The Effect of Implementing Good Corporate Governance (GCG) on the Financial Performance of Islamic Banks in Indonesia

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The implementation of Good Corporate Governance (GCG) in Indonesia's Islamic banking sector is an important step to ensure transparency, accountability and fairness in the operations of financial institutions. As an integral part of the financial system, Islamic Banks not only provide services in accordance with Islamic economic principles but are also expected to implement good corporate practices to maintain the sustainability and reliability of the financial system.Corporate governance in the banking sector gained attention after the 1997 financial crisis, with the establishment of the National Committee on Governance Policy (KNKG) in 1999. Analysis of previous research results shows variations in the effect of GCG implementation on the financial performance of Islamic banks. Some studies found a significant positive impact, while others showed negative or insignificant results. Variations in results are also seen in performance indicators such as CAR, NPF, ROA, and ROE, reflecting the complexity of the relationship between GCG and aspects of financial performance. Therefore, deeper contextual understanding and improved effectiveness of GCG implementation are needed to understand and maximize its impact amidst increasingly complex financial market dynamics.

Keywords: GCG, Financial Performance, Islamic Banking

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INTRODUCTION

The implementation of Good Corporate Governance (GCG) in Indonesia's Islamic banking sector is a crucial step to ensure that financial institutions conduct their operations with the principles of transparency, accountability and fairness. As a pillar in Indonesia's financial system, Islamic Banks have a responsibility not only to provide financial services in accordance with the principles of Islamic economics, but are also expected to implement good corporate practices to ensure the sustainability and reliability of the financial system.

Attention to corporate governance first emerged after the financial crisis in 1997. This event triggered the establishment of the National Committee on Corporate Governance Policy in 1999 in Indonesia, which later became the National Committee on Governance Policy (KNKG). The KNKG issued the National Guidelines on Corporate Governance in 1999, which was later revised in 2001 and 2006. In addition, the KNKG also issued guidelines for Sharia Business Governance in 2011.

The implementation of Good Corporate Governance (GCG) is very important to build public and international trust, as an absolute requirement for good and healthy development in the banking world. Institutions such as the Bank for International Settlements (BIS) continue to review the prudential principles that must be followed by banks and issue GCG Implementation Guidelines for the banking world internationally. Similar guidelines are also issued by other international institutions.

In Indonesia, several entities, especially Islamic banks, have implemented GCG. GCG in the context of banking (including Islamic banking) is a management system designed to improve the performance of Islamic banks, protect the interests of stakeholders, and improve compliance with legislation and generally accepted ethical values.

The implementation of GCG in Islamic banks is based on agency theory, which describes the relationship between shareholders as principals and the board of directors as agents who have the authority to manage Islamic banks. Such management requires accountability to shareholders, emphasizing the importance of responsiveness, accountability and transparency. Fairness and independence are also key and core factors in the relationship between investors and managers of Islamic banks, reflected in the bank's financial performance.

Good management will contribute to improving the financial performance of Islamic commercial banks, which can be measured by profit growth. This profit growth is an indicator of the efficiency and development potential of Islamic commercial banks, in accordance with public perception.

GCG in Islamic banking refers to the principles and practices applied to ensure that Islamic banks operate efficiently, ethically, and transparently while considering the principles of Sharia or Islamic law. Good corporate governance is essential in Islamic banking to maintain trust, manage risks, and ensure compliance with ethical and legal standards.

Implementing strong corporate governance practices in Islamic banks not only ensures their compliance with Sharia principles but also enhances their credibility, stability, and long-term sustainability. It promotes trust among stakeholders and contributes to the overall development and growth of the Islamic banking industry.

Several studies have been conducted to examine the impact of Good Corporate Governance (GCG) on the financial performance of Islamic banks in Indonesia. Research results by (Adi & Suwarti, 2022) stated that although the implementation of GCG does not directly affect the performance of Islamic banks, its impact can be felt indirectly through financing risk. Other findings revealed by (Pratiwi, 2016) (Pratiwi, 2016) stated that the quality of GCG implementation, as measured by indicators of the board of commissioners, directors, independent commissioners, audit committee, and sharia supervisory board, has a significant influence on the financial performance of Islamic banks. However, the impact of each indicator varies, with some having a positive effect and others having a negative effect. Thus, it can be concluded that GCG implementation has an important role in determining the financial performance of Islamic banks in Indonesia. Other studies on GCG on Indonesia Islamic banks can be found at Mukhibad & Khafid (2018), Dewany (2015), Saputra & Ihsan (2021), Rini (2018), and also Mukhibad et al., (2017).

