (2020). However, research from Al-Okaily and Naueihed (2020), Alqatamin (2018).

The test of the committee meeting variable illustrates that there is no significant relationship with the company's performance so that H_3 rejected. Darko *et al* (2016) explained several things, such as the costs incurred increasing along with the large number of meetings held and the results of the decisions taken may change the more frequent the meetings. These results support the statement by Fariha *et al* (2022) regarding the number of meetings held by the audit committee can cause delays in making decisions so that it will not encourage firm performance. Research by Anaima and Trisnaningsih (2021), Khatib and Nour (2021) and Rahman *et al* (2019) support this insignificant effect. Meanwhile, Ashari and Krismiaji (2020) and Farooque *et al* (2019) concluded that frequent meetings can improve performance by detecting fraud.

In testing the size of the board shows a significant relationship with firm performance so that H_4 is accepted. Bansal and Sharma (2016) explain that a large board size will bring more knowledge, opinions, investment proposals, and visions that will benefit stakeholders. Board diversification can focus on improving firm performance and reducing agency problems and financial fraud activities. Tests by several researchers support a significant relationship such as Ali *et al* (2022), Fariha *et al* (2022), Merendino and Melville (2019). Meanwhile, other research states that the number of board members does not have agreement and cohesiveness which causes conflicts in taking considerations, where research is shown by Shao (2018), Arora and Sharma (2016), Malik and Makhdoom (2016).

Based on the test results, managerial ownership does not affect firm performance because managerial ownership owned by management tends to encourage other shareholders to try to supervise so that there is a delay in decision-making. Managerial shareholders are classified as low, so managers do not have the motivation to improve performance because the profits are small. One-way research is supported by Rivai and Putra (2021), Nilayanti and Suaryana (2019) prove that H_5 is rejected. However, contrary to Shao (2018), Iswajuni *et al* (2018), Hermiyetti and Erlinda (2016) say that managerial owners are encouraged to be careful in their job to optimize the value of the company.

Institutional ownership has insignificant results on firm performance so H_6 is rejected. Institutional ownership is not the main owner of the company so it does not have more power in encouraging managers to work to achieve company goals. So high institutional ownership can reduce firm performance. This result is in line with Pratomo and Nuraulia (2021), Hartati (2020), Arora and Sharma (2016). However, this research contradicts Nilayanti and Suaryana (2019), Hermiyetti and Erlinda (2016).

Variable company size control explained the larger the company, the greater the total sales and will encourage better performance. The results of the study are in line with Hung *et al* (2021), Hertina *et al* (2021) and Kuncová *et al* (2016). However, this contradicts the results of Risna and Putra (2021) and Irma (2019).

Based on the research, company age was found to not affect firm performance. Rossi (2016) states that in general the age of the company cannot encourage performance management because it tends not to follow new changes and newly established companies have renewable innovations so that they can pursue new opportunities that create firm performance. The results of this study are in line with Putri *et al* (2020). However, these results differ from those of Ekadjaja et al (2021) and Silwal (2016) who state that age influences because of experience in management.

Results of this study conclude that debt has a significant relationship to firm performance. This is because when companies apply for loans to improve their operations, the greater the demands from lenders on companies to try to improve their performance. The results of this study are supported by Balios and Zaroulea (2021), Bagais and Aljaaidi (2020) and Gie (2019). However, in contrast to Saputri and Bahri (2021) and Fujianti *et al* (2020).

4. CONCLUSION

The study was conducted on Islamic commercial banks for the period 2013 to 2020 with a total of 2013 data as the research sample showing the variable board size has a significant negative influence on banking performance because the more the number of boards, the more diverse knowledge and abilities in important

decision-making strategies to focus on improving firm performance. The control variable in the form of company size has a significant effect on performance because it produces large total sales.

This study shows that other variables do not improve the performance of Islamic banking companies in Indonesia. The independence of the audit committee only serves as a supervisor who does not participate in decision making, the large size of the audit committee causes ineffective decision making and audit committee meetings that often allow decisions to change every meeting. On the other hand, managerial ownership is still low and the profits earned are small institutional owners are not the main owners so they do not have great power in driving performance. The control variable, namely debt provides more responsibility for increasing profitability and the age of the company cannot be used as a benchmark so no significant relationship is found.

In this study, there are limitations in the preparation, namely, the sample only covers the Islamic banking sector in Indonesia and the amount of data used is 112 data and is limited to 14 Islamic banking in the 2013-2020 period which causes the effect of the results of the variables studied to be significant. Therefore, the researcher recommends further research to increase the number of samples and data to obtain higher significance results and suggestions to include sharia units as research objects.

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