

# ISLAMIC CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE OF SHARIA BANKS

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## Abstract

**How to cite this paper:** Rusdi, D., Mutamimah, & Widiyanto. (2026). Islamic corporate governance and the financial performance of Sharia banks. *Journal of Governance and Regulation*, 15(1), 233–242. <https://doi.org/10.22495/jgrv15i1art21>

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**ISSN Print:** 2220-9352  
**ISSN Online:** 2306-6784

**Received:** 01.03.2025  
**Revised:** 02.07.2025; 30.08.2025; 07.01.2026  
**Accepted:** 29.01.2026

**JEL Classification:** E5, G3, M21  
**DOI:** 10.22495/jgrv15i1art21

The growth of the Islamic banking industry in Indonesia is increasingly significant, but the financial performance of several Islamic banks still shows fluctuations, especially in terms of profitability and problematic financing. One factor that is believed to play a role in creating financial stability and sustainability is the implementation of Islamic corporate governance (ICG), especially the role of the Sharia Supervisory Board (SSB). This study aims to analyze the effect of the number of SSBs on the financial performance of Islamic commercial banks in Indonesia, using data from 13 Islamic banks listed on the Indonesia Stock Exchange (IDX) during the 2020–2023 period. The method used is multiple linear regression, with financial performance indicators in the form of capital adequacy ratio (CAR), return on assets (ROA), non-performing financing (NPF), financing to deposit ratio (FDR), and operating expenses to operating income (*beban operasional pendapatan operasional*, BOPO). The results show that the number of SSBs has a significant positive effect on profitability (ROA) and a significant negative effect on NPF. This finding aligns with Mollah and Zaman (2015), who stated that “a better Sharia supervisory board’s effectiveness could increase Sharia compliance in Sharia banks” (p. 418). This study emphasizes the urgency of strengthening the role of the SSB in supporting financial stability and Sharia compliance of Islamic banks in Indonesia.

**Keywords:** Islamic Corporate Governance, Financial Performance, Sharia Supervisory Board

**Authors’ individual contribution:** Conceptualization — D.S.; Methodology — D.S. and M.; Formal Analysis — M.; Investigation — D.S., M., and W.; Writing — Original Draft — D.S., M., and W.; Writing — Review & Editing — D.S., M., and W.

**Declaration of conflicting interests:** The Authors declare that there is no conflict of interest.

## 1. INTRODUCTION

The development of Islamic banks, particularly Islamic rural credit banks in Indonesia, shows a positive trend (Faozan et al., 2023; Mawardi et al., 2024; Othman & Othman, 2025). Based on data from the Indonesian Banking Industry by the Financial Services Authority (*Otoritas Jasa Keuangan*, OJK), the financial performance of Islamic rural credit banks increased significantly by 18.39% in 2022

compared to the previous year (Akbar & Siti-Nabiha, 2022). In 2023, the financial performance of Islamic rural credit banks remained stable. Banking sustainability is crucial to maintain amidst of competition in the banking business. Sholikah and Miranti (2020) state that financial sustainability is influenced by financial performance.

Banking activities are currently regulated under Law No. 10 of 1998 concerning Amendments to Law No. 7 of 1992 on banking, hereinafter referred to as

the Banking Law (Alam et al., 2021). Not only are conventional banks that have long existed in Indonesia dominant, but banks in the Islamic sector are now beginning to develop and gain acceptance in society. Islamic banks are recognized within Indonesia's banking system in accordance with legal provisions. This law provides greater opportunities for the development of Islamic banking in Indonesia as it explicitly distinguishes banks based on conventional principles from those based on Islamic principles (Jan et al., 2021; Almici, 2023; Chatterjee et al., 2024).

The financial performance of Islamic commercial banks in Indonesia from 2020 to 2024 showed a positive trend, despite fluctuations in some indicators. The capital adequacy ratio (CAR) increased from 21.64% to 25.86%, supported by capital growth from Indonesian rupiah (IDR) 46.85 trillion to IDR 79.73 trillion and a rise in risk-weighted assets from IDR 216.55 trillion to IDR 308.38 trillion. Profitability also improved, as reflected by the increase in return on assets (ROA) from 1.40% to 1.90% and net profit growth from IDR 5.09 trillion to IDR 11.14 trillion, alongside an increase in average total assets from IDR 362.69 trillion to IDR 586.06 trillion. The non-performing financing (NPF) ratio decreased from 3.31% to 2.05%, while net NPF dropped from 1.57% to 0.65%, indicating improved financing quality. The financing to deposit ratio (FDR) rose from 76.36% to 80.59%, suggesting better efficiency in fund distribution, in line with the growth of third-party funds from IDR 322.85 trillion to IDR 463.41 trillion. Meanwhile, the operating expenses to operating income (*beban operasional pendapatan operasional*, BOPO) ratio declined from 85.55% to 78.45%, reflecting improved operational efficiency. The sharp decline in operating expenses in 2024 also suggests significant efficiency improvements or changes in reporting structure.