In this context, research on the effect of GCG implementation on the financial performance of Islamic Banks in Indonesia is very important. With increasing public awareness of fairness, ethics and transparency in financial management, an in-depth understanding of how GCG implementation can affect the financial performance of Islamic Banks is essential. GCG is not only seen as a legal obligation, but also as a driver to strengthen the trust of shareholders, customers and the public in Islamic Banks, especially in an increasingly dynamic and complex environment.

RESEARCH METHOD

In this study, researchers applied descriptive qualitative methods and conducted library research. By reviewing previous research related or relevant to this topic, researchers collected data from the GoogleScholar application and used Mendeley as a reference for the bibliography. This qualitative research article was based on consistent methodological assumptions, with the aim of avoiding questions from the reader. One of the main reasons for conducting this research is that it is exploratory in nature.

Qualitative methods refer to research techniques used in various fields, such as social sciences, anthropology, psychology, and other disciplines, to gather non-numerical data and gain insights into people's behaviors, beliefs, experiences, and attitudes. These methods are focused on understanding the depth, context, and meanings associated with human experiences rather than quantifying data through numerical measurements.

RESULT AND ANALYSIS

Good Corporate Governance (GCG)

According to Bank Indonesia Regulation PBI number 11/33/PBI/2009, *Good Corporate Governance* (GCG) in the context of banking is defined as a governance system that applies the principles of *transparency*, *accountability*, *responsibility*, *professionalism*, and fairness. The Forum for *Corporate Governance in Indonesia* (FCGI) explains *Corporate Governance* as a set of rules that regulate the relationship between shareholders, company management, creditors, government, employees, and other internal and external stakeholders, relating to their rights and obligations, or in other words, as a system of regulating and controlling the company. (*Bank Indonesia Regulation Number 11/33/PBI/2009 on the Implementation of GCG for Sharia Commercial Banks*, n.d.)

In the perspective of Keasey and Wright presented by (Sayidah, 2007)(Sayidah, 2007), corporate governance has two main dimensions. First is the monitoring of management performance that emphasizes management accountability to shareholders. The second is the governance structures, mechanisms, and processes that encourage managerial behavior to increase business and corporate prosperity. These two perspectives are important considerations in creating governance structures and procedures that contribute to improved performance. *Corporate governance* can be defined as a framework that regulates the balanced relationship between the Board of Commissioners, Board of Directors, GMS, and other stakeholders. It also includes a *Check and balance* system that involves the division of authority to control the company and prevent mismanagement and misuse of company assets. In addition, corporate governance is considered a transparent process of setting and achieving corporate objectives and measuring performance.

Principles of *Good Corporate Governance*

GCG principles involve transparency, which is defined as openness in conveying material and relevant information and in the decision-making process. Transparency, according to Linan as described by Hastuti (2005), includes the disclosure of important information that must be prepared, audited and disclosed in line with quality accounting. This principle also emphasizes the fair, timely, and efficient dissemination of information. In the context of Islamic banking, Islamic banking managers have a great responsibility for the safety of funds entrusted to them by customers.

The principle of accountability, in accordance with Bank Indonesia Regulation number 11/33/PBI/2009, includes the conformity of bank management with laws and regulations and the principles of sound bank management. (OECD, 2004) explains that accountability involves the responsibility of the board in management, management supervision, and accountability to the company and shareholders. *Corporate governance* should create strategic guidelines for the company, effective monitoring of company management by the Board of Commissioners, and accountability to the company and shareholders.

Benefits of *Good Corporate Governance* Implementation

According to (Hamdani, 2016)(Hamdani, 2016), the benefits of GCG implementation include improved company performance through better decision-making processes, increased operational efficiency, and better service to stakeholders. GCG implementation also facilitates the acquisition of financing funds from stakeholders and the public due to increased trust in the company, which in turn can increase the value of the company and the value of its shares. A good *Corporate Governance* structure helps ensure that management uses the company's resources appropriately in accordance with the interests of the principals and reports the condition of the company's financial statements and operational performance to the principals. Thus, the main function of *Corporate Governance* is to provide a check on the power of management and ensure that the interests of shareholders are met.

