RISK MANAGEMENT, CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE OF SHARIA COMMERCIAL BANKS

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Abstract

Financial performance is an organization that can be used to describe the success of an organization, both in good and bad times. Due to the high complexity and risks associated with banking institutions, a bank's financial performance can be improved by developing an effective risk management strategy through good corporate governance. This study uses quantitative. This study aims to determine the effect of risk management on financial performance by using NPF and FDR to measure financing risk, BOPO to measure operational risk, NOM to measure capital adequacy, and the impact of GCG by using the size of the Board of Independent Commissioners, Directors. Data analysis uses Partial Least Square Software, namely the SmartPLS version 3 program to measure risk management of a company's financial performance. The study results show that risk management, as measured by NPF, BOPO, and CAR ratios, significantly positively affects financial performance in Islamic Commercial Banks. GCG has not been able to moderate management risk on financial performance. The risk management variable significantly impacts financial performance, so it is essential for sustainable financial performance improvement. The GCG variable has a negligible but not significant effect on financial results. It indicates that the GCG effort variable to convey the relationship between risk management and financial performance is unsuccessful.

Keywords: *Risk Management, Financial Performance, Corporate Governance*

1. INTRODUCTION

Banks are intermediary institutions in their business activities, depending on funds and public trust at the national and world levels. Banks are exposed to various risks when engaging in business activities, including credit, market, operational, and reputation risks (Otero González et al., 2020). The development of Sharia banks in Indonesia shows exemplary achievements. It becomes a challenge to maintain the image and good name of the community so that they can maintain trust and loyalty to Sharia banks (Erviana, 2021).

A good and bad description of a company's success in its operations can be seen from its financial performance. An organization's financial performance can provide a favorable and unfavorable evaluation of its business success. The current state of the business indicates good financial performance (Sudrajat & Ubaidillah, 2022). The financial ratios used to measure financial performance in producing good profitability in this study are the Return On Assets (ROA) and Net Profit Margin (NPM) ratios.

The ability of bank management to obtain profit before tax which is determined by the average value of company assets, can be assessed using ROA. NPM is also the ratio of the results of operations to the bank's net profit after tax (Sinurat & Siregar, 2019).

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Table 1.
ROA and NPM Ratio of Sharia Commercial Banks in Indonesia

Ratio (%)	2015	2016	2017	2018	2019	2020	2021
ROA	0,77	0,95	0,51	1,28	1,73	1,4	1,55
NPM	0,77	0,71	0,72	1,42	0,62	1,46	1,66

Source: OJK, December 2021

Based on the table above, the financial performance of Islamic commercial banks between 2015 and 2021 varied in terms of ROA and NPM ratios. Business operations must be carried out honestly to achieve good financial performance. In addition, it is essential to maintain the level of compliance with established and implemented rules and to develop several risk management strategies (Suci Izdihar, 2017).

Risk management identifies, measures, monitors, and controls risks arising from all aspects of a bank's business. Reducing risk and improving bank financial performance by implementing an effective risk management strategy can improve performance (Moezaque & Daito, 2020). There are several types of risk management in this study: financing risk (NPF), operational risk (FDR), market risk (NOM), and liquidity risk (BOPO).

Bad risk management reduces a company's profit margin. Good business monitoring and management are essential to reduce risk (Simanjutak, 2022). Good corporate governance is characterized by integrity, accountability, responsibility, professionalism, and fairness. The reputational risk of the global banking industry is included in the risks associated with the inability of banks to implement responsible corporate governance. Good governance can reduce high risks, prevent losses, and improve the organization's financial performance. It can strengthen oversight of several decisions that have responsibility and authority over risk management (Krisnando & Sakti, 2019).

Previous studies (Sudrajat & Ubaidillah, 2022) empirically show that risk management can affect financial performance by showing that NPF and BOPO significantly impact ROA. According to research (Suci Izdihar, 2017) LDR results have a positive impact on ROA financial performance, but the implementation of BOPO operational risk management has a negative and significant impact. Another research (Sinurat & Siregar, 2019) shows that the variable capital adequacy ratio (CAR) or non-performing loan (NPL) and (ROA) has a significant negative effect on capital yield (ROA) and operational efficiency (BOPO). There are differences with previous research, so Sharia commercial banks must improve their financial performance.

