CORPORATE GOVERNANCE AND FINANCING RISK OF SHARIA BANK IN INDONESIA

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Abstract
This study aims to examine the influence of Islamic bank governance on the financing risk of Islamic Commercial Banks in Indonesia. Sharia bank governance is proxied by the variables of the board of commissioners, audit committee, and sharia supervisory board (SSB). This study used panel data of Islamic commercial banks from 2015 to 2020 using purposive sampling. The data analysis technique used panel data regression through a fixed effect model. The test results show that the audit committee variable has a significant negative effect on the financing risk of Islamic commercial banks. Meanwhile, the board of commissioners and the SSB of the bank have no effect on the financing risk of Islamic commercial banks.

Keywords: Governance, Board of Commissioners, Audit Committee, Sharia Supervisory Board, Sharia Bank Size, Islamic Commercial Bank Financing Risk.

INTRODUCTION
The overall growth of Islamic banking has been tremendous over the last two decades, and Islamic financial institutions have become an integral part of the world's financial system (Mahdi & Abbes, 2018). Islamic banking is one of the fastest growing sectors of the global financial industry. The following is data on the development of sharia banking summarized by the Financial Services Authority.
The data above shows the development of Islamic banks in Indonesia from 2016 to June 2020 with positive developments in Assets, Distributed Financing (PYD), and Third Party Funds (DPK) which continue to grow. Increasing the market share of Islamic banking loans and deposits to get higher profits has increased the interest of researchers to explore the risks of Islamic banking financing in Indonesia. Research by Sobarsyah et al., (2020) investigates the correlation of loan growth, bank capital and financing risk in Islamic banking. The research was conducted in the post-crisis period, the results were the business and work context of Islamic banks, the 2015 to 2019 period was more mature than the pre-crisis period. It is important for regulators in banking to formulate guidelines for the growth and sustainability of the Islamic financial system.

In the Financial Services Authority Regulation No.8/POJK.03/2014 and the Financial Services Authority Circular Letter No.10/SEOJK.03/2014, it is stated that the assessment of the soundness level of a bank, both individually and in consolidation, uses a risk approach (Risk-Based Bank Rating) is mandatory. One of the assessments in the RBBR method is the Risk Profile, which in this study is measured by NPF (Non Performing Financing). NPF is a ratio to calculate the proportion or level of the amount of problem financing faced by banks RSSizal and Humaidi, (2021). The following is the development of the NPF of Islamic Commercial Banks from 2015-2020:
The data shows that the NPF of Islamic Commercial Banks during the period is in healthy condition but the condition is less stable where there is an increase and decrease every year. This means that the bank is able to control problem financing properly. According to POJK Number 8/POJK.03/2014 Concerning Soundness Rating of Sharia Commercial Banks and Sharia Business Units or POJK Number 4/POJK.03/2016 Concerning Rating of Soundness Level of Commercial Banks, the NPF value can be concluded as good if it is below 5%. The average NPF ratio of 3.9% indicates that BUS is in the healthy predicate. The smaller the bank's NPF, the higher the bank's performance and operations (Rizal & Humaidi, 2021; Wahasusmiah & Watie, 2018).

Financing Risk is an indicator of financial stability referred to by several international institutions and policy makers to assess the financial sector (Tekathen & Dechow, 2013). Therefore, effective financing risk management appears to be essential for bank survival and global financial stability. Financing risk results in the inability of the borrower to repay the loan that has been obtained or to repay the loan principal under the conditions specified in the financing agreement (Greuning & Brajovic-Bratanovic, 2003). Some researchers believe that Financing risk is the most important financial risk for a bank (Campbell, 2007). Risk taking on misappropriated financing can result in ineffective governance mechanisms. Thus, good risk management is necessary to ensure good corporate governance and create value for all stakeholders (Greuning & Bratanovic, 2020).

In understanding the risk of financing is carried out through agency theory which emphasizes agency problems arising from differences in interests. From these conflicts Jensen and
Meckling H., (1976) discuss agency problems, conflicts of interest, information asymmetry problems and the resulting agency costs. Since these costs are significant, some researchers suggest that they can be reduced by ensuring effective control over the behavior of managers by introducing governance mechanisms. Among these mechanisms, special importance has been given to the board of commissioners. In a complex sector such as banking, the board of directors plays a key role as administrators are accountable to shareholders, depositors and regulators. All sectors of the complex are asked to agree on a common policy on risk management (Pathan, 2009).

