

The Influence of the Characteristics of the Board of Directors and the Sharia Supervisory Board on the Risks of Islamic Commercial Banks in Indonesia

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ABSTRACT

This study aims to examine the characteristics of the Board of Directors (BoD) and the Sharia Supervisory Board (SSB) on the risk of Islamic commercial banks in Indonesia. This study is an associative study with a quantitative approach. The data used are secondary data in the form of annual financial report data and GCG reports of Islamic commercial banks. Based on purposive sampling technique, the sample of this study consists of 12 Islamic commercial banks listed with the Financial Services Authority (OJK) that published annual financial reports and GCG reports continuously for 5 years from 2019-2023. The results of the study indicate that female board of directors have a negative effect on Non-Performing Financing (NPF). In addition, the study found that age of the BoD has no effect on NPF, while the level of education and competence of the SSB have a negative relationship but do not have a significant effect on NPF. This study implies that Islamic banks in Indonesia need to strengthen the role of the BoD as the highest level of management, especially the existence of female BoD in Islamic commercial banks regarding their function in managing problematic financing risks. Moreover, increasing SSB competence through certification will support SSB performance to maximize the implementation of effective sharia governance

INTRODUCTION

A good corporate governance in banking industry is crucial to prevent risk-taking behavior that has the potential to diminish bank performance (Pradana & Rani, 2020). Understanding and controlling the level of financial risk is essential for banks to avoid the possibility of large losses (Anggriani & Rusyida, 2022). Therefore, risk management is very important for banks, especially Islamic banks, which must manage financial and operational risks by complying with Islamic principles. In this context, the risk in question is the risk of failure of financing (problematic financing) as measured by Non-Performing Financing (NPF).

The risk of problematic financing is a risk that is highly avoided by Islamic banks, because it concerns the ability of bank management to handle the financing provided. Bank management has a responsibility to minimize risk (Nugraheni & Muhammad, 2019). The consequences of the risk of default will have an impact on losses and a decrease in the value of bank assets, which in turn reduces the bank capital. A high level of credit risk may lead to customers' lack of trust (Warmana et al, 2024).

The statistical data of Islamic banking that published by the Financial Services Authority (OJK) in 2023, shows that the total financing of Islamic banks in Indonesia experienced a favorable trend as shown by increasing trend for four consecutive years for the year 2020-2023. A significant increase of more than 20% occurred between 2021 and 2022. This indicates a growing public interest in utilizing Islamic bank financing facilities. Furthermore, the NPF value of Islamic banks fluctuated during 2020-2023, where in 2020 it had a value of IDR7,294M and decreased significantly in 2021 to IDR6,228M. However, it is once again experienced a significant increase in 2022 and 2023. This evidenced the high level of problematic financing risk in Islamic banks.

The governance and risk management mechanisms in Islamic banks can be maximized by having a board of directors with diverse characteristics (Handayani & Panjaitan, 2019). Aisyah & Narulitasari (2023) found that the age of the board of directors can minimize the risk of problematic financing. In addition, the characteristics of the board of directors, age, gender, and education level affect the risk of banking portfolios (Fariza, 2019). Anisa et al. (2024), and Minh & Bich (2023) also proves that the presence of female directors on the board of directors is able to reduce credit risk.

Many studies show that one of the biggest challenges in Islamic banking is the lack of proper and effective sharia governance (Ulfi et al., 2020). The effectiveness of sharia governance can be optimized by having a monitoring system that can control problems arising from risks or activities that are not in accordance with Islamic values and principles. Thus, the existence of an independent board, namely the Sharia Supervisory Board (SSB), is a key factor that cannot be ignored. SSB functions as an independent monitor to limit excessive risks taken by the board of directors and to fulfill internal governance objectives, namely transparency of information disclosure (Yuanisa et al., 2022). Gusrianti & Sari (2023), and Dewindaru & Sari (2022) proves that the experience and knowledge gained by SSB members from their positions as SSB in various

other Islamic financial institutions, financial expertise, and doctoral education have a positive influence on the SSB's ability to increase the transparency of SSB information in Islamic banks.