It is indicated by (Gustifera, 2021) which shows that institutional commissions have a negative and limited impact on the financial performance of the banking industry. Significantly and profitably, the Independent Board of Commissioners impacts the banking industry's financial performance. The Board of Directors has a small and detrimental effect on the financial performance of the banking industry. The Examination Committee has a moderate impact on the bank's financial performance, although not too strong. Furthermore, research (Suci Izdihar, 2017) shows the number of the Board of Commissioners, its composition, frequency of meetings, size of the Risk Management and Examiner Committees, as well as BPD financial performance, in this case, are all evaluated using Profitability (ROA). Measure means that the size, composition, and frequency of the Board of Commissioners' meetings are evaluated.

Based on this, this study aims to determine the effect of risk management with GCG as a moderating variable on the financial performance of Sharia commercial banks (2015-2021). The results of this research are expected to be a reference for banking companies as well as the Financial Services Authority and Bank Indonesia in implementing risk management and corporate governance.

2. LITERATURE REVIEW

Signal Theory

According to signaling theory, corporate financial users must exhibit certain behaviors. Business leaders use financial reports to communicate information about using conservative accounting principles that results in qualitatively superior profits. Signal theory serves as the basis for the relationship between the effect of financial performance on firm value. This information is visible when a company reports increasing profits because it shows that the business is doing well. On the other hand, if a company's exit profit is decreasing, it is considered bad and, therefore, a bad indicator (Mariani et al., 2018).

Risk Management

Identification, measurement, supervision, and control of bank operations with reasonable and sustainable risks are steps in the risk management process (Sudrajat & Ubaidillah, 2022). All are expected to be able to manage these risks according to their respective responsibilities and authorities. Therefore, management must realize that risks are associated with every action. Any relationship between assumed risk and outcome must be plausible. The risk increases with the expected result (Citra & Handayani, 2014)

Good Corporate Governance

GCG implementation is critical to increase company value and maintain competitiveness (Krisnando & Sakti, 2019). Strong corporate governance must be implemented to foster local and international trust so that the banking industry can grow effectively and healthily. As a result, banks, bodies that routinely check the supervisory requirements that banks must meet, also issue guidelines on the introduction of GCG to the world banking industry (Visiana & Tidore, 2022). Good corporate governance requires several laws, rules, and regulations to be complied with to support effective corporate performance, leading to a long-term sustainable economy for investors and local communities (Gustifera, 2021).

Financial Performance

Financial performance in a company describes the status and progress of the company's finances. Organizations will need indications to assess the performance efficacy of their management processes (Gayatri & Sunarsih, 2020). Sucipto explained that the management of the company's financial performance determines the company's success in generating profits (Angelia et al., 2020). Financial performance is also used to measure current organizational development activities and future growth potential. It is done because of changes in financial performance due to new trends in each period, such as changes in statements of financial position, profit or loss, or cash flow. All financial performance that defines the company's financial condition must be consistent with the company's objectives, standards, and qualifications (Devi et al., 2020).

Financial performance evaluation is a significant consideration for the banking industry because it can be used to determine how good or bad a bank's performance is and to estimate the amount of profitability or profit generated (Paulina et al., 2016). (Sudrajat & Ubaidillah, 2022) emphasized that a bank's financial performance during a specific period will reflect its financial condition in obtaining and distributing funds. Usually, to measure a bank's financial performance, indicators of capital adequacy, liquidity, and profitability are used.

Previous Study and Hypothesis

Risk is the potential for financial loss resulting from the occurrence of a specific event. Risk management implements several procedures to identify, measure, monitor, and manage potential risks. The relationship between risk and financial performance is that risk management is used to improve financial performance because minimizing risk means preventing losses and maximizing financial performance.

Financing risk is measured by Non-Performing Financing (NPF). The lower the NPF ratio, the lower the financing risk faced by the bank. Research (Nazariyah, 2019) shows that financing risk or NPF has a significant effect on ROA, but contrary to research (Yara Nurintan, 2016) shows that NPF has no significant effect on ROA.