The bank governance system is basically based on regulatory and internal control mechanisms. It helps to discipline managers, control bank policies and their proper implementation and influence risk strategy (Andres & Vallelado, 2008). Banking governance seems to be the first mechanism that can prevent bank risk. The banking sector is characterized by its complexity and the board of directors is the most effective control mechanism. Its role is to ensure that the interests of all stakeholders (shareholders, regulators, managers) are needed. Therefore, good governance is needed to manage all stakeholders.

This study aims to analyze corporate governance that affects the financing risk of Islamic banks in Indonesia. Financing risk studies in the banking industry are important for the following reasons. First, financing risk is one of the criteria used to measure a bank's financial performance. Thus, the high level of NPF in banks will have a negative impact on bank income and business continuity (Haniifah, 2015). Second, a high NPF ratio does not only have an impact on individual banks but also has an impact on the stability of a country's economy. According to Abdul-rahman et al., (2017) poor NPF management "will lead to banking failures and financial vulnerabilities". The correlation between the governance structure of the board and financing risk has been the subject of much (Farag & Mallin, 2015; Giovannoni et al., 2014).

This research refers to Rafay's research, (2020) by proxying corporate governance with the size of the board of commissioners, independent board of commissioners, audit committees conducted at conventional banks. The researcher claims that the Sharia Supervisory Board is because the object of research is Islamic banks as an independent variable on financing risk. Corporate governance is considered capable of minimizing financing risks.

According to Aslam and Haron, (2021) board size can influence bank risk-making decisions. Thus, several studies have demonstrated a relationship between the number of directors on a board and bank risk. As a result, the diversity and expertise of each director helps to better manage risks and thereby minimize financing risks (Hillman & Dalziel, 2003).

The audit committee is considered one of the most important committees in the work of banks and the banking sector in general, and this importance stems from its oversight role over
bank operations and increases the efficiency of internal and external audits (Al et al., 2019). As one of the rules of corporate governance, the audit committee has played a major role in increasing their efficiency and effectiveness in carrying out their work and reducing the risks that can cause serious financial losses.

Subsequent governance in Islamic banking is the existence of a Sharia Supervisory Board which is an autonomous body of Islamic banks consisting of Sharia scholars who have good knowledge in Fiqh Muamalat (Islamic jurisprudence that regulates commercial transactions). They are appointed based on recommendations from the Board of Directors, but they work independently. SSB is primarily responsible for supporting financial products and services (ex-best) and screening operations and activities (ex-post) on behalf of shareholders and stakeholders to ensure all operations comply with Sharia law. SSB is considered as an additional layer of corporate governance to complement the oversight role of the Board of Directors (Mollah & Zaman, 2015; Nomran et al., 2016). Due to Sharia violations, financial exposure and harm and high levels of transparency in Islamic banks (Nomran et al., 2016). Thus, a more significant level of disclosure and transparency helps Islamic banks to take less risks and this increases investor confidence and performance of Islamic banks. In addition, Mollah et al., (2017) documented that SSB helps Islamic banks to adhere to deep qualities and morals as opposed to greed and social equality. The multi-layer governance provided by SSB functions as an autonomous control instrument in controlling top management not to participate in extreme risk taking.

LITERATURE REVIEW

Agency Theory

Agency theory arises from the separation between ownership and control. Agency theory finds its origin in property rights theory where there is a distinction between shareholders and agents, namely managers (Eisenhardt et al., 1989). From this agency conflict, management is needed that is agreed between the owners (shareholders) and agents (management) (Hendrastuti & Harahap, 2023).

Corporate Governance is a system where rules and regulations are made to ensure trust, accountability, fairness, independence, responsibility, transparency, social responsibility and shareholder rights (Alsagr et al., 2018; Farag & Mallin, 2015). Corporate governance mechanisms play an important role in banking operations to enhance the ability of Islamic banks to withstand external shocks, including external financial difficulties (Berger et al., 2016). Therefore, in banking governance, commissioners perform an effective monitoring and advisory role based on their experience and capabilities. In short, corporate governance is an approach in which shareholders protect their investment from management and maintain return on investment (Aslam & Haron,
2021). This study focuses on governance into the variables of the board of commissioners, sharia supervisory board and audit committee with financing risk.