Based on previous discussion, this study attempts to examine the board of directors characteristics that emphasize the presence of women on the board of directors and the age of the board of directors on the risk of non-performing financing (NPF). We focus on the expertise/competence and education level of the SSB on the risk of non-performing financing (NPF) as the novelty of this study as previous studies only used the composition and number of SSB meetings. In addition, previous studies focused more on bank performance rather than on financing risk. The purpose of this study is to examine the characteristics of the board of directors and the SSB on the risk of Islamic commercial banks in Indonesia.

LITERATURE REVIEW

Bank Risk

Uncertainty caused by changes that allow future losses to occur is called risk (Aisyah & Narulitasari, 2023). Bank risk is measured using financing risk which is proxied by NPF (Non-Performing Financing), which is a ratio that measures financing risk in Islamic banks. Based on the Financial Services Authority Regulation (POJK) 2019, NPF is formulated as follows:

$$NPF = \frac{JPB}{JP} \times 100\%$$

where:

NPF = Non-Performing Financing/ problematic financing ratio

JPB = the amount of financing classified as Substandard, Doubtful, and Loss collectability.

JP = amount of financing

Characteristics of the Board of Directors

The characteristics of the board of directors are proxied by the proportion of female board directors, namely the percentage of female board directors divided by the total board of directors. Female BoD is formulated as follows:

$$\text{Female BoD} = \frac{\Sigma \text{Female Board of Directors}}{\Sigma \text{Board of Directors}} \times 100\%$$

The second characteristic employed in this study is the age of the board of directors, which is measured by the number of board members aged over 40 years divided by the total board of directors. BoD age is formulated as follows:

$$\text{BoD Age} = \frac{\Sigma \text{ Board of Directors Age} > 40 \text{ Years}}{\Sigma \text{ Board of Directors}} \times 100\%$$

Sharia Supervisory Board (SSB)

In this study, SSB is proxied by the level of education and competence of SSB members. The level of education in question is the number of SSB who have a postgraduate degree (Doctorate/Ph.D.). SSB level education is formulated as follows:

$$\text{SSB Dr/Ph.D Degree} = \frac{\Sigma \text{ SSB with Doctorate Degree (Dr/PhD)}}{\Sigma \text{ SSB}} \times 100\%$$

Meanwhile, competence is the number of SSB that have a Sharia Supervisory Board competency certificate. Formulated as follows:

$$\text{SSB Competency} = \frac{\Sigma \text{ SSB with Sharia Supervisor Certification}}{\Sigma \text{ SSB}} \times 100\%$$

The Influence of Female Board of Directors on NPF

Greater female representation on the board of directors can reduce the risk of bankruptcy and has a significant influence on the risk taking of Islamic banks (Jabari & Muhamad, 2022). Anisa et al. (2024) proves that the presence of female directors on the board of directors is negatively and significantly related to credit risk. Minh & Bich (2023) also stated that there is a negative relationship between the presence of female directors and bank risk taking. Characteristics of directors such as gender affect banking portfolio risk (Fariza, 2019).

However, those finding is not in line with Aisyah & Narulitasari (2023) as well as Laili & Mulyati (2023) who found that female board of directors had no effect on financing risk. Likewise, Handayani & Panjaitan (2019) shows that the presence of female directors has a negative but not significant effect on financial risk. The same thing was expressed by Jao et al. (2021) which states that the presence of women on the board of directors has not had a significant impact on the company's financial performance. Based on this discussion, we propose the first hypotheses as:

H1: Female Board of Directors has a negative influence against NPF

The Influence of Board of Directors Age on NPF

Studies show that the age of the board of directors has a negative and significant impact on financing risk (Aisyah & Narulitasari, 2023). Winantisan et al. (2024) found that the diversity of the board of directors' age has a significant effect on financial performance. The characteristics of the board of directors represented by the age of the board of directors, have an effect on the risk of the banking portfolio (Fariza, 2019). These results provide evidence that the characteristics of the board of directors as a specific banking factor have an effect on the level of banking risk in Indonesia. Based on this discussion, we propose the following hypotheses as:

H2: The age of the Board of Directors has a negative effect on NPF.