According to Canh et al. (2021), institutional quality significantly influences the relationship between non-performing loans and bank performance, indicating that good governance plays a crucial role in maintaining financial stability and profitability. This finding reinforces the importance of implementing Islamic corporate governance in Sharia banks to enhance financial performance while ensuring compliance with Sharia principles.

In the Indonesian context, the existence of a Sharia Supervisory Board (SSB) is not only mandated by the OJK but also serves as a guarantee of the commitment of Islamic financial institutions in the public eye. However, the effectiveness of the SSB is still influenced by various factors such as the competence of its members, the frequency of supervision, and differences in capacity across regions. Therefore, it is important to further explain how the number of SSBs can reflect the strength of sharia governance, particularly in Indonesia, which has institutional and geographical diversity.

The above data highlights an interesting phenomenon regarding the financial performance of Islamic commercial banks in Indonesia. According to data from the OJK of the Republic of Indonesia, the CAR in the Islamic banking industry increased significantly each year from 2020 to 2024, except in 2021, due to the impact of COVID-19. The profitability ratio (ROA) also saw significant

improvement over the past five years. However, the NPF ratio in the Islamic banking industry experienced fluctuations. From 2020 to 2022, NPF values decreased, but in the following two years, there was a significant increase.

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This fluctuation indicates that although Islamic banks have demonstrated resilience in terms of capital adequacy and profitability, their asset quality remains vulnerable. In this context, the strengthening of Islamic corporate governance becomes crucial to ensure effective risk management and sustainable financial performance. Moreover, as Lutfiah (2024) emphasizes, the rapid development of Sharia fintech in Indonesia also presents new challenges related to regulatory compliance and technological adaptation. These challenges underline the importance of robust governance mechanisms that not only uphold Sharia compliance but also support innovation and financial stability within the Islamic banking sector.

Santoso et al. (2024) emphasize that integrating good corporate governance (GCG) with religious values such as accountability, transparency, and credibility can enhance trust and performance in Islamic institutions. This concept aligns with the study of Mutamimah et al. (2021), which found that good corporate governance practices effectively reduce credit risk and improve financial performance among small and medium enterprises in Indonesia. These findings highlight that sound governance when combined with Islamic ethical principles plays a crucial role in strengthening financial stability and performance in Sharia based institutions. Consistent with these views, Virgantara (2024) found that GCG also plays a significant role in reducing credit risk in Indonesian banking companies, underscoring the importance of governance mechanisms in improving financial performance and maintaining stability within the banking industry.

GCG also influences financial performance (Hermanto et al., 2021; Eugster & Wagner, 2020; Badu & Assabil, 2022). Corporate governance analysis involves improving and disseminating governance-related information to capital market participants through governance reports and ratings (Huang et al., 2020; Akhmadi & Januarsi, 2021). Thus, corporate governance analysis can facilitate the creation of corporate value through management monitoring, enhanced information production/dissemination, and increased investor recognition (Akhmadi & Januarsi, 2021). Consistent with this view, Al-Ahdal et al. (2020) found that increased corporate governance analyst coverage due to exogenous shocks enhances firm value in UK firms. However, what kind of governance can improve firm performance in an Islamic manner?

Previous researchers have extensively studied performance (Kostyuk et al., 2011; Eugster & Wagner, 2020; Hermanto et al., 2021; Badu & Assabil, 2022; Al Azizah & Haron, 2025). Many factors affect financial performance, one of which is corporate governance. Prior studies examining the impact of corporate governance on financial performance have produced inconsistent results, which remain unresolved to date. Article 6 of Banking Law No. 10 of 1998 on Islamic banking mandates that Islamic banking institutions must establish a Sharia Supervisory Board (SSB). The SSB is responsible for overseeing bank activities to ensure compliance with Islamic principles. Fitriana et al. (2019) concluded that the SSB positively impacts the performance of Islamic banking in Indonesia. However, studies by Haddad et al. (2022), Gozali et al. (2022), Fatmawati et al. (2022), and Ferretti et al. (2024) found that the SSB does not affect Islamic bank performance. Therefore, it is compelling to re-examine the impact of the SSB on the performance of Islamic banks.

