

CHAPTER I

INTRODUCTION

A. Research Background

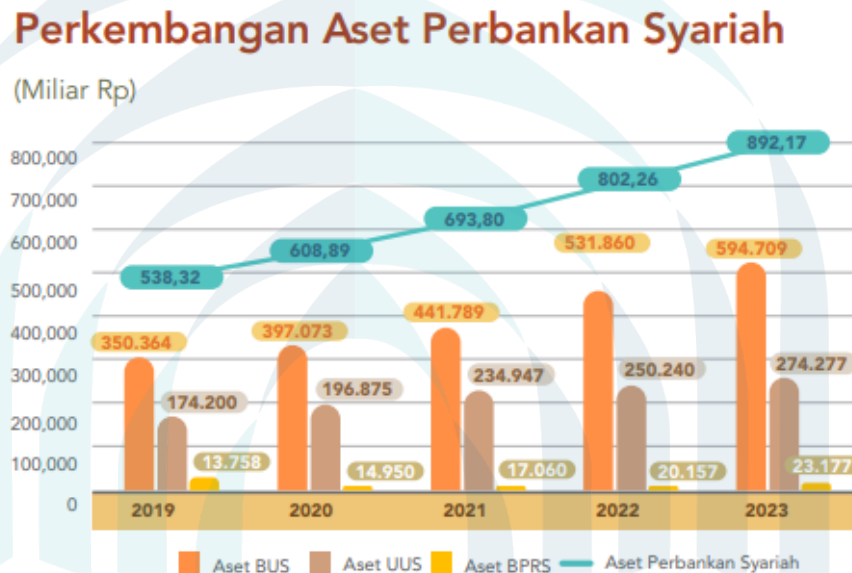


Figure 1. Development of Islamic Banking Assets in Indonesia 2019 to 2023

Source: OJK

Globally, the Islamic Financial Services Board (IFSB) report shows that the world's total Islamic banking assets have reached USD 3.4 trillion by the end of 2022, where Indonesia plays an important role as one of the key markets in the industry.¹ The Islamic banking industry in Indonesia has recorded significant growth in the past five years, making it one of the main pillars of the national financial system.² Based on data from the Financial Services Authority (OJK) in 2023, the total assets of national Islamic banks reached IDR 892.17 trillion, growing 11.21% compared to the previous year, with consistent double-digit growth over the last five years.³

¹ "Bank Indonesia and the Islamic Financial Services Board (IFSB) collaborate to develop a global Islamic finance development plan 2025 – 2027," accessed November 14, 2024, https://www.bi.go.id/id/publikasi/ruang-media/news-release/pages/sp_268624.aspx.

² Goodstats Data, "Growth Trend of Total Assets of Indonesian Sharia Commercial Banks 2016-2024," Goodstats Data, accessed October 26, 2024, <https://data.goodstats.id/statistic/tren-pertumbuhan-total-aset-bank-umum-syariah-indonesia-2016-2024-jqhya>.

³ "Total Assets of Islamic Banks Reach IDR 765.36 Trillion in January 2023," Data Indonesia: Data Indonesia For Better Decision. Valid, Accurate, Relevant, Accessed October 1,

This significant asset growth is inseparable from the role of Islamic Corporate Governance (ICG) in maintaining public trust in the applied Sharia principles.⁴ In the enforcement of Sharia principles, there is a responsible body, namely the Sharia Supervisory Board. This is an independent body tasked with ensuring that all operational activities and products of Islamic financial institutions are by Islamic Sharia principles.⁵

SSB consists of experts in *fiqh muamalah* and sharia finance, who are authorized to provide fatwas, advice, and supervision on the implementation of sharia rules in the institution's activities.⁶ The existence of SSB is regulated by regulatory authorities, such as the Indonesian Ulema Council (MUI) and the Financial Services Authority (OJK), to maintain the integrity and public trust in the Islamic financial system.

The existence of SSB causes this governance to be a solid foundation for the operations of Islamic banks. However, the industry still faces challenges, such as low Islamic financial literacy in the community and limited product variety available. These obstacles need to be overcome to ensure sustainable growth.

The phenomenon of rapid growth of Islamic banking in Indonesia shows interesting dynamics, especially in terms of increasing total assets.⁷ According to the 2022 OJK report, the market share of Islamic banking reached 6.57% of the total national banking industry.⁸ In this context, total assets are considered

2024, <https://DataIndonesia.Id/Keuangan/Detail/Total-Aset-Bank-Syariah-Capai-Rp76536-Triliun-Pada-Januari-2023>.