Liquidity risk is measured by the Financing to Deposit Ratio (FDR). A higher FDR ratio means the bank is illiquid, so the company's performance decreases. In research (Nazariyah, 2019) shows that liquidity risk only affects financial performance by proxy Tobin's Q, whereas (Yara Nurintan, 2016) , in his research results, liquidity risk has a significant effect on ROA.

The NOM (Net Operating Margin) ratio can be used to measure market risk in Islamic banking by determining the capacity of productive assets to generate profits. Banks that can control their assets and liabilities and prevent losses from fluctuations in market prices can reduce market risk, control assets, and improve business performance. According to research (Nazariyah, 2019), market risk has a sizeable impact on ROA. However, research (Yara Nurintan, 2016) states that market risk does not partially affect financial performance.

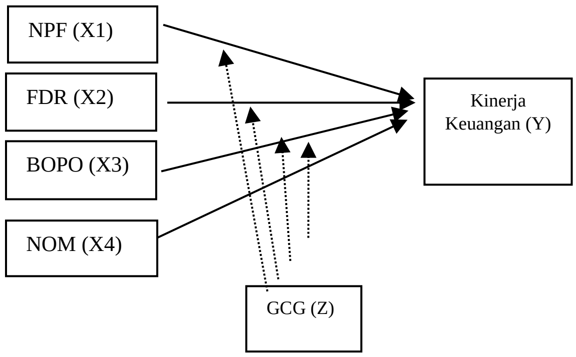
The small ratio of operating expenses to operating income (BOPO) indicates the bank's effectiveness in spending expenses used to quantify operational risk. Yara Nurintan (2016), showed the same result that partially or simultaneously, BOPO significantly affects ROA. In contrast to research (Nazariyah, 2019) which shows BOPO has no effect on ROA but has an effect on Tobin's Q. Based on the explanation above, the hypothesis submission is:

H1: Risk management has a positive effect on financial performance.

The implementation of risk management is significantly influenced by how well the structure of company organs, such as the board of directors, audit committee, and directors, are in running the business. Applying risk management techniques in this way cannot be separated from the roles and responsibilities of the corporate structure in implementing good corporate governance to achieve alignment of performance and reduce bank risk, which seeks to achieve the highest financial performance and is open to investors or the general public (Citra & Handayani, 2014).

According to several previous studies, GCG factors can mediate between risk management and financial performance based on how it relates to risk management and financial results. First, it is proven by research Putu Yutika Ariestya (2016), Based on the description above and the results of previous research, researchers will moderate the GCG variable on the relationship between risk management and financial performance. The higher the Risk Management and the higher the GCG value, the higher the financial performance. But conversely, the higher the risk management and low GCG, the lower the financial performance of Sharia Commercial Banks.

H2: The Good Corporate Governance variable can moderate the relationship between Risk Management and Financial Performance.



3. RESEARCH METHODS

This type of research is descriptive research using quantitative techniques. The independent variables in this study are risk management which is proxied by Non-Performing Financing (NPF), Financing to Deposit Ratio (FDR), Operating Costs to Operating Income (BOPO), and Net Operating Margin (NOM). The dependent variable in this study is financial performance proxied by Return On Assets (ROA) and Net Profit Margin (NPM). In contrast, the moderating variable is proxied by the Board of Directors, Board of Examiners, Audit Committee, and Independent Board of Commissioners.

The analytical method uses secondary data collected from OJK and examined using the partial linear regression analysis method of the SmartPLS Version 4 (partial least square) program. PLS is an alternative approach that shifts from the covariance basis of the previous structural equation model (SEM) to the variance basis.

This study used a purposive sampling technique to determine the research sample. There are several criteria for obtaining the research sample, namely companies that present complete financial statements and have been published at the time of the study, companies that were registered with the OJK during the study period, Sharia commercial banks that were registered with Bank Indonesia and continued to operate during the study period. One of the quantitative research methods used in this study is the publication of the GCG annual report and the financial reports of Indonesian Sharia Commercial Bank subsidiaries from 2015 to 2021.