A literature gap emerges from previous studies showing inconsistencies in the impact of the SSB on the financial performance of Islamic banks. These discrepancies highlight an important empirical gap that warrants further investigation in the Indonesian context. Therefore, this study aims to analyze the impact of the number of SSB members on the financial performance of Islamic commercial banks in Indonesia from 2020 to 2023. The main research question is:

*RQ1: Does the number of SSB members significantly affect financial performance indicators such as ROA, CAR, NPF, FDR, and BOPO?*

This study is expected to contribute academically by enriching the literature on Islamic corporate governance (ICG) and the role of the SSB in the financial performance of Islamic banks. Additionally, the findings provide practical implications for regulators and industry stakeholders in designing strategies to strengthen Sharia-based supervisory functions.

This study is anchored in agency theory, which explains the relationship between principals and agents and how governance can mitigate conflicts of interest (Claessens et al., 2000; Mohammed & Muhammed, 2017). In the context of Islamic banking, the SSB serves as a supervisory mechanism based on Islamic values, ensuring bank operations align with Islamic principles. The research methodology employs a quantitative approach with multiple linear regression techniques. The sample consists of 13 Islamic commercial banks listed on the Indonesia Stock Exchange (IDX) that consistently reported financial statements from 2020 to 2023. The independent variable is measured by the number of SSB members, while the dependent variables are financial performance indicators.

The paper is structured as follows. Section 1 outlines the context of Islamic banking development, research problems, literature gaps, research objectives and questions, as well as the theoretical framework and methodology in brief. Section 2 discusses agency theory, GCG principles, and the impact of ICG on financial performance. Section 3 explains the quantitative approach with multiple linear regression, using data from 13 Islamic banks from 2020 to 2023. Section 4 presents descriptive data and regression tests, showing a positive impact

of the number of SSB members on ROA and a negative impact on NPF. Section 5 summarizes the main findings, addresses research limitations, and provides suggestions for future studies.

## 2. LITERATURE REVIEW

### 2.1. Agency theory

Agency theory explains the separation between ownership and control (Claessens et al., 2000). The separation between ownership and control can be an efficient form of the company in the framework of the “series of contracts” perspective.

“An agency relationship is a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent” (Jensen & Meckling, 1976, p. 310).

As stated above, an agency relationship is a contract between one or more people (as principals) who employ other people (as agents) to carry out work on behalf of the principal, including granting authorization rights for important decision-making (Agustin et al., 2020; Jørgensen et al., 2022; Karsono, 2023).

There are several assumptions underlying agency theory. First, agency theory assumes that a company is a “nexus of contracts” or a network of contracts. The contracts made are incomplete and do not specify the obligations of each group in uncertain conditions. Second, it is assumed that the efficiency of the capital market is strong, and the residual value claims expected by shareholders are reflected in the stock price. Third, it is assumed that there is a separation between control and ownership, thus allowing managers to take opportunistic actions that benefit themselves. Fourth, it is assumed that the basic nature of humans is: 1) humans are generally self-interested, 2) humans have limited thinking power regarding future perceptions (bounded rationality), and 3) humans always avoid risk (risk-averse).

Agency problems arise when there is a conflict of interest between the agent and the principal. This agency problem is called the type 1 agency problem. The type 1 agency problem occurs in companies with a dispersed ownership structure, such as the US. For example, managers can embezzle investor funds and sell products to companies owned by managers at lower prices to sell company assets, including earnings management (Hayes et al., 2012; Dong et al., 2021). Cetin et al. (2016) found other agency problems, namely between majority shareholders and minority shareholders, which is called the type 2 agency problem.

Type 2 agency problems usually occur in companies with concentrated share ownership, such as many companies in East Asian countries or emerging market countries such as Indonesia. This conflict of interest occurs because the controlling shareholder has a control right over assets (voting control right) greater than the right to obtain profit (cash flow right). The majority shareholder obtains this control through a stock pyramid, cross-holding ownership, and using different classes of stocks (multiple classes of stocks). The difference between

cash flow rights and control rights incentivizes the controlling shareholder to expropriate the rights of minority shareholders (Claessens et al., 2000; Zhang et al., 2022).