**Board of Commissioners Size and Financing Risk**

According to agency theory, board size can affect a bank's risk-making decisions. Thus, several studies have shown a relationship between the number of commissioners on the board and bank risk. As a result, the diversity and expertise of individual directors helps to better manage risks and thereby minimize financing risks (Hillman & Dalziel, 2003). In addition, with reference to the shareholder moral hazard hypothesis, small board size is associated with a high level of risk because shareholders support excessive risk taking at the expense of other stakeholders.

Rachdi and Ameur, (2011) found a negative relationship between board size and bankruptcy and financing risk in Tanzanian banks. Similarly, Switzer and Wang, (2013) suggest that larger boards reduce the risk of American banks in terms of idiosyncratic risk, bankruptcy risk, systematic risk and total risk. From this description, the hypothesis is taken:

**H1. The size of the Board of Commissioners has a negative effect on the risk of Islamic bank financing**

**Sharia Supervisory Board and Financing Risk**

The Sharia Supervisory Board is an autonomous body of Islamic banks consisting of Sharia scholars who have good knowledge in Fiqh Muamalat (Islamic jurisprudence governing commercial transactions. They are appointed based on recommendations from the Board of Directors, but they work independently. SSB is responsible for supporting products and services financial statements (ex-best) and screen operations and activities (ex-post) on behalf of shareholders and stakeholders to ensure all operations comply with Sharia law. In short, SSB is considered as an additional layer of corporate governance to complement the supervisory role of the commissioner (Mollah & Zaman, 2015; Nomran et al., 2016). Due to Sharia confinement, financial exposure and danger and high level of transparency in Islamic banks (M. Hasan & Dridi, 2011; M. M. Hasan et al., 2010). Thus, a more significant level of disclosure and transparency helps Islamic banks to take less risks and this increases investor confidence and performance of Islamic banks. In addition, Mollah et al., (2017) documented that SSB helps Islamic banks to adhere to deep qualities and morals as opposed to greed and social equality. The multi-layer governance provided by SSB functions as an autonomous control instrument in controlling top management not to participate in extreme risk taking. From this description, the hypothesis is taken:

**H2. The Sharia Supervisory Board has a negative effect on the risk of Islamic bank financing.**
Audit committee size has been widely analyzed in the context of banking governance, measuring the total audit committee members in an organization (Oussii & Klibi, 2020; Pillai & Al-malkawi, 2017). Rafay, (2020) claims that the existence of an audit committee shows transparency and accountability. Agency theory assumes that conflicts between management and shareholders often encourage the fulfillment of personal interests from opportunistic management behavior and damage the interests of shareholders (Khan, 2017). Thus, in light of agency theory, Connelly et al., (2011) argues that a strong audit committee supports organizations to differentiate from other organizations in their risk-taking behavior. In addition, the size of the audit committee examines the efficiency of the organization, because the larger size of the audit committee has diverse skills and expertise, thereby increasing their effectiveness to screen banking operations (Abdeljawad & Saleh, 2020).

A previous research by Abdeljawad and Saleh, (2020) observed a negative relationship between audit committees and risk taking. A study by Jermias and Gani, (2013) reported a negative and significant relationship between the audit committee and risk taking. From this description, the hypothesis is below.

**H3. The Audit Committee has a negative effect on the risk of Islamic bank financing**

**METHOD**

The research method of this study used a quantitative research method. The quantitative method can be interpreted as a research method based on the philosophy of positivism, used to examine certain populations or samples, data collection using research instruments, data analysis is quantitative or statistical, aims to describe and test hypotheses (Sugiyono, 2014). The type of data in this study used panel data for annual financial reports for the period 2015 to 2020 at Islamic banks in Indonesia.

