Exploring how good corporate governance shapes financial performance

Ines Muharrromah Fatmasari*

Master of Accounting, University of Lampung

ABSTRACT
This research aims to comprehensively investigate the impact of Sharia Supervisory Board, Board of Commissioners, Board of Directors, and Audit Committee on the financial performance of Islamic banks in Indonesia through a literature review approach. Utilizing the SINTA database as the primary source, the study will identify, select, and analyze relevant literature to understand the extent of each supervisory entity’s influence on the financial performance. According to the analyzed literatures, the Sharia Supervisory Board profoundly influences Islamic financial institutions, ensuring adherence to Sharia principles, building trust, and mitigating risks, positively impacting financial performance. The Board of Commissioners, integral in strategic decisions, risk management, and governance, shapes overall financial well-being. The Board of Directors significantly influences financial outcomes, overseeing transparency and regulatory compliance. The proposed commissioners’ board, with an independent judiciary, aims for unbiased management evaluations, essential for good corporate governance. Lastly, the Audit Committee enhances financial performance by ensuring transparency and mitigating risks, a crucial component mandated for public companies in Indonesia.

KEYWORDS
Good Corporate Governance; Financial Performance; Banking

Introduction
This research aims to investigate the influence of Sharia Supervisory Boards, Boards of Commissioners, Boards of Directors, and Audit Committees on the financial performance of Islamic banks in Indonesia, utilizing a literature review methodology. Employing the SINTA database as the primary source, this study will identify, select, and analyze relevant literature to comprehend the extent of each governance entity’s impact on the financial performance of Islamic banks. A particular focus will be placed on empirical findings published in academic journals, books, and scholarly articles available in SINTA to construct a comprehensive understanding of the roles of Sharia Supervisory Boards, Boards of Commissioners, Boards of Directors, and Audit Committees in enhancing the financial performance of Islamic banks within the Indonesian context. By adopting this approach, this research is expected to significantly contribute to both practical and academic understanding of the governance dynamics of Islamic financial institutions in Indonesia.

Good corporate governance (GCG) is particularly crucial in managing a company’s financial performance when discussing Islamic financial institutions. In this context, Sharia Governance becomes relevant as it emphasizes the importance of adherence to Sharia principles in every aspect of a company’s activities and operations (Risna, 2018). Sharia Governance involves critical elements designed to ensure Sharia compliance in business transactions and operations of Islamic financial institutions. Instruments such as Sharia Boards, internal and external Sharia Review Units, and Internal Sharia Compliance Units are crucial in implementing GCG principles in a Sharia context.

The significance of GCG in Islamic banking is reflected in the implementation regulations by Bank Indonesia (BI). Although BI Regulation No. 8/4/PBI/2006 no longer applies to Islamic banks since 2010, it was replaced by BI Regulation No. 11/33/PBI/2009, reaffirming the necessity of GCG application for Sharia Commercial Banks and Sharia Business Units. This reflects the integration of GCG principles with Sharia principles to create a business environment consistent with ethical and moral values. From the perspective of its impact on financial performance, applying GCG principles, such as transparency, accountability, fairness, and adherence to the law, can enhance stakeholder trust, including investors and customers. Therefore, Islamic financial institutions that effectively implement GCG are more likely to achieve optimal financial performance.

The Sharia Supervisory Board is essential in maintaining compliance and managing Islamic banking activities. The duties and responsibilities of the Sharia Supervisory Board reflect a commitment to Sharia principles, forming an integral part of GCG implementation in the Islamic banking environment (Hisamuddin, 2015). Overall, GCG is not only a regulatory obligation but also a critical factor in maintaining the integrity and sustainability of Islamic financial institutions amid the increasingly competitive dynamics of the global market. By understanding the importance of GCG implementation, Islamic financial institutions can strengthen their foundations to adapt to market changes, attract investors, and maintain public trust. Thus, GCG in Islamic financial institutions is not just about rules but ethics, integrity, and sustainability.