Agency theory concerning corporate governance refers to the contradiction between principals and managers concerning interests (Mohammed & Muhammed, 2017). The relationship between the two parties has different opinions, and the owner focuses on increasing the profit level. There are several models of corporate governance around the world in various countries. The prominent models include the Anglo-Saxon, Continental European, value-based, Islamic, and family business organization models. In addition, some prominent country-specific models exist, such as Japan, Germany, France, China, and India. The value-based, Islamic, and country-specific models have significant differences between the basic and the others, but they all originate from the basic model (Bodin & Taks, 2022). These and all other models have adapted the basic principles of one of the basic models or combined the best practices of both models and adapted them to national, socio-cultural, and religious needs. For example, the Islamic model adapts the stakeholder model (Continental Europe), combines Anglo-Saxon best practices, and blends it with Sharia principles (derived from the Qur'an and Sunnah/the traditions of the Prophet Muhammad SAW) to facilitate the Islamic concept of leadership (L'Huillier, 2014; Tjahjadi et al., 2021).

## 2.2. Good corporate governance

The beginning of the creation of GCG was the crisis in the banking sector, which was generally dominated by conventional banks from 1997 to 2000. The crisis was due to the lack of GCG practices in banking. competition in the banking industry required Bank Indonesia (BI) to change the system of monitoring health conditions and effective bank policies. The government and BI implemented GCG to create a conducive, healthy, efficient, and transparent business climate. BI issued Bank Indonesia Regulation No. 11/33/PBI/2009 concerning implementing GCG for Sharia commercial banks and business units to maintain the sustainability of GCG in banking (Marwa et al. 2023; Sofiani & Suhendar, 2024). GCG is a framework that underlies globally recognized principles and best practices applied in the management and supervision of companies, including financial institutions such as banks. The principles of GCG are designed to create an operating environment aligned with the values of ethics, transparency, accountability, and fairness. GCG primarily aims to create a framework that ensures companies operate with transparency, accountability, and responsibility, thereby safeguarding the interests of shareholders and other stakeholders (Karyatun et al., 2023).

Agency theory assumes a complete contract that caters to all possible eventualities, such as inconvenience, conflict, unforeseen circumstances, disputes, and so forth (Agustin et al., 2020). Bounded rationality does not allow for complete and efficient contracts. Information asymmetry, transaction costs, and selfishness are possible conditions that cannot be overcome in contracts.

Agency theory assumes contracts can eliminate agency costs, but agency costs arise. The many imperfections in the market show that this assumption is not valid. Shareholders are assumed to be only interested in financial performance. Directors and management are assumed to have job responsibilities from shareholders. The board has some roles in making corporate policy. Most corporate governance research is conceptualized as a barrier to managerial interests (Rohyati & Suropto, 2021). Agency theory does not appreciate agent competence. Agency theory is a value of the capitalist economic system because it eliminates the understanding of human values such as feeling, intuition, spirituality, mutual trust, mutual respect, and honesty. The context of agency theory includes the aim of being selfish by principals and agents. Management behavior tends to benefit directors as controllers. This is because directors are part of management, and directors have appointed and recruited managers. The explanation above shows that in agency theory, many problems conflict with Islamic economics based on the Qur'an and Hadith.

## 2.3. The influence of Islamic governance on financial performance

GCG is a concept based on agency theory that is expected to function as a tool to overcome agency problems and ensure managers act on behalf of shareholders. GCG in Sharia banking has one additional function, namely, SSB, which has the special task of providing advice and suggestions to the board of directors and supervising bank activities to comply with Sharia principles (PBI No. 11/33/PBI/2009).

According to Muttakin and Ullah (2012), SSB will encourage better performance in Sharia banking. Mollah and Zaman (2015) stated that a better SSB's effectiveness could increase Sharia compliance in Sharia banks. Hayat and Hassan (2017) and Muhammad et al. (2021) found that SSB positively affects profitability performance in Pakistani Sharia banks. The existence of SSB can increase the company's profitability and reduce the NPF level by ensuring compliance with Sharia principles through the establishment of standard operating procedures (SOP) and supervision of their implementation so that in this case SSB can limit management in conducting credit transactions that are not in accordance with sharia principles, as well as aggressive risk-taking that may harm the company (Mollah & Zaman, 2015). Therefore, the hypothesis is proposed as follows:

*H1: The SSB positively influences the profitability of Sharia banking.*

## 3. RESEARCH METHODS

The regression model applied in this study is a panel data regression, considering the data structure that combines both cross-sectional dimensions (13 Islamic commercial banks) and time series observations (2020-2023). To determine the most appropriate estimation technique, several diagnostic tests were performed. The Chow test was used to compare pooled ordinary least squares (OLS) with the fixed effect model (FEM), the Hausman test was applied to distinguish between FEM and the random

effect model (REM), and the Lagrange multiplier test was conducted to evaluate the suitability of REM against pooled OLS. Based on the results of these tests, the regression test was selected as the most appropriate specification, ensuring robust and unbiased parameter estimation. The regression analysis was conducted using statistical software such as Statistics and Data (STATA) and Statistical Package for the Social Sciences (SPSS).