Corporate Governance Mechanism

According to (Levine et al., 2003) (Levine et al., 2003), *corporate governance* mechanisms play a role in reducing the appropriation of bank resources and promoting bank efficiency. *Corporate governance* refers to a group of mechanisms that influence managers' decisions when there is a separation between ownership and control. Some of these mechanisms lie in the functions of the board of directors, institutional shareholders, and control of market mechanisms. The success of the company is greatly influenced by the decisions or strategies taken, and the board of directors plays a major role in determining the company's strategy. Indonesia uses a two-tier concept, with the board consisting of the Board of Directors and the Board of Commissioners.

Financial Performance of Islamic Banking

Basically, the purpose of measuring the performance of Islamic banking is not much different from the performance of companies in general. The measurement of company performance is carried out to make improvements and control over its operational activities in order to compete with other companies in a competitive financial market. Assessment of bank performance is very important for all stakeholders, including bank management, customers, business partners, and the government.

Banks that are able to maintain their performance well, especially in achieving a high level of profitability, as well as being able to distribute dividends well and have growing business prospects, can fulfill the provisions of prudential banking regulations well. In this case, it is likely that the value of shares and the amount of third party funds will increase. This increase in the value of shares and third party funds is an indicator of increased public confidence in the bank.

This new assessment method is regulated by Bank Indonesia Regulation (PBI) No. 9 of 2007 concerning the Health Level Assessment System for Commercial Banks Based on Sharia Principles. This assessment system covers several aspects, among others:

a. *Asset Quality*: Aims to evaluate the condition of the bank's assets, including the anticipation of default risk from financing *(credit risk)*. This asset quality assessment is carried out in two ways, namely through the quality of earning assets (KAP) and *Non-Performing* Financing (NPF).
b. Liquidity: Aims to evaluate the bank's ability to maintain an adequate level of liquidity, including anticipation of liquidity risks that may arise. The liquidity assessment is conducted in three ways, namely through *Short Term Mismatch* (STM), *Short Term Mismatch Plus* (STMP), and Interbank Pasiva (RABP) ratios.
c. Rentability *(Earning)*: Aims to evaluate the ability of Islamic banks to generate profits. This rentability assessment involves six aspects, namely *Net Operating Margin* (NOM), *Return on Assets* (ROA), *Operating Activity Efficiency* Ratio (REO), Income Diversification (DP), *Return on Equity* (ROE), and Composition of Fund Placement in Securities (IdFR).

DISCUSSION

Conduct a *review of* relevant journals as a basis for explaining the results of previous research. According to (Hisamuddin, 2015) "The Effect of *Good Corporate Gorvernance* on the Financial Performance of Islamic Commercial Banks" shows the results of research that GCG affects financial performance proxied by ROA and ROE. This shows that the implementation of GCG by BI in commercial banks can reduce conflicts of interest that occur and foster the performance of Islamic banking in particular in the hope of attracting investors to increase their investment.

According to (Ardana, 2019) "Implementation of *Good Corporate Governance* (GCG) in Measuring the Risk and Financial Performance of Islamic Banks in Indonesia" shows the results that *Good Corporate Governance* (GCG) in measuring the risk and financial performance of Islamic banks has no significant effect. According to (Ali & Saputra, 2023) "The Effect of Transparency, Accountability and Responsibility on *Good Corporate Governance*" Shows the Results 1) Transparency affects GCG; 2) Accountability affects GCG; 3) Responsibility affects GCG.

According to (Amelinda & Anwar, 2021) "The Effect of *Good Corporate Governance* Implementation on the Financial Performance of Islamic Commercial Banks in Indonesia" shows the results that only the audit committee board has a significant effect on financial performance. Meanwhile, other results prove that *Good Corporate Governance* has a significant role in the company's financial performance. According to (Trilaksono et al., 2021) "The Effect of *Islamic Corporate Governance and Islamic Social Reporting* on the Financial

Performance of Islamic Banks in Indonesia" shows the results that the variables that affect the performance of Islamic banks in this study are not implemented effectively.

According to (Pratiwi, 2016) "The Effect of the Quality of Implementation of *Good Corporate Governance* (GCG) on Financial Performance at Islamic Commercial Banks in Indonesia (period 2010-2015)" Shows the results that the application of GCG based on the data collected has an average of 1.55 - 2.20 which is in the "Good" category. This means that the quality of GCG implementation is in accordance with the BUS 11 indicators set by Bank Indonesia. The results of the t test (partial test) show that the quality of GCG implementation has a significant positive effect on CAR, NPF and ROA. The quality of GCG implementation has a negative effect on ROA and ROE significantly. While the statistical test results showed that the implementation of GCG has no effect on the performance ratios of NIM and FDR.