4. RESULT AND ANALYSIS

Measurement model analysis (outer model)

Tests carried out on the outer model with reflective indicators as follows:

The importance of factor loading, which is referred to as an indicator in each concept, and convergent validity. The item-score-to-construction-score correlation shows that the reflective model can converge. Values on separate reflective measures must have a construct measurement correlation coefficient greater than 0.5.

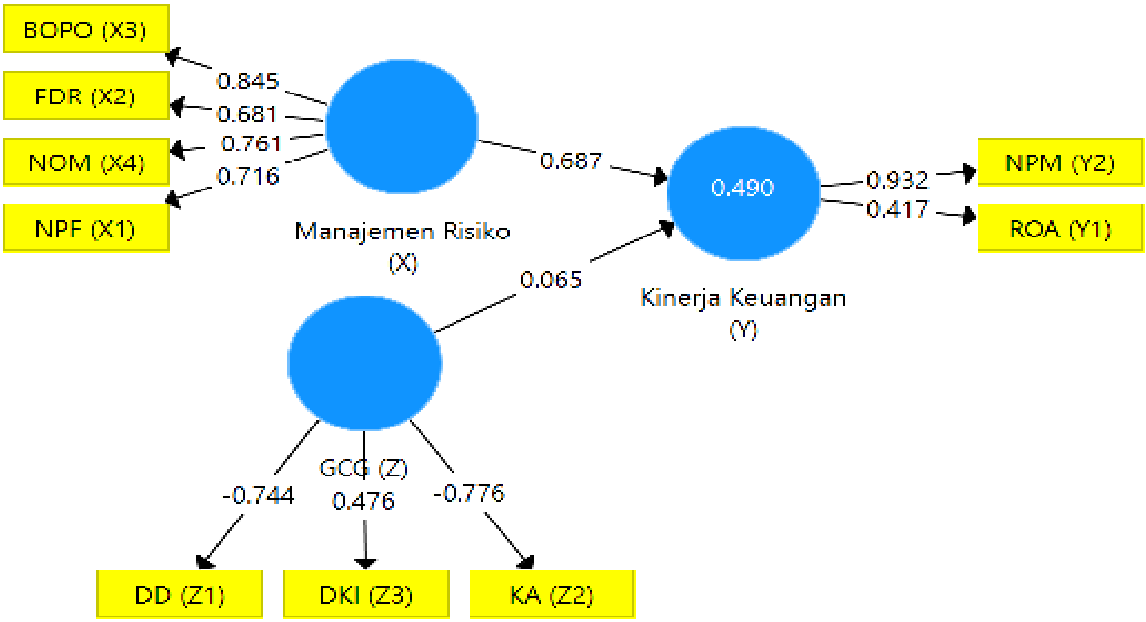


Figure 1.
Loading Factor Value

Source: Data processing with SmartPLS version 4

The results graph above illustrates the lag between indicators with various watt builds. GCG Board Construct indicators for Directors, DKI, and Audit Committee are examples of indicators of financial and performance constructs with a negative added value or a value below 0. When the indicator value is invalid, it is not considered or deleted. The modified model is depicted in the following figure:

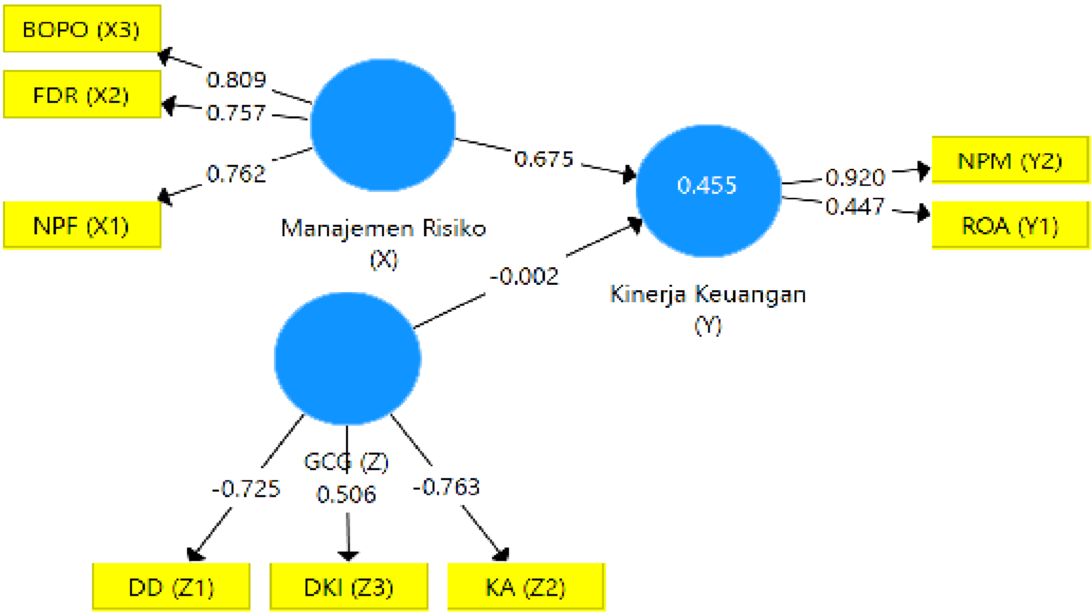


Figure 2.
Loading Factors Value

Source: Data processing with SmartPLS version 4

The second step is composite reliability and Cronbach alpha. The following calculation results:

Table 2.
Composite Reliability Result

	Composite reliability
GCG	0,371
Financial Performance	0,662
Risk Management	0,819

Source: Data processing with SmartPLS version 4

Only the risk management variable shows a high level of validity and reliability because it shows a reliability value above 0.70, which has a combined reliability value. In addition, Cronbach's Alpha results are as follows:

Table 3.
Cronbach Alpha Result

	Cronbach alpha
GCG	0,421
Financial Performance	0,112
Risk Management	0,67

Source: Data processing with SmartPLS version 4

No results have a reliability value of more than 0.70 and show good validity and reliability according to Cronbach's alpha value. The calculation algorithm is used to determine the convergent validity moderation value. The following results are:

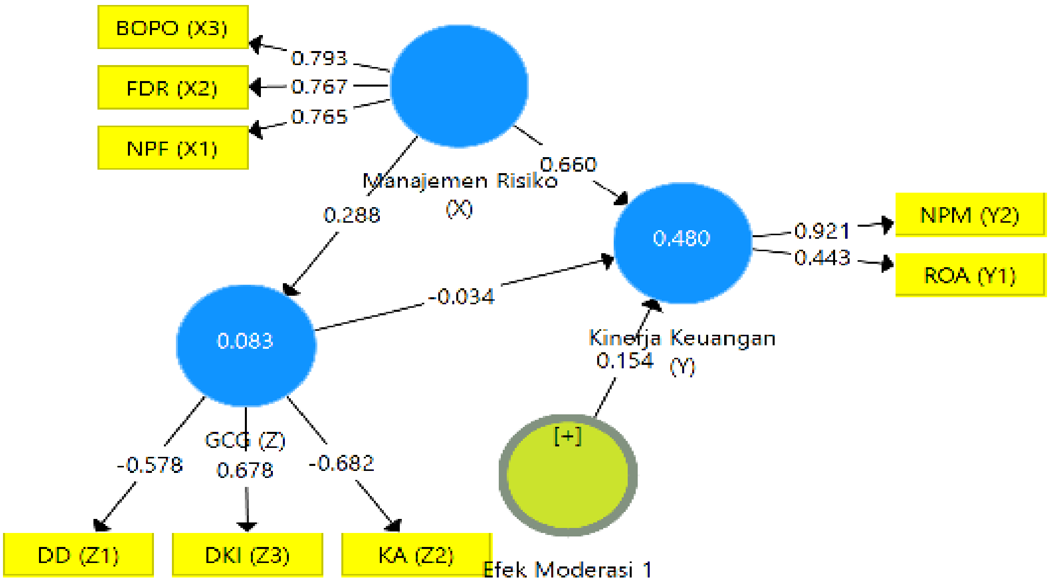


Figure 3.
Output Model Moderating SmartPLS

Source: Data processing with SmartPLS version 4

This value is still acceptable for ratios above 0.50 to 0.60 in the model development stage. According to convergent validity, the value of the loading factor determines the value of the outer model. However, a reading above 0.70 is also recommended. Only risk management key figures, GCG proxies in the board of commissioners, and financial performance key figures for NPMs with a value above 0.50 are represented in the output as reliable key figures.
The second level consists of Cronbach's Alpha and combined reliability. Using the results of the calculations, we can say the following:

Table 4.
Composite Reliability

	Composite reliability
Moderation effect 1	1
GCG	0,163
Financial Performance	0,661
Risk Management	0,819

Source: Data processing with SmartPLS version 4

Table 5.
Cronbachs Alpha Value

	Cronbach alpha
Moderation effect 1	1
GCG	0,426
Financial Performance	0,112
Risk Management	0,67

Source: Data processing with SmartPLS version 4

Only the Risk Management Construction has a value greater than 0.80 for the combined reliability value determined by the PLS algorithm calculation, as shown in Table 5. Moreover, only Risk Management has a value of 0.5 for the Cronbach Alpha Weight in Table 6, which yielded a yield of 0.670.
After convergence validity is met, discrimination validity is evaluated. The results of the calculations are, as follows:

Tabel 6.
Discriminant Validty

	Moderation effect 1	GCG (Z)	Financial Performance	Risk Management
Moderation effect 1	1.000			
GCG (Z)	0,132	0,648		
Financial Performance	0,264	0,175	0,723	
Risk Management	0,183	0,288	0,677	0,775

Source: Data processing with SmartPLS version 4

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Evaluation of the Structural Model (Inner Model) The outer model test has been fulfilled to continue with the value test of the structural model or inner model. Here are the results of Bootstrapping:

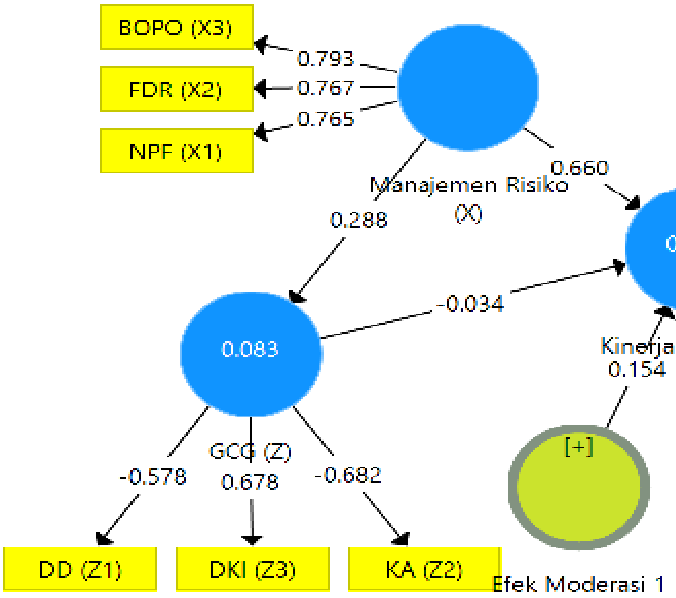

Figure 4.
Output Model Moderating SmartPLS

Source: Data processing with SmartPLS version 4

The inner model aims to determine each construct's correlation and significance value and the R-square. The following is the calculation of the R-square results:

Table 7.
R Square

	R square
Financial Performance	0,48

Source: Data processing with SmartPLS version 4

The variance in the financial performance construct explained by the risk management and GCG constructs has a reversal effect of 48% based on the R-squared equation of 0.480. It shows that the dependent variable in the internal model can identify a weak model.