The Influence of SSB Education Level on NPF

Jabari & Muhamad (2022) found evidence that SSB has a significant influence on the risk taking of Islamic banks. Research results by Dewindaru & Sari (2022) shows the fact that SSB with a doctoral education level has been proven to be able to increase customer trust. This is in accordance with the findings of Umar et al. (2023) which states that the level of education of SSB who have a doctoral degree can minimize the risk of bankruptcy in Islamic banks. On the other hand, Mukhibad & Setiawan (2023) proves that the level of SSB education encourages directors to take risks. This is reinforced by Listyorini et al. (2024); and Serly & Oktamirza (2022) which revealed that SSB members who have doctoral degrees have no influence on the performance and health of Islamic banks. Based on this discussion, we propose the following hypotheses as:

H3: SSB education level has a negative effect on NPF

The Influence of SSB Competence on NPF

Increasing the skills and competencies of SSB members will have a better and more effective impact on the performance of Islamic banking (Ulfi et al., 2020). Dewindaru & Sari (2022) found the fact that SSB expertise was proven to be able to increase customer trust. On the other hand, Gusrianti & Sari (2023) proves that SSB expertise does not affect SSB disclosure by Islamic banks. The results of the analysis of Kholidah et al. (2024) also found that financial and accounting expertise had little impact on the financial performance of Islamic banking. On the other hand, Umar et al. (2023) also found that Islamic financial professional expertise and SSB competence can increase the risk of bankruptcy. Based on this discussion, we propose the following hypotheses as:

H4: SSB competence has a negative effect on NPF

METHODOLOGY

This research is associative research with a quantitative approach. Associative research aims to test the relationship between two or more variables. In this study, Non-Performing Financing is the dependent variable, while the independent variables are the proportion of Female Board of Directors, the proportion of Board of Directors Age, SSB Education Level, and SSB Competence. The data used are secondary data in the form of quantitative and qualitative data taken from the annual financial reports and GCG reports of Islamic banks. We employ purposive sampling technique to determine our sample. The criteria including Islamic commercial banks registered with the OJK and published annual financial reports and GCG reports for 5 years consecutively, starting from 2019 to 2023.

Based on these criteria, 12 Islamic general banks were obtained which is equal to 60 firm-years observation. The dependent variable in this study is bank risk which is proxied by NPF (Non-Performing Financing). The independent variables are the proportion of female board of directors and the proportion of board of directors aged over 40 years, as well as the proportion of SSB Dr/Ph.D. education level and the proportion of sharia supervisor certification competency.

Data were analyzed by employing panel data regression to test whether the proportion of female board of directors and the age of the board of directors and the proportion of education level and competence of the Sharia Supervisory Board (SSB) affect bank risk as proxied by NPF (Non-Performing Financing). The regression equation model is described as follows:

Multiple Regression Model

$$NPF = \alpha + \beta_1 \%FBoD + \beta_2 \%BoDAge + \beta_3 \%SSBD + \beta_4 \%SSBC + e$$

where:

α	= Constant
β	= Regression coefficient
NPF	= Non-Performing Financing
%FBoD	= Proportion of Female Board of Directors
%BoDAge	= Proportion of Board of Directors Age >40 years
%SSBD	= Proportion of SSB with Dr/Ph.D. degree
%SSBC	= Proportion of SSB that have sharia supervisor certification
e	= Error

RESULT

Descriptive Data

Based on the results of statistical testing. Thus, the description of the research results begins with an explanation of the descriptive data shown in table 1 below.

Table 1. Descriptive Data

	Y	X1	X2	X3	X4
Mean	0.027603	0.180552	0.945833	0.555553	0.333333
Median	0.02595	0.200000	1.000000	0.500000	0.000000
Maximum	0.095400	0.750000	1.000000	1.000000	1.000000
Minimum	0.000000	0.000000	0.250000	0.000000	0.000000
Std. Dev.	0.020133	0.192956	0.140608	0.366522	0.438281

(Source: Processed Data, 2024)

Table 1 depicts the result of descriptive statistics. Descriptive data in table 1 shows that the maximum value of the NPF is 0.0954, while the minimum value is 0.0000. The mean value of NPF is 0.0276. In other words, the average Islamic bank has an NPF of 2.76%. Furthermore, the maximum value of the female board of directors (X1) is 0.7500, with a minimum value of 0.0000 and a mean of 0.1805. This shows the insignificant proportion of female board of directors in Islamic banks.