The following is the measurement formulation for each variable:

**Table 1. Variable Measurement**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sharia Bank Financing Risk</td>
<td>NPF Aslam &amp; Haron, (2021)</td>
</tr>
<tr>
<td>Governance</td>
<td></td>
</tr>
<tr>
<td>Board of Commissioners</td>
<td>Number of Commissioners Board Aslam &amp; Haron, (2021)</td>
</tr>
<tr>
<td>Sharia Supervisory Board</td>
<td>Total SSB(Arifin et al., 2021)</td>
</tr>
<tr>
<td>Audit Committee</td>
<td>Number of Audit Committees (Ahzar et al., 2021)</td>
</tr>
</tbody>
</table>
To test the hypothesis, the following model is used:

\[ NPF = \alpha + \beta_1 UKOM_{it} + \beta_2 UDPS_{it} + \beta_3 UDPS_{it} + \beta_4 LN_{ASET_{it}} + e \]

**RESULT AND DISCUSSION**

The research was conducted at Islamic Commercial Banks in Indonesia in 2015-2020.

The results of the descriptive analysis can be seen from the following table:

<table>
<thead>
<tr>
<th></th>
<th>NPF</th>
<th>UKOM</th>
<th>UKAUDIT</th>
<th>UDPS</th>
<th>LN_ASET</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>2.900972</td>
<td>2.277778</td>
<td>3.361111</td>
<td>3.569444</td>
<td>29.98736</td>
</tr>
<tr>
<td>Median</td>
<td>2.555000</td>
<td>2.000000</td>
<td>3.000000</td>
<td>3.000000</td>
<td>29.79500</td>
</tr>
<tr>
<td>Maximum</td>
<td>12.52000</td>
<td>4.000000</td>
<td>6.000000</td>
<td>5.000000</td>
<td>32.47000</td>
</tr>
<tr>
<td>Minimum</td>
<td>0.320000</td>
<td>2.000000</td>
<td>2.000000</td>
<td>1.000000</td>
<td>27.22000</td>
</tr>
<tr>
<td>Std. Dev.</td>
<td>2.042110</td>
<td>0.481266</td>
<td>0.877024</td>
<td>0.801871</td>
<td>2.540797</td>
</tr>
<tr>
<td>Skewness</td>
<td>2.070774</td>
<td>1.368266</td>
<td>2.006825</td>
<td>0.102191</td>
<td>-0.066041</td>
</tr>
<tr>
<td>Kurtosis</td>
<td>9.617898</td>
<td>3.730278</td>
<td>6.426050</td>
<td>3.321443</td>
<td>2.540797</td>
</tr>
</tbody>
</table>

Based on the descriptive statistics table above, the results of the descriptive statistical test can be explained as follows. From the results of descriptive statistics on financing risk as measured by NPF, the highest value is 12.5%, the lowest is 0.32%, while the mean is 2.90. These results indicate that the average Islamic bank in Indonesia is in good condition because it has an NPF value of <5%.

The independent variables consist of the board of commissioners, the audit committee and the Sharia Supervisory Board. The board of commissioners variable has a value indicating the minimum number of members of the board of commissioners is 2 people, the maximum value of the number of commissioners is 4 people and the average has 2.27. The audit committee variable has a value indicating the minimum number of members of the board of commissioners is 2 people, the maximum value of the number of audit committees is 6 people and the average has 3.3. The Sharia Supervisory Board variable has a value indicating the minimum number of members of the SSB is 2 people, the maximum value of the number of SSB is 5 people and the average has 3.5.

**Uji Pemilihan Model**

Panel data regression test is used to select the best model. Panel data is observational data that combines time series data and cross section data. Time series means that the data consists of several periods and cross section means that the data consists of several objects, so the panel
regression uses 3 models, namely the common effect model (CEM), fixed effect model (FEM) and random effect model (REM). The following is the result of model selection using the Chow test, Hausman test and LM test:

Tabel 3. Chow test, Hausman test and LM test

<table>
<thead>
<tr>
<th>Models Choice</th>
<th>Chow Test</th>
<th>Hausman Test</th>
<th>LM Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>common effect model (CEM)</td>
<td></td>
<td></td>
<td>0.000</td>
</tr>
<tr>
<td>fixed effect model (FEM)</td>
<td>0.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>random effect model (REM)</td>
<td></td>
<td>0.853</td>
<td></td>
</tr>
</tbody>
</table>

**Selection of the best Model**

FEM of Value of Prob. 0.00<0.05

Source: Data processed with eviews 12, 2023

The results of the chow test on the fixed effect model (FEM) obtained a probability value of 0.000 <0.005, so H0 is rejected. So the results show that the fixed effect model is the chosen model. Next, do a classic assumption test on the results of the fixed effect model.

