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Board of Commissioners Effectiveness, Transparency, Shari'ah Supervisory Board, and Financial Performance of Indonesian Shari'ah Banks

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ABSTRACT

This study aims to provide empirical evidence of the Effect of Board of Commissioners' Effectiveness and Risk Transparency on Performance with the Sharia Supervisory Board as Moderating Variable. Performance is measured using the Return On Assets (ROA) ratio. The effectiveness of the Board of Commissioners and the Sharia Supervisory Board in this study was measured by the Score Index Item. Risk transparency is measured using a dummy variable. The sample used in this study was a Sharia Commercial Bank company registered with the Financial Services Authority in 2015-2019 with a total sample of 70 observations.

The results of the study indicate that the effectiveness of the board of commissioners has no effect on performance. Risk transparency has a positive effect on performance. The sharia supervisory board is not able to moderate the effect of the effectiveness of the board of commissioners and risk transparency on bank performance

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INTRODUCTION

Banks are financial institutions that have a very broad public responsibility, so they will receive the spotlight in various aspects including financial performance. Financial performance describes the financial condition of the bank in a certain period (Faisal *et al.*, 2018). The better the financial performance, the better or healthier the health level of the bank (Maheswari & Suryanawa, 2016). The performance of Islamic banking fluctuates greatly between banks and tends to show a slowdown in profit growth. This is influenced by various factors, especially bank management factors*(Corporate Governance)* and transparency towards risk in banks. Forum for Corporate Governance in Indonesia (FCGI), (2002) reveals that *corporate governance* is a set of rules governing the relationship between shareholders, company management, creditors, government, employees and internal and external stakeholders relating to their rights and obligations. The implementation of *corporate governance* can be carried out through monitoring mechanisms to reduce or harmonize various conflicts of interest. This mechanism can be in the form of the effectiveness of the board of commissioners. The effectiveness of the board of commissioners is considered to reduce agency problems that occur between the management of the board of directors and shareholders so that all actions taken by management are not only solely concerned with one party

The effectiveness of the Board of Commissioners (EDK) is said to be able to supervise company management so as to improve the company's financial performance. According to Kartin and Dewi, (2019) the board of commissioners has a role in supervising the policies of the directors in running the company and advising the board of directors so that the board of commissioners is the center of the company's resilience and success. The effectiveness of the board of commissioners in carrying out its role can be seen from several indicators such as the size of the board of commissioners, board independence and board of commissioners meetings (Neifar and Jourbui, 2020). Board size is considered one of the main important mechanisms of *Corporate Governance*. In the context of Islamic banking, the minimum members of the board of commissioners cannot be less than 3 and cannot be more than 15 (Bukhair & Rahman, 2015). Mollah & Zaman, (2015), Adebayo, (2013) found that board size has no impact at all on performance. While Al Saidi and Al-Shammari, (2013), Rachdi & Ben Ameur, (2011) found that board size can improve performance.

The effectiveness of the board of commissioners also requires board independence. Board independence is considered as one of the important *corporate governance* mechanisms that serves to enhance the supervisory and monitoring functions of the board and consequently can improve firm performance (Haniffa & Cooke, 2002). Board independence is considered important also because outside directors are considered as erroneous monitors and can discipline management and improve firm performance (Duchin *et al*., 2010). Bukhair and Rahman, (2015), Al Manaseer and Al-Hindawi, (2012) found that board independence has a positive effect on firm performance. Meanwhile, Mollah & Zaman, (2015) found that board independence has a negative effect on performance. Apart from board independence, the effectiveness of the board of commissioners is also supported by the existence of board meetings. Boards that meet frequently or hold meetings will carry out their obligations diligently which can be beneficial to stakeholders (Yatim *et al*., 2006). Therefore, it can be said that the more often the frequency of meetings is held, the more and faster the board of commissioners will get information on company developments. Through these meetings the board deliberates and makes decisions based on the information obtained so that the supervisory function of the board of commissioners on management will be effective (Restria, 2014). Liang *et al*., (2013) and Ntim and Osei, (2011) in research show that the number of board meetings has a positive effect on the number of board meetings.

Risk disclosure is considered to be one way that companies can issue accountability and can maintain shareholder trust. By disclosing risk, the company can communicate how it is responsible for the risk profile to stakeholders (Nahar, 2016). Broader risk disclosure can reduce information asymmetry and ensure shareholders can fully assess company performance. Risk disclosure serves to monitor, discipline, and remove ineffective management systems, which can improve company performance (Riskanah & Juliarto, 2018). Risk aspects disclosed in banks include aspects of credit risk, market risk, liquidity risk, operational risk, compliance risk, strategic risk, legal risk, and reputation risk. Indicators disclosed in credit risk such as the composition of the asset portfolio and the level of concentration, the quality of the provision of funds and the adequacy of reserves, the strategy of providing funds and the source of origin of the provision of funds, external factors

In market risk the indicators disclosed include volume and composition of the portfolio,*potential loss*, interest rate risk in the *Banking Book* and business strategy and policy. Furthermore, in liquidity risk, the indicators disclosed include the composition of assets, liabilities, and Administrative Account Transactions (TRA), concentration of assets and liabilities, vulnerability to funding needs, access to funding sources. In operational risk, the indicators disclosed include business characteristics and complexity,*people*, information technology and supporting infrastructure (*system*), frequency of internal *fraud* and external *fraud*, frequency of external events. In compliance risk, the indicators disclosed include the type and significance of violations or non-compliance committed by the bank, the bank's compliance *track record* (the same type and frequency of violations within 3 years), violation of provisions on certain transactions.

Strategic risk disclosed indicators such as the suitability of the strategy with the conditions of the business environment, the bank's strategy, the bank's business position, the achievement of the bank's business plan. Legal risk disclosed indicators such as litigation factors, weakness of engagement factors, absence/change of legislation factors. Reputation risk disclosed indicators such as the influence of the reputation of bank owners and related companies, violations of business ethics, the complexity of the bank's products and business cooperation, the frequency, materiality and exposure of negative bank news, the frequency and materiality of customer complaints. Nahar, (2016) In