This study employs a quantitative approach using multiple linear regression analysis to examine the impact of the number of SSB members on the financial performance of Islamic commercial banks in Indonesia. The population consists of all Islamic commercial banks listed on the IDX, with sample selection conducted through purposive sampling based on the following criteria: 1) banks listed on the IDX, and 2) banks with complete financial reports for the period 2020-2023. The population of this study is all Sharia commercial banks (SCB) listed on the IDX, totaling 13 SCBs. The research period is four years, from 2020 to 2023. Thus, the sample in this study is 52 SCBs. Table 1 lists the SCBs that are sampled in this study.

**Table 1.** List of Sharia commercial banks

No.	Bank
1	BCA Syariah Bank
2	Victoria Syariah Bank
3	KB Bukopin Syariah Bank
4	Indonesian Islamic Bank
5	Nano Bank Syariah
6	BTPN Islamic Bank
7	Mega Syariah Bank
8	Islamic Muamalat Bank
9	Aladin Islamic Bank
10	Bank Aceh Syariah
11	NTB Sharia Bank
12	Islamic Bank of Kepri
13	BJB Syariah Bank

As an alternative approach, this study also considers the use of qualitative methods, such as content studies of SSB reports or in-depth interviews with SSB members and Islamic bank management. This approach has the potential to provide a deeper understanding of the SSB's substantive role beyond the observed quantitative indicators.

The independent variable in this study is the *number of SSB members*, representing aspects of ICG. The dependent variables include five financial performance indicators: *CAR*, *ROA*, *NPF*, *FDR*, and *BOPO*. All data were obtained from annual reports and financial statements officially published by each bank through the IDX website or the respective bank's website (Temiz, 2021).

Data analysis was conducted using statistical software, with steps including classical assumption tests (normality, multicollinearity, heteroscedasticity, and autocorrelation), followed by multiple linear regression to measure the significance and direction of the relationship between variables. The data analysis technique used in the study is multiple regression testing. This research model can be formulated with the following statistical equation for regression:

$$KK_{it} = \alpha + \beta ICG_{it} + \varepsilon_{it} \quad (1)$$

where, *KK* = financial performance variable; *ICG* = corporate governance variable.

#### 4. RESULTS AND DISCUSSION

Table 2 shows descriptive statistical data for each variable. The financial performance variable has an average *CAR* of 24.98%, meaning that the financial ratio for Sharia banking capital adequacy is quite good because it is above 8% in accordance with Indonesian banking standards. The financial performance variable has an average *ROA* of 2.00%, meaning that the financial ratio for Sharia banking profits is not good because it is below 5% according to Indonesian banking standards. For the financial performance variable, the average *NPF* is 3.31, meaning that the financial ratio for the risk level of Sharia banking financing is quite good because it is below 5% in accordance with Indonesian banking standards. For the financial performance variable, the average *FDR* is 80.59, meaning that the financial ratio (*FDR*) of Sharia banking is quite good because it is above 80% in accordance with Indonesian banking standards. For the financial performance variable, the average *BOPO* is 85.55, meaning that the financial ratio (*BOPO*) of Sharia banking is quite good because the maximum is 85% in accordance with Indonesian banking standards. For the *ICG* variable, the average is 2.6, meaning that the number of SSB in Sharia banking is in accordance with OJK requirements of at least two people.

**Table 2.** Descriptive statistics

Variables	Mean	Min	Max	Std. dev.
<i>CAR</i>	24.98	21.64	26.28	1.89
<i>ROA</i>	1.74	1.40	2.00	0.25
<i>NPF</i>	2.48	2.05	3.31	0.51
<i>FDR</i>	76.26	70.12	80.59	4.04
<i>BOPO</i>	80.78	77.28	85.55	3.84
<i>ICG</i>	2.60	2.00	3.00	0.41

**Table 3.** Regression test results

Independent variable	<i>CAR</i>	<i>ROA</i>	<i>NPF</i>	<i>FDR</i>	<i>BOPO</i>
	(β)	(β)	(β)	(β)	(β)
Constant	22.87	0.62	3.72	58.81	98.21
<i>ICG</i>	1.03	0.43***	-0.47**	6.71	-6.70

Note: \*\*\* significant at 5% level, \*\* significant at 1% level.