CONTACT Ines Muharrromah Fatmasari
ines.muharrromah79@gmail.com

© 2024 The Author(s). Published with license by Lighthouse Publishing. This is an Open Access article distributed under the terms of the Creative Commons Attribution-ShareAlike 4.0 International (CC BY-NC-ND 4.0) License (https://creativecommons.org/licenses/by-sa/4.0/), which allows others to share the work with an acknowledgement of the work’s authorship and initial publication in this journal.
Methods

The methodology adopted for this investigation is a systematic literature review, focusing specifically on sources within the SINTA database from the past five years. This methodological choice is intended to facilitate a detailed examination of the impact exerted by Sharia Supervisory Boards, Boards of Commissioners, Boards of Directors, and Audit Committees on the financial performance of Islamic banks in Indonesia. The initial phase of this research involves a strategic identification of pertinent literature within the SINTA database, employing key terminologies such as "Sharia Supervisory Board," "Board of Commissioners," "Audit Committee," "financial performance," and "Islamic bank." The selection of literature is guided by criteria that prioritize accuracy, recency, and relevance to the research aims.

Subsequent to the selection process, a rigorous analysis of the literature is undertaken to extract empirical findings and fundamental concepts pertaining to the nexus between governance structures and the financial performance of Islamic banks. This stage entails a meticulous examination of the research methodologies, sample populations, variables measured, and salient conclusions drawn in the relevant studies. The insights obtained from this literature review are synthesized to construct a nuanced understanding of the degree to which Sharia Supervisory Boards, Boards of Commissioners, Boards of Directors, and Audit Committees influence the financial performance of Islamic banks in Indonesia. By harnessing the resources of the SINTA database, this study aspires to substantially augment both the scholarly and practical understanding of the interplay between governance mechanisms and financial performance in Islamic banking institutions within the Indonesian setting.

Results

Article ready to review

<table>
<thead>
<tr>
<th>Num.</th>
<th>Author &amp; Year</th>
<th>Title</th>
<th>Journal</th>
</tr>
</thead>
</table>
**Theory used**

Agency theory, a fundamental economic concept, delves into the intricate dynamics between principals, typically the owners or shareholders of an organization, and agents, often the managerial figures entrusted with running the company. It posits that conflicts of interest emerge due to the divergent objectives of these two groups. In this theoretical framework, the effectiveness of corporate governance mechanisms becomes paramount in harmonizing the interests of principals and agents. Good Corporate Governance (GCG) practices, encompassing structures like the Sharia Supervisory Board (Dewan Pengawas Syariah), Board of Commissioners (Dewan Komisaris), Board of Directors (Dewan Direksi), and the Audit Committee (Komite Audit), function as crucial tools to address agency issues. The Sharia Supervisory Board, for instance, ensures compliance with Sharia principles, acting as a control mechanism to prevent actions conflicting with ethical standards. Similarly, the Board of Commissioners serves as a vigilant overseer, safeguarding shareholders’ interests and minimizing the agency gap. These governance components collectively play a pivotal role in enhancing financial performance by aligning managerial actions with the broader goals and ethical values of the organization.