The next step is to test the hypothesis or the significance by comparing the calculated T value higher than the estimate with the T-table. The path coefficient results are as follows:

Tabel 8.
Path Coefficients

	Original Sample (O)	Mean Sampel (M)	Standard Deviation	T Statistik	P Values
Moderation effect 1-> Financial Performance (Y)	0,154	0,038	0,194	0,792	0,428

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GCG (Z) -> Fianncial Performance (Y)	-0,034	-0,045	0,169	0,202	0,84
Risk Management (X) -> GCG (Z)	0,288	-0,014	0,344	0,838	0,402
Risk Management (X) -> Financial Performance (Y)	0,66	0,664	0,102	6,5	0.000

Source: Data processing with SmartPLS version 4

The correlation between constructs shows that risk management positively impacts financial success, with an initial sample value of 0.66 and a significance level of 5% with a T value of 6.55 > 1.96. The fact that GCG has a negligible effect at 5% and produces a negative result with an initial sample value of -0.034 on performance indicates that GCG has no discernible adverse effect on financial performance. In addition, with an initial sample value of 0.154 and a T-count of 5% (T-count 0.792 1.96), the moderating effect of the relationship between risk management and financial performance yields unavoidable results, concluding that no moderation has any effect.

Risk Management Has a Positive Impact on the Financial Performance of Sharia Commercial Banks

SmartPLS analysis reveals the relationship between risk management as measured by BOPO, NPF, FDR, and NOM, and financial performance with an initial sample value of 0.66; A positive value indicates a favorable relationship between risk management and the company's financial performance. The first hypothesis, which states that risk management has a beneficial impact, is refuted by the T-value of 6.5, which is higher than the T-table > 1.96. In contrast, the analysis findings show that risk management significantly improves financial performance.

According to the metric data used to assess risk management, Islamic banks meet the value standards set by Bank Indonesia for the metrics NOM (capital adequacy), BOPO (business risk), NPF, and FDR (funding risk). In other words, the worse the financial performance, the higher the NPF value, and the worse it is to improve financial performance, the higher the BOPO ratio. Lastly, the NOM ratio shows that profitability gets more negligible because it shows the inability of a bank to cover the risks associated with its banking operations. The position of the financial kennels that reflects risk management must be maintained in all conditions so that the business operations of Islamic commercial banks can continue without interruption and the bank's financial performance remains stable. The NOM ratio for Sharia Commercial Banks shows that Sharia Commercial Banks have extraordinary capital to support risk-adjusted asset values. The NPF level at Sharia Commercial Bank does not accurately reflect the extent of the bank's financing challenges.

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Variabel Good Corporate Governance can moderate the relationship between Risk Management and Financial Performance in Sharia Commercial Banks

Research using SmartPLS produces the following results: GCG has a negative correlation with the company's financial performance and has a value of -0.034 for the value of the initial sample to proxy for the percentage of members of the independent commission, prerogative, and audit committee. Because T arithmetic and T table are equal to 0.202 and 1.96, respectively, the GCG variable does not significantly affect financial performance. It indicates that the corporate structure has not carried out its duties and responsibilities to implement corporate governance effectively, which has resulted in a decline in the performance of the risk monitoring committee at Sharia commercial banks. As a result, the second hypothesis is rejected, which indicates that GCG cannot mitigate the impact of risk management on financial performance.

The results of data analysis in the second discussion show and prove that the implementation of GCG for many administrative bodies will produce some deficiencies or problems, including an increase in internal activities, which will cause problems of less effective communication and coordination for organizations like all. The same is true when the boards of Sharia commercial banks recognize the oversight role of organizations, which, despite having the maximum number of board members available, they cannot perform their duties to the highest standards due to a lack of members and few meetings..

5. CONCLUSION

Based on the results of research on the effect of risk management on financial performance with corporate governance as a moderating variable in Sharia commercial banks in Indonesia for the 2015-2021 period, it can be concluded:

The risk management variable significantly impacts financial performance, so it is essential for sustainable financial performance improvement. It shows the financial metrics used to measure risk management. If the value of this metric differs from that required by Bank Indonesia, it has a negative impact on the level of bank profitability.

The GCG variable has a negligible but not significant effect on financial results. It indicates that the GCG effort variable to convey the relationship between risk management and financial performance is unsuccessful.

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