Regression findings indicate that the *ICG* variable, represented by the number of SSB members, has a significant positive effect on *ROA* ( $\beta = 0.43$ , significant at the 1% level). This suggests that an increase in the number of SSB members is associated with higher profitability in Islamic commercial banks. The finding aligns with the *H1* that the SSB positively influences the profitability of Sharia banking, as proposed in the study.

This result is consistent with prior research by Muttakin and Ullah (2012), who found that the presence of a robust SSB enhances the performance of Islamic banks in Bangladesh by ensuring stricter adherence to Sharia principles, which fosters stakeholder trust and improves operational efficiency. Similarly, Mollah and Zaman (2015) argue that an effective SSB increases Sharia compliance, which in turn enhances financial performance by reducing operational risks associated with non-compliant activities. Their study

on conventional versus Islamic banks highlights that SSBs play a critical role in aligning bank operations with ethical and religious expectations, thereby attracting more customers and investors who prioritize Sharia-compliant services.

Additionally, Hayat and Hassan (2017) found a positive relationship between SSB effectiveness and profitability in Pakistani Islamic banks, emphasizing that SSBs contribute to profitability by overseeing the development of Sharia-compliant financial products and ensuring robust risk management practices. The current study's finding that a larger SSB is associated with higher *ROA* may reflect the enhanced supervisory capacity of a larger board, which can provide more comprehensive oversight, develop SOPs, and ensure that financial products align with Islamic principles. This is particularly relevant in the Indonesian context, where Islamic banking is gaining traction, and customer trust in Sharia compliance is a key driver of profitability.

However, the positive effect on *ROA* contrasts with some studies, such as those by Haddad et al. (2022) and Fatmawati et al. (2022), which found no significant impact of SSBs on Islamic bank performance. These discrepancies may be attributed to differences in sample size, time periods, or contextual factors such as regulatory environments or the maturity of Islamic banking systems in different countries. For instance, Indonesia's Islamic banking sector is relatively young compared to that of Pakistan or Malaysia, and the role of SSBs may be more pronounced in ensuring compliance and building market confidence, thus directly impacting profitability. These findings are further supported by Nomran and Haron (2020), who found that the SSB's influence on profitability is more significant if its members possess dual competencies in sharia and finance. Therefore, this study's findings confirm that, in the context of Indonesia's still-developing Islamic banking, increasing the number of SSB members can strengthen Sharia supervisory capacity and compliance, thereby boosting bank profitability.

The average *ROA* in the study (2.00%) is noted to be below the Indonesian banking standard of 5%, indicating that while SSBs contribute positively, Islamic banks still face challenges in achieving optimal profitability. This could be due to external factors such as economic recovery post-COVID-19 or internal factors like limited product diversification. Future research could explore whether the quality of SSB members (e.g., their expertise in Islamic finance or frequency of supervisory activities) amplifies this positive effect on *ROA*, as suggested by Fitriana et al. (2019), who emphasized the importance of SSB characteristics in enhancing performance. The regression results also show that the *ICG* variable has a significant negative effect on *NPF* ( $\beta = -0.47$ , significant at the 5% level). This indicates that an increase in the number of SSB members is associated with a reduction in the level of problematic financing, which is a critical indicator of financing quality in Islamic banks.

This finding supports Mollah and Zaman (2015), who argue that effective SSBs reduce *NPF* by enforcing Sharia-compliant SOPs and limiting aggressive risk-taking behaviors by management. By ensuring that financing contracts adhere to Islamic

principles (e.g., avoiding riba-based transactions or speculative investments), SSBs mitigate the risk of defaults, which directly impacts *NPF* levels. The supervisory role of SSBs includes reviewing financing agreements to ensure compliance with Sharia principles, such as ensuring that profit-sharing arrangements (e.g., *mudharaba* or *musharaka*) are structured to minimize risk exposure. This result is also in line with Hayat and Hassan (2017), who found that SSBs in Pakistani Islamic banks contribute to lower *NPF* ratios by enhancing risk management practices. The current study's finding suggests that a larger SSB may enhance the thoroughness of oversight, allowing for better identification and mitigation of risky financing practices. For example, SSBs may enforce stricter due diligence processes for financing approvals, ensuring that only viable and Sharia-compliant projects are funded.

Differences in the influence of the SSB across institutions can also be influenced by regional conditions and institutional characteristics. For example, Islamic banks operating in urban areas with more skilled human resources tend to have a more active SSB than those in remote areas. This variation reflects the importance of considering local context when designing SSB strengthening policies.