**Result**

<table>
<thead>
<tr>
<th>Num.</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>First, the Proportion of Independent Board of Commissioners was found to have no discernible impact on the Financial Performance of Banks. Second, the Size of the Board of Directors emerged as a significant factor influencing the Financial Performance of Banks. Third, the findings revealed that the presence of an Audit Committee did not demonstrate a notable influence on the Financial Performance of Banks. Lastly, the analysis indicated that Blockholder Ownership did not exert a substantial effect on the Financial Performance of Banks within the specified period.</td>
</tr>
<tr>
<td>2</td>
<td>The research examines the impact of independent board of commissioners, audit committee, managerial ownership, and institutional ownership on financial performance in the Indonesian banking sector. Findings reveal a significant positive influence from the independent board of commissioners, audit committee, and institutional ownership, while managerial ownership does not exhibit a significant effect. The study contributes to understanding corporate governance dynamics and their implications for financial performance in the banking industry.</td>
</tr>
<tr>
<td>3</td>
<td>The study finds that the board of directors has no significant impact on financial performance, suggesting variations in board size don’t affect financial outcomes. However, an increase in independent commissioners positively influences financial performance, enhancing oversight and minimizing managerial practices. Sharia supervisory boards show no significant impact, as their role mainly focuses on supervision without direct financial influence. The study suggests a need for further investigation, considering variables like audit committees and audit quality for a comprehensive understanding of corporate governance's impact on financial performance.</td>
</tr>
<tr>
<td>4</td>
<td>The study concludes that the Sharia supervisory board significantly influences financial performance, supported by statistical evidence. Additionally, the proportion of independent board commissioners also exhibits a significant impact on financial performance. Simultaneously, both the Sharia supervisory board and the proportion of independent commissioners jointly contribute to financial performance, emphasizing the importance of Good Corporate Governance principles in enhancing financial outcomes. The findings align with prior research, emphasizing the constructive roles of these governance mechanisms in fostering financial success.</td>
</tr>
<tr>
<td>5</td>
<td>The study reveals a significant influence of the audit committee on the board of commissioners, with a positive effect. The board of commissioners significantly affects a company's financial performance. The research suggests that an effective board, assisted by an audit committee, enhances governance and positively impacts financial outcomes. Additionally, indirect testing through path analysis indicates that the audit committee's influence on financial performance is more substantial when considered directly rather than through the board of commissioners. The findings align with prior research emphasizing the essential role of the audit committee in effective oversight.</td>
</tr>
<tr>
<td>6</td>
<td>Managerial ownership positively impacts financial performance, minimizing agency conflicts in Indonesian manufacturing firms. The audit committee's influence on financial performance is significant, with its effectiveness linked to the committee’s size. Leverage positively affects financial performance, suggesting prudent debt usage enhances profitability. However, company size doesn’t guarantee superior financial performance.</td>
</tr>
<tr>
<td>7</td>
<td>This study aims to demonstrate the influence of Sharia Supervisory Board (SSB) characteristics on the performance and financing risk of Islamic banking in Indonesia. The variables include the number of members, education, multiple positions, competence, meeting frequency, reputation, and changes in composition. Factor analysis is employed to summarize these variables. The research anticipates that companies can effectively optimize the role of the Sharia Supervisory Board to enhance the performance of Islamic banking in Indonesia.</td>
</tr>
<tr>
<td>8</td>
<td>The study examines the influence of the Board of Commissioners, Board of Directors, Audit Committee, and Risk Monitoring Committee on Return on Assets (ROA). Results show that none of these components significantly affect financial performance. The findings suggest that companies should prioritize the quality, competency, skills, and professionalism of each governance body rather than focusing solely on quantity.</td>
</tr>
</tbody>
</table>
Increasing the Board of Commissioners may not necessarily improve financial performance. The Audit Committee’s increase may not enhance financial performance. Institutional ownership, however, positively influences financial performance. Simultaneously, increasing the Board of Commissioners, Audit Committee, and Institutional Ownership collectively enhances overall financial performance.

The institutional ownership percentage, board composition, and independent commissioner composition individually do not significantly affect financial performance. High institutional ownership doesn’t guarantee control for improved performance. Larger board composition may not benefit due to coordination challenges, slowing decision-making. Independent commissioner composition isn’t effective, indicating strong majority shareholder control. Simultaneously, these factors significantly impact financial performance. Future research should consider additional variables like managerial and foreign ownership, expanding beyond specific banking sectors for a more comprehensive study period.