**Multicollinearity Test Results**

<table>
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<tr>
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<td>UKOM</td>
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<td>UDPS</td>
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In the table results, it reveals that the correlation value for each independent variable has a value of less than 0.8, so it can be seen that all independent variables, namely the Board of Commissioners, Sharia Supervisory Board, Audit Committee and Islamic bank size, can be said to have no multicollinearity in this model.

The results of the panel data regression test can be seen in table 5 below;

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RESULTS & DISCUSSION

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The results of the panel data regression test can be seen in table 5 below;
DISCUSSION
The Influence of the Board of Commissioners on Financing Risk

This study shows that the board of commissioners has no effect on the financing risk of Islamic banks, this is due to the small board size, Alipour and Ghanbari, (2019) in the agency theory argues that a larger board has a higher ability to monitor top management, decision making, asset allocation, related uncertainties and reducing agency problems. The results of this study are in line with research conducted by Marinova et al., (2016) claiming that the Board of Commissioners has no effect on financing risk.

The data shows that the average size of the board of commissioners is only two board members. The small number of commissioners results in the ineffectiveness of the board's ability to supervise financing. Alipour and Ghanbari, (2019) reveal that the bigger the board, the better the supervision will be carried out.

The Influence of SSB on Financing Risk

The results of this study indicate that SSB has no effect on financing risk. SSB in Islamic banks is only a compliance supervisor for bank activities in sharia (Mollah et al., 2017). In agency theory, to control banks, especially Islamic banks, so that they are suitable in carrying out sharia financing, a SSB is formed to supervise them The results of this study are in line with research conducted by Rouyer (2016) which states that SSB has no effect on financing risk. Meanwhile, this research is not in line with research conducted by Nomran et al., (2016), claiming that SSB has a negative effect on financing risk, and research conducted by Hasan et al., (2010) revealing that SSB has a negative effect on financing risk.

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<th>Std. Error</th>
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</thead>
<tbody>
<tr>
<td>C</td>
<td>38.47385</td>
<td>13.25163</td>
<td>2.903330</td>
<td>0.0053</td>
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<tr>
<td>UKOM</td>
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<td>LN_ASET</td>
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<td>0.449875</td>
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R-squared 0.573669
Adjusted R-squared 0.459474
F-statistic 5.023561
Prob(F-statistic) 0.000004

Source: Data processed with eviews 12 (2022)
The Influence of the Audit Committee on Financing Risk

The results of this study indicate that the audit committee has a positive effect on financing risk. In agency theory, it states that with stricter supervision from the audit committee, it will reduce the problem of problematic financing. The audit committee can act as a party that monitors the company because the higher the proportion of the audit committee will reduce the risk of better financing to maintain the soundness of the bank from problem financing. The audit committee supervises bank financing so that financing problems do not occur (Aslam & Haron, 2021).

The result of this study is in line with research conducted by Abdeljawad and Saleh, (2020) and Aslam and Haron, (2021) which state that audit committees have a negative effect on financing risk. The audit committee plays a role in dealing with problem financing, the larger the size of the audit committee, the smaller the problem financing.

CONCLUSION

This study determines governance which includes the Board of Commissioners, the Sharia Supervisory Board, the size audit committee of Islamic banks on financial performance. The test results show that the audit committee variable has a significant negative effect on the financing risk of Islamic commercial banks. Meanwhile, the board of commissioners and the sharia supervisory board have no effect on the risk of financing sharia commercial banks. The implication of this research is that Islamic banks can strengthen audit committees so that supervision related to financing risks will be better. The limitation of this study is that it only proxies governance to be the board of commissioners, SSB and audit committee variables. Suggestions for further research are to add proxies to governance variables, namely the independent board of commissioners, bank risk committee and share ownership in Islamic banks.

REFERENCES


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