However, the average *NPF* of 3.31% in the study, while within the acceptable Indonesian banking standard of below 5%, indicates room for improvement. The negative relationship between SSB size and *NPF* underscores the importance of SSBs in maintaining financing quality, particularly in a post-COVID-19 economic environment where financing risks may have increased due to economic uncertainties. This finding contrasts with studies like Gozali et al. (2022), which found no significant impact of SSBs on *NPF*, possibly due to differences in the scope of SSB activities or the specific economic conditions during their study period. This finding also aligns with the agency theory view that the SSB acts as a governance mechanism to mitigate opportunistic management behavior. By strengthening its oversight function over Sharia-compliant financing, the SSB not only reduces default risk but also improves bank asset quality, as demonstrated in Hayat and Hassan's (2017) study in the Pakistani context.

The negative effect on *NPF* highlights the SSB's role as a governance mechanism rooted in agency theory, as discussed in the study. By acting as a supervisory agent, the SSB aligns management actions with the interests of stakeholders (e.g., depositors and investors) by reducing risky financing practices that could harm the bank's financial stability. This finding has practical implications for Islamic banks in Indonesia, suggesting that increasing the number of SSB members could be a strategic move to enhance financing quality and reduce credit risk.

The regression results indicate that the *ICG* variable does not significantly affect *CAR* ( $\beta = 1.03$ ), *FDR* ( $\beta = 6.71$ ), or *BOPO* ( $\beta = -6.70$ ) at the 5% significance level. These non-significant findings suggest that the number of SSB members does not directly influence capital adequacy, liquidity, or operational efficiency in the sampled Islamic banks.

The lack of a significant effect on *CAR* (average 24.98%, well above the Indonesian standard

of 8%) may indicate that capital adequacy is more influenced by external regulatory requirements or internal capital management strategies than by SSB size. According to Alam et al. (2021), *CAR* is primarily driven by regulatory compliance and capital injection decisions, which may fall outside the SSB's direct purview. The high *CAR* in the sample suggests that Islamic banks maintain strong capital buffers, possibly due to stringent regulations by the OJK, rendering SSB size less impactful.

The non-significant effect on *FDR* (average 80.59%, above the Indonesian standard of 80%) suggests that the SSB's role in overseeing financing distribution relative to deposits is limited. *FDR* is influenced by market demand for financing and the bank's ability to mobilize third-party funds, as noted in the study's introduction. Jan et al. (2021) suggest that liquidity management in Islamic banks is more closely tied to macroeconomic conditions and deposit growth than governance structures like the SSB. The non-significant result may also reflect the fact that SSBs focus more on Sharia compliance than on liquidity management.

The non-significant effect on *BOPO* (average 85.55%, within the Indonesian standard of 85%) indicates that SSB size does not directly impact operational efficiency. *BOPO* is influenced by factors such as cost control, operational scale, and technological investments, which may be outside the SSB's primary responsibilities. Ferretti et al. (2024) note that operational efficiency in banks is often driven by management decisions and technological advancements rather than governance structures. However, the study's introduction mentions a sharp decline in operating expenses in 2024, suggesting potential improvements in efficiency that may not be captured within the 2020–2023 study period. These non-significant findings are consistent with some prior studies, such as Fatmawati et al. (2022), which found that SSBs do not universally impact all financial performance indicators. The lack of significance may also stem from the study's focus on the number of SSB members rather than their quality or activities, as noted in the conclusion's limitations. For instance, Fitriana et al. (2019) suggest that the expertise and engagement level of SSB members may have a stronger influence on certain financial metrics than mere board size.

These results support the research of Alam et al. (2021) and Jan et al. (2021), which showed that bank capital adequacy and liquidity are more influenced by regulations and macroeconomic conditions than by the structure of the SSB. Furthermore, as emphasized by Fitriana et al. (2019), the quality and competence of SSB members can be a greater determinant of supervisory effectiveness than the number of members alone. This explains why increasing the number of SSB members does not necessarily have a significant impact on operational efficiency and liquidity management in Islamic banks.

These findings also indicate alignment with international Islamic financial governance principles as outlined in the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) standards. For example, AAOIFI Governance Standard No. 1 emphasizes the need for the independence, integrity, and competence of

the SSB in overseeing the activities of financial institutions. Therefore, adhering to this standard can help Indonesian Islamic banks improve their accountability and global competitiveness.