Discussion

Supervisory board on financial performance

The Sharia Supervisory Board exerts a substantial influence on the financial performance of Islamic financial institutions by guaranteeing compliance with Sharia principles. This adherence fosters trust among investors and clients, thereby garnering additional support. Moreover, the Board’s supervisory role is instrumental in risk identification and mitigation, contributing to the overall financial stability of the institution. By upholding ethical standards, the Board not only ensures alignment with transparency and accountability but also enhances the institution’s reputation, subsequently attracting further investment. In essence, the Sharia Supervisory Board positively impacts financial performance through the promotion of trust, risk management, and adherence to ethical practices in accordance with Islamic principles.

The role of the Sharia Supervisory Board in the operational oversight of Islamic banks to ensure compliance with Sharia law is critical. Nugroho (2020) posits a direct correlation between the number of members on the Sharia Supervisory Board and the financial performance of the institution, suggesting that an increased board membership amplifies the supervision of corporate management, thereby ensuring that financial performance is in accordance with Sharia principles. This vigilance averts the allocation of funds in ways that contravene Sharia law, leading to heightened profitability. The research conducted by Intia & Azizah (2021) and Umam (2020) corroborates the positive influence of the Sharia Supervisory Board on financial performance, demonstrating that effective oversight by the Board in ensuring Sharia compliance positively affects the bank’s financial outcomes.

In summary, the Sharia Supervisory Board plays a pivotal role in influencing the financial performance of an organization through its strategic oversight and financial governance. One of its primary responsibilities is to set the strategic direction of the company, making decisions that directly impact business strategies, goals, and overall objectives. By carefully considering and approving key financial decisions, such as investments, acquisitions, and financial policies, the Board contributes significantly to the organization’s financial well-being. Additionally, the Board oversees financial reporting processes, ensuring accuracy, transparency, and compliance with relevant regulations. Its role in risk management is also crucial, as the Board assesses and manages potential risks that could impact the financial stability of the organization. In essence, the Board of Commissioners serves as a cornerstone in shaping and guiding the financial performance of the company, with its decisions and oversight playing a vital role in ensuring sustainable and successful financial outcomes.

The proposed board of commissioners is believed to have no impact on company execution, thanks to the presence of an independent judiciary (Shanti, 2020). This ensures that the administrative capacity of the directorate and management is more ideal, fostering unbiased evaluations of executives. Independent commissioners, constituting at least 30% of the total, aim to contribute to decision-making within the board of commissioners. Their role is vital in overseeing the establishment of a well-functioning and efficient company. The connection between independent commissioners and banking executives is reinforced, emphasizing their role as monitors for a directed and independent sector (Septiana & Aris, 2023; Sitanggang, 2021). Independent commissioners are crucial for minimizing unclean and non-transparent corporate management, playing a significant role in upholding good corporate governance.

In Shariah banking, the Board of Commissioners significantly shapes financial performance by ensuring adherence to Islamic principles. They guide strategic decisions aligned with Shariah, impacting investments and policies. Independence ensures unbiased evaluations, crucial for Shariah integrity. This commitment attracts trust, and the presence of independent commissioners reinforces decision-making for an efficient and Shariah-compliant organization. Their role minimizes non-compliance risks, promoting transparent and Shariah-compliant management, ultimately enhancing the overall financial performance of the Shariah banking institution.
Board of directors on financial performance

The Board of Directors significantly shapes the financial performance of a company by spearheading strategic decision-making and providing oversight. Charged with setting the organization’s direction, the board’s decisions on business strategies, risk management, and capital allocation directly impact financial outcomes. Through vigilant financial oversight, the board ensures transparency and regulatory compliance in reporting, fostering investor trust. Additionally, the board determines executive compensation, linking it to financial performance goals and influencing the motivation of the leadership team. By upholding good corporate governance, ethical standards, and shareholder value, an effective Board of Directors plays a pivotal role in steering the company toward sustainable financial success.