⁴ Rana Shabilah, Achmad Fauzi, and Indah Muliasari, "The Influence Of Islamic Corporate Governance (ICG), Company Size, And Leverage (DAR) On Financial Performance (ROA) In Sharia People's Financing Banks In Indonesia" 2, No. 4 (2023): 23.

⁵ Rahmat Ilyas, "The Role of the Sharia Supervisory Board in Sharia Banking," *JPS (Journal of Sharia Banking)* 2, No. 1 (April 9, 2021): 11, <https://doi.org/10.46367/jps.v2i1.295>.

⁶ Mahipal et al., "Opportunities and Challenges in Sharia Banking Management and the Urgency of the Existence of Sharia Supervisory Board in Indonesia," *Palar (Pakuan Law Review)* 8, No. 2 (June 21, 2022): 11, <https://doi.org/10.33751/palar.v8i1.4846>.

⁷ Mochamad Januar Rizki, "Low Financial Literacy and Its Implications for Consumers," *Hukumonline.Com*, 1, accessed January 17, 2025, <https://www.hukumonline.com/berita/a/rendahnya-literasi-keuangan-dan-implikasinya-terhadap-konsumen-lt637dc488aed5f/>.

⁸ "Boosting the Market Share of Sharia Banking in the Country," *investor.id*, accessed January 28, 2025, <https://investor.id/finance/333962/mendongkrak-pangsa-pasar-perbankan-syariah-tanah-air>.

relevant as an indicator that reflects the competitiveness, stability, and efficiency of Islamic banks. The research also included total assets as a form of bank characteristics to understand how economies of scale affect financial performance.

The financial performance of Islamic banks is measured using several financial ratios, namely, liquidity ratio, solvency ratio, activity ratio, and profitability ratio.⁹ Return on Equity (ROE) is one of the main indicators in assessing the financial performance of a company. ROE measures the rate of return that shareholders get on the equity they invest. This ratio is calculated by comparing net income with shareholders' equity, which is then expressed as a percentage. The higher the ROE value, the more efficient the company is in utilizing its equity to generate profits.¹⁰

In assessing the financial performance of banks, bank characteristics are one of the factors that have a significant impact on profitability and operational efficiency.¹¹ These characteristics can be measured through various indicators, one of which is total assets, which is often expressed in the form of natural logarithm (Ln Total Assets) to provide a more proportional picture of the size of the bank. This characteristic plays a role in determining the competitiveness, cost efficiency, and ability of the bank to manage its financial resources.

In addition, the size of the bank also determines its ability to diversify risk. Large banks have broader loan and investment portfolios, thus reducing market and credit risks. With better risk management, profits become more stable, so ROE remains optimal.

⁹ Umma Atul, Yuwita Sari, and Yuyun Lestari, "Financial Ratio Analysis to Measure the Financial Performance of Companies," *Tsm Accounting E-Journal* 2 (September 30, 2022): 91–92, <https://doi.org/10.34208/Ejatsm.V2i3.1396>.

¹⁰ Muhammad Gozali dkk., "Pemetaan penelitian seputar variabel determinan Return on Equity (ROE) pada perbankan syariah: studi Bibliometrik VOSviewer dan literature review," *IDEI: Jurnal Ekonomi & Bisnis* 4, no. 1 (2 Juni 2023): 7.

¹¹ Bella Giovana Putri (STIE Malangkecewara Malang) dan Siti-Munfaqiroh (STIE Malangkecewara Malang), "Analisis Rasio Keuangan Untuk Mengukur Kinerja Keuangan," *INSPIRASI: JURNAL ILMU-ILMU SOSIAL* 17, no. 1 (2020): 9, <https://doi.org/10.29100/insp.v17i1.1563>.

However, large bank sizes also face challenges in regulation and management complexity. Stricter regulations may limit flexibility in business decision-making. In addition, complex organizational structures may hinder efficiency, potentially lowering ROE.¹² The relationship between Ln Total Assets and ROE is not always linear. Medium-sized banks often have higher ROE than very large or very small banks. This is due to the balance between operational efficiency and managerial complexity.

Several studies have explored the relationship between Islamic Corporate Governance (ICG), bank characteristics, and financial performance. Tarihoran found that ICG had a significant effect on ROE in Islamic banks. Meanwhile, Dianti identified that several elements of ICG affect operational efficiency, which ultimately impacts ROE.

Ayusaleha and Laila's¹³ research confirms that bank size contributes significantly to financial performance through economies of scale effects. International research such as Hassan and Basri shows that strict governance in the Middle East results in a significant increase in ROE. The local context remains a key factor, as Al-Harbi said, that the effectiveness of governance depends on regulations and public trust in the Sharia system.

The focus of this research is to explore how the indicators of the general guidelines for the governance of Indonesian sharia entities (PUG-ESI) published by the National Committee on Governance Policy (KNKG) are applied specifically in measuring ICG related to financial performance. In previous research, this guideline has not been used as a reference for measuring ICG in companies.

This guideline guides Sharia governance, covering stakeholder rights, regulatory oversight, ethics, and risk disclosure. The eight main principles of this guideline include the responsibilities of the board of directors, the board of

¹² Arif Rahmansyah dan Helliana, "Pengaruh Likuiditas Dan Ukuran Perusahaan Terhadap Kinerja Keuangan," *Jurnal Riset Akuntansi*, 23 Desember 2023, 11, <https://doi.org/10.29313/jra.v3i2.2795>.

¹³ Annisa Ayusaleha dan Nisful Laila, "Diversifikasi, Bank Karakteristik, dan Profitabilitas Bank Umum Syariah di Indonesia," *Jurnal Ekonomi Syariah Teori dan Terapan* 9, no. 3 (31 Mei 2022): 9, <https://doi.org/10.20473/vol9iss20223pp299-309>.

commissioners, and the DPS; composition and remuneration; constructive working relationships; ethical behavior; risk management; transparency; protection of shareholder rights; and stakeholder respect. These principles are applied through 195 recommendations to improve the efficiency, transparency, and sustainability of Islamic finance.¹⁴

Based on this background, this research aims to fill the gap in previous research in that it identifies the relationship between Islamic corporate governance, bank characteristics, and financial performance measured through ROE. This research is different by identifying the simultaneous relationship between Sharia governance, total assets as a Form Characteristic, and ROE. The low efficiency compared to conventional banks indicates the need for further strengthening of Sharia operational and governance strategies.

This research uses a sample of 12 Islamic banks in Indonesia during the 2019 to 2023 period, reflecting the latest dynamics in the industry. Thus, this research is expected to make a significant contribution to the development of sharia governance literature and practices in Indonesia. Based on this, this research is entitled "The Influence of Islamic Corporate Governance (ICG) and Form Characteristics on the Financial Performance of Islamic Banking in Indonesia in 2019 to 2023"

B. Problem Formulation

Based on the Research background description above, the problems identified in this research are as follows:

1. Does Islamic Corporate Governance (ICG) positively impact on the financial performance of Islamic banks in Indonesia?
2. Does the Characteristic Form positively impact on the financial performance of Sharia Banks in Indonesia?

¹⁴ "Pedoman Umum Governansi Entitas Syariah Indonesia (PUG-ESI)" (KOMite Nasional Kebijakan Governansi, 2023), 25.

3. Does Islamic Corporate Governance (ICG) and form characteristics positively impact on the Financial Performance of Islamic Banks in Indonesia?

C. Purpose of Research

1. To analyze the influence of Islamic Corporate Governance (ICG) on the Financial Performance of Islamic Banks in Indonesia.
2. To analyze the influence of the Form Characteristics on the Financial Performance of Islamic banks in Indonesia.
3. To analyze the influence of Islamic Corporate Governance and the Form Characteristics on the Financial Performance of Islamic banks in Indonesia.

D. Research Benefits

The results of this research are expected to provide benefits for the following parties:

1. Benefits for academics

This research is expected to increase the knowledge of academics and provide a deeper understanding of the influence of Islamic Corporate Governance (ICG) and Form Characteristics on the Financial Performance of Islamic Banks in Indonesia.

2. Benefits for practitioners

- 1) Government

This research is expected to be considered by the government or financial institutions in Indonesia to improve financial performance, especially for Islamic banks.

- 2) Social society

This research is expected to increase financial literacy in the community, both for investors and potential investors, by allowing them to review the financial performance of the banking that will be used.

3) Researcher

This research is expected to be a medium for the application of science and can increase knowledge about financial literacy, and financial attitudes and behaviors.