The significant effects on *ROA* and *NPF* align with the broader literature on ICG, particularly studies emphasizing the SSB's role in enhancing Sharia compliance and financial stability (Mollah & Zaman, 2015; Hayat & Hassan, 2017). However, the non-significant effects on *CAR*, *FDR*, and *BOPO* highlight the nuanced role of SSBs in Islamic banking. These findings suggest that while SSBs are critical for ensuring Sharia compliance and reducing financing risks, their impact on other financial metrics may be indirect or mediated by other factors, such as regulatory frameworks or management practices. In the Indonesian context, the findings are particularly relevant given the rapid growth of Islamic banking and the increasing emphasis on Sharia compliance. The OJK data cited in the study shows significant growth in Islamic banking assets and profitability from 2020 to 2023, despite fluctuations in *NPF*. The positive effect of SSBs on *ROA* and the negative effect on *NPF* underscore their importance in supporting this growth by enhancing stakeholder confidence and reducing risk exposure.

The discrepancies with studies like Haddad et al. (2022) and Gozali et al. (2022) may be attributed to Indonesia's unique regulatory and cultural environment. For example, Indonesia's Islamic banking sector operates under strict OJK regulations, including mandatory SSB requirements (PBI No. 11/33/PBI/2009), which may amplify the SSB's impact on financial performance compared to countries with less stringent governance frameworks. Additionally, the cultural emphasis on Sharia compliance in Indonesia may enhance the SSB's role in building customer trust, thereby indirectly boosting profitability.

Overall, the results of this study enrich the literature on Islamic banking governance by demonstrating that the SSB plays a crucial role in increasing profitability and mitigating financing risks, although its impact on other aspects such as capital adequacy, liquidity, and operational efficiency remains limited. These findings are consistent with international Islamic governance principles as stipulated in the AAOIFI standards, which emphasize the independence and competence of the SSB as key pillars of ICG.

The findings have several implications for Islamic banks and regulators in Indonesia. Strengthening SSB capacity by increasing the number of SSB members could enhance financial performance, as evidenced by the positive effect on *ROA* and the negative effect on *NPF*. Banks could consider optimizing SSB composition to include members with diverse expertise in Islamic finance, risk management, and governance. The OJK could further strengthen SSB guidelines to ensure consistent Sharia compliance across banks, potentially amplifying the positive effects on profitability and financing quality. By emphasizing the SSB's role in reducing *NPF*, banks can enhance deposit histories and investor confidence, attracting more capital to the Islamic banking sector.

The study's limitations, as noted in the conclusion, provide clear directions for future

research. Expanding the scope to include SSB activities (e.g., frequency of meetings, quality of supervision) could provide deeper insights into their impact on financial performance. Distinguishing between government-owned and private Islamic banks may reveal variations in SSB effectiveness, as government banks may face different regulatory or operational constraints. Extending the study period beyond 2023 could capture post-COVID-19 recovery trends and their impact on SSB influence. Incorporating qualitative data, such as interviews with SSB members or bank managers, could provide a richer understanding of how SSBs influence financial outcomes.

## 5. CONCLUSION

Based on the analysis results, the number of SSBs positively affects profitability and financial performance. In addition, the number of SSBs has a negative effect on NPF's financial performance. This study has limitations and provides recommendations for future research to complete the findings. First, the sample is limited to the number of SSBs, and the activities carried out by the SSB are not tested. Future research can analyze the SSB's role in its supervisory activities. Second, this study does not distinguish between government-owned and non-government banks, which may affect the results of this study. Future research can further distinguish between government-owned and private banks.

This study found that the number of SSB members has a positive effect on profitability (ROA) and a negative effect on NPF in Islamic banks in Indonesia. This finding is consistent with previous literature highlighting the strategic role of the SSB in ensuring Sharia compliance and minimizing financing risks. These results underscore the urgency of strengthening the SSB, both in terms of quantity and quality. Policy implications include the need for financial authorities, such as the OJK, to establish competency standards and ongoing training for SSB members, and to encourage the adoption of international Sharia governance principles. Thus, Sharia governance can be more optimal in supporting the stability and financial performance of national Islamic banks.

The findings also imply that strengthening ICG, particularly through enhancing the composition and effectiveness of the SSB, is crucial for Islamic banks in Indonesia. Regulators such as the OJK should not only mandate the existence of SSBs but also ensure their competence, independence, and diversity of expertise. For Islamic banks, optimizing the number and quality of SSB members can improve profitability and reduce financing risks, thereby reinforcing stakeholder trust. These implications highlight the strategic role of ICG in aligning financial stability with Sharia compliance, consistent with AAOIFI governance standards, and contribute to building a more resilient Islamic banking sector.

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