The age variable of the board of directors (X2) has a maximum value of 1.0000, with a minimum value of 0.2500. Meanwhile, the mean value of this variable is 0.9458. Thus, it can be concluded that the number of board of directors aged over 40 years in Islamic banks has a very large proportion, of which 94.58% are over 40 years old.

The descriptive statistics results also show that the SSB education level variable (X3) has a maximum value of 1.0000. The minimum value of this variable is 0.0000. The mean value shows the number 0.5555, meaning that of the total number of SSB members in the Islamic banks studied, more than 50% have a doctoral education level.

The SSB competency (X4) shows a maximum value of 1.0000, while the minimum value is 0.0000, with a mean value of 0.3333. This indicates the low proportion of SSB members who have competence/certification as sharia supervisors, or only 33% of the total.

Hypothesis Testing

Based on statistical testing of the variables studied, the following results were obtained.

Table 2. Hypothesis Testing

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.041595	0.006868	6.056543	0.0000
X1	-0.037547	0.015384	-2.440637	0.0179
X2	0.009135	0.012901	0.708074	0.4819
X3	-0.005218	0.007329	-0.711936	0.4795
X4	-0.010925	0.006258	-1.745807	0.0864
R-squared		0.169469	Mean dependent var	0.027603
Adjusted R-squared		0.109067	S.D. dependent var	0.020133
S.E. of regression		0.019004	Akaike info criterion	-5.008728
Sum squared resid		0.019862	Schwarz criterion	-4.834200
Log likelihood		155.2619	Hannan-Quinn criter.	-4.940461
F-statistic		2.805670	Durbin-Watson stat	1.836930
Prob (F-statistic)		0.034287		

(Source: Processed Data 2024)

Table 2 shows that of female board of directors has a negative effect on NPF. This is evidenced by the coefficient value showing a figure of -0.0375 and a prob. of 0.0179, which means that H1 is accepted. Meanwhile, the age of the board of directors has no effect on NPF. This is indicated by the coefficient value of 0.0091 with a prob. of 0.4819, which means that H2 is rejected.

Furthermore, the SSB education level and SSB competence have a negative relationship direction but do not have a significant effect on NPF. This can be seen from the coefficient value of the SSB education level variable, which is -0.0052 and the prob. is 0.4795. Meanwhile, the SSB competence variable has a coefficient value of -0.0109 and a prob. of 0.0864. Thus, it can be concluded that H3 and H4 are rejected.

The results of the determination coefficient test show that the adjusted R-square value is 0.1090, which means that the NPF variable can be explained by the variables of female board of directors, age of board of directors, education level and SSB competence as much as 10.90%, while the rest is explained by other variables not included in this study.

DISCUSSION

The Influence of Female Board of Directors on NPF

The results of the study show that female board of directors has a negative effect on NPF. This result is consistent with Jabari & Muhamad (2022); Anisa et al. (2024); Minh & Bich (2023); and Fariza (2019) which states that the presence of female directors on the board of directors has a negative effect on risk. This is confirmed Mansoor et al. (2020) and Khoirotunnisa (2021) who found that female board directors have a negative effect on bank risk taking.

However, this result is contrary to the research results of Aisyah & Narulitasari (2023); Jao et al. (2021); and Handayani & Panjaitan (2019) which revealed that the presence of female directors on the board of directors has no effect on financing risk. This is supported by research by Pradana & Rani (2020) which proves that the presence of female directors on the board of directors has a positive and significant effect. Furthermore, research by Laili & Mulyati (2023) which states that the proportion of female directors has no effect on credit risk variables in Islamic banking.

The effectiveness of risk management in improving financial performance is greatly influenced by the governance structure, especially the board of directors (Kurniawan & Hanggraeni (2024); Syafruddin (2020)). Although the data shows that the proportion of female board of directors is still low, their role is quite important in minimizing the risk of problematic financing in Islamic banks.

The Influence of Board of Directors Age on NPF

The results of the study indicate that the age of the board of directors has no effect on NPF. The results of this study are in line with the research of Caesar & Yanuar (2024) which explains that the age of the board of directors has no effect on the performance of Islamic banks. However, it is not in line with the research of Aisyah & Narulitasari (2023); Winantisan et al. (2024); and Fariza (2019) who found that the age of the board of directors influences the level of banking risk in Indonesia.