According to (Fadhillah, 2018) "The Effect of *Good Corporate Governance* Implementation on Financial Performance and Financing Risks in Islamic Commercial Banks" Shows the results that Good Corporate Governance has a positive effect on financial performance in the profitability ratio with the *Return On Asset* indicator. In addition, *Good Corporate Governance* also has a negative effect on financing risk with an indicator of the level of *Non Performing Financing*. And there is a relationship that affects the level of *Non Performing Financing and Return On Asset.*

The effect of Good Corporate Governance on financial performance

Based on the analysis of the research results that have been described, there are various findings regarding the significant impact of the implementation of Good Corporate Governance (GCG) on the financial performance of Islamic banks in Indonesia. From this context, the following conclusions can be drawn:

1. Significant Positive Influence

Several studies, such as the work of Nur Hisamuddin and M. Yayang Tirta K, show that the implementation of GCG has a significant positive impact on the financial performance of Islamic banks. The increase in Return on Assets (ROA) and Return on Equity (ROE) is an indicator that illustrates the improvement of financial performance.

2. Negative or Insignificant Effect

In contrast, research such as that conducted by Yudhistira Ardana found that GCG has no significant influence in measuring the risk and financial performance of Islamic banks. This shows the variation of findings among these studies.

3. Importance of Certain GCG Elements

Several studies highlight the importance of certain elements in GCG implementation. For example, Tiara Novia Amelinda and Lucky Rachmawati's research shows that the audit committee board has a significant influence on financial performance. This suggests that focusing on certain aspects of GCG may be more crucial in achieving a significant impact.

4. Variation in Results in Performance Indicators

Agrum Pratiwi found variations in results on performance indicators such as CAR, NPF, ROA, and ROE. These variations indicate the complexity of the relationship between GCG implementation and various aspects of financial performance, where the effects may differ on each indicator.

5. Need for Evaluation and Improvement of Effectiveness

The findings of Ibnu Trilaksono, Agrianti Komalasari, Chara P.T. Tubarad, and Yuliansyah that the variables affecting the performance of Islamic banks are not effectively implemented indicate the need to evaluate and improve the effectiveness of GCG implementation to achieve a significant impact.

Thus, although several studies show a significant positive impact between GCG implementation and financial performance of Islamic banks, the varied results also reflect the complexity of this relationship. Hence, further research, contextual understanding.

CONCLUSION

The implementation of Good Corporate Governance (GCG) in Indonesia's Islamic banking sector plays a crucial role in ensuring that financial institutions operate with the principles of transparency, accountability and fairness. As a pillar of Indonesia's financial system, Islamic banks are not only responsible for providing financial services in accordance with Islamic economic principles, but are also expected to implement good corporate practices to ensure the sustainability and reliability of the financial system.

Corporate governance in the banking sector started to gain attention after the 1997 financial crisis, with the establishment of the National Committee on Governance Policy (KNKG) in 1999 in Indonesia. The implementation of GCG is key to building public and international market confidence, ensuring good growth in the banking world.

On the other hand, the financial performance of Islamic banking is measured by various indicators such as Return on Assets (ROA) and Return on Equity (ROE). The system of assessing the soundness of Islamic banks, which is regulated by Bank Indonesia Regulations, involves evaluating asset quality, liquidity, and profitability.

Analysis of previous research results shows variations in the findings of the effect of GCG implementation on the financial performance of Islamic banks. Some studies found a significant positive effect, while others showed negative or insignificant results. Certain GCG elements, such as the audit committee board, are considered to have a significant influence.

Variations in results are also seen in performance indicators such as CAR, NPF, ROA, and ROE. These findings reflect the complexity of the relationship between GCG and aspects of financial performance, and point to the need to evaluate and improve the effectiveness of GCG implementation.

In conclusion, GCG implementation has the potential to positively impact the financial performance of Islamic banks. However, deeper contextual understanding, further research, and improved effectiveness of GCG implementation are needed to fully understand and maximize its impact amidst increasingly complex financial market dynamics. As a recommendation, in the future analysis can use a bibliometric or SLR approach for more comprehensive results (Puspita, 2022; Uula, 2022; Maulida & Rusydiana, 2022; Riani & Rusydiana, 2022; Avedta, 2023).

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