The Board of Directors, in conjunction with fellow board members, is responsible for decision-making and implementing policies approved by the Board of Commissioners. Their responsibilities encompass strategy formulation, maintenance of organizational structure, and the effectiveness of authority delegation. An increased number of board members allows for clearer task distribution, potentially exerting a positive impact on the company and strengthening external networks (Situmorang & Simanjuntak, 2019). Research indicates that the presence and number of board directors positively influence financial performance, enhance external connectivity, and refine corporate strategy (Honi et al., 2020).

In the context of Shariah banking, the Board of Directors holds a crucial role in shaping financial performance. Their decisions align with Shariah principles, impacting business strategies and risk management to ensure compliance. The emphasis on ethical standards and shareholder value resonates with Shariah values, fostering transparency and trust among investors. The larger board, as suggested by research, can potentially enhance connectivity and strategies in Shariah banking. This positive impact reflects in improved financial performance, contributing to the sustainability and success of Shariah-compliant practices within the institution.

Audit committee on financial performance

The Audit Committee occupies a pivotal position in bolstering financial performance through its commitment to transparency, precision, and adherence in a firm’s financial reporting mechanisms. This committee is entrusted with the oversight of financial reporting processes, internal control systems, and the efficacy of both internal and external audit functions. Through its independent and objective supervision, the Audit Committee plays a key role in identifying and mitigating financial risks, deterring fraudulent activities, and augmenting the trustworthiness of financial disclosures. A well-functioning Audit Committee is instrumental in cultivating investor confidence, ensuring regulatory compliance, and upholding the overall integrity of financial information. Consequently, this contributes positively to an organization’s financial performance by nurturing stakeholder trust and promoting prudent financial management practices.

Acting as an intermediary among shareholders, the board of commissioners, and management, the Audit Committee addresses issues related to control and governance. Research conducted by Hartati (2020) demonstrates a notable positive correlation between the efficacy of the audit committee and financial performance. In Indonesia, the formation of an audit committee is a compulsory requirement for all companies, necessitating a resolution by the board of commissioners. This independent and proficient body bolsters the board’s capabilities in financial reporting, risk management, audit execution, and the implementation of corporate governance (Sari et al., 2020; Shanti, 2020). For publicly listed companies, the presence of an audit committee, comprising a minimum of three members with an independent external individual as the chair, is mandated and plays a critical role in the evaluation of financial performance.

Within the sphere of Shariah banking, the Audit Committee assumes an essential function in enhancing financial performance. Its oversight responsibilities ensure that financial reporting is congruent with Shariah principles, particularly in terms of transparency and accuracy. By effectively overseeing internal controls and audit operations, the committee aids in identifying and mitigating financial risks, thus preventing deviations from Shariah standards. This robust committee bolsters investor confidence and regulatory compliance, reinforcing the integrity of financial information in the realm of Shariah banking. The compulsory establishment of an audit committee in Indonesian Shariah banking institutions highlights its indispensable role in maintaining financial performance, achieved through efficacious governance and adherence to Islamic principles.

Conclusion

In summation, entities such as the Sharia Supervisory Board, Board of Commissioners, Board of Directors, and Audit Committee are integral to the financial success of organizations. The Sharia Supervisory Board is instrumental in maintaining Islamic values, thereby cultivating trust and ethical practices. The Board of Commissioners plays a crucial role in overseeing strategic decision-making and governance processes, whereas the Board of Directors is pivotal in influencing financial outcomes. The proposed establishment of a board of commissioners, characterized by an independent judiciary, aims at ensuring impartial management assessments. Furthermore, the Audit Committee is essential for upholding financial transparency and integrity. The efficacious operation of each of these entities is vital for sustained financial prosperity, demonstrating the synergy of governance structures in enhancing financial performance across various sectors.

Acknowledgements

I would like to express my gratitude to all individuals and entities who contributed to this research.
Funding
This research received no specific grant from any funding agency in the public, commercial, or not-for-profit sectors.

References