Risk mitigation can be implemented effectively if the board of directors is able to manage credit risk appropriately (Nugraheni & Muhammad, 2019). Older boards of directors tend to be more conservative (Caesar & Yanuar, 2024). This conservatism is based on knowledge, experience and expertise that the risks faced by Islamic banks do not only come from internal sources, but also from uncontrollable external influences. Older boards of directors already understand very well that every Islamic bank has a governance structure supported by a risk management system that functions to identify and address problems that arise due to these risks.

The Influence of SSB Education Level on NPF

The results of the study indicate that the level of education of SSB has a negative relationship but does not have a significant effect on NPF. This finding is in accordance with Mukhibad & Setiawan (2023); and Serly & Oktamirza (2022). However, it is contrary to the results of Jabari & Muhamad (2022); Dewindaru & Sari (2022); and Umar et al. (2023) which states that SSB who have a doctoral degree can minimize the risk of bankruptcy in Islamic banks.

These findings raise the suspicion that the level of SSB education does not affect NPF because the education background of SSB members who hold doctoral/Ph.D. degrees does not all come from Islamic finance/Islamic banking/accounting background. Although some of them are doctors in the field of Islamic law/sharia or Islamic studies and are not specifically related to finance. This suspicion is reinforced by the statement of Hanafi & Ratmono (2021) which states that SSB members who have a doctoral background would be better off if they have a background that is appropriate to their scope of duties, such as economic education including finance or accounting, and muamalah.

Ideally, SSB with a doctoral education level will be more able to think critically, so that they are faster and more precise in solving each problem (Listyorini et al., 2024). This will certainly further strengthen the role of SSB in the governance of Islamic banks (Ghazali et al., 2021). However, the suspicion of background irrelevance is an obstacle for SSB to be able to easily understand the mechanisms of Islamic finance/banking, because there needs to be adjustment and understanding of literacy in the Islamic banking industry.

The Influence of SSB Competence on NPF

The results of the study indicate that SSB competence has a negative relationship but does not have a significant effect on NPF. This result is consistent with Gusrianti & Sari (2023); Kholidah et al. (2024); and Umar et al. (2023) which found that Islamic financial professional expertise and SSB competence would increase the risk of bankruptcy. On the other hand, this result contradicts the research of Ulfi et al. (2020); and Dewindaru & Sari (2022) which revealed that the better the competence and expertise of SSB, the better the performance of Islamic banks, which means the lower the risk faced by Islamic banks.

Effective governance in Islamic banks will protect the company from vulnerability to risk (Ulussever et al., 2019). The existence of SSB with competent experience, knowledge and skills will be better in implementing compliance with sharia principles in operational activities, so that it tends to minimize the risks that must be faced by Islamic banks (Mansoor et al., 2020). However, this study obtained facts related to the minimal number of SSB members who have competence/expertise, as evidenced by certification as sharia supervisors. Thus, it can be concluded that the low competence of SSB is the reason for the absence of significant influence of SSB competence on NPF because SSB is considered not to have optimal performance in carrying out supervision of sharia compliance.

CONCLUSION AND RECOMMENDATION

The results of the study indicate that female board of directors has a negative effect on NPF. The age of the board of directors does not affect NPF. The level of education and competence of the SSB has a negative relationship but does not significantly affect NPF.

This study has several implications for Islamic banks in Indonesia, the first of which is related to strengthening the role of the board of directors as the highest level of management, especially the representation of female board of directors in Islamic banks regarding their function in managing the risk of problematic financing faced by Islamic banks that have the potential to disrupt the financial stability of Islamic banks. Second, the need to improve competence through certification that will support the performance of the SSB in carrying out its supervisory function and as a key element in the implementation of effective Islamic governance.

Future study may consider other characteristics of the board of directors to be studied such as education level, nationality, remuneration and other attributes not included in this study. Likewise with other attributes related to the SSB variable, such as experience in terms of time holding a position as a SSB member, the SSB's financial/Islamic banking educational background, and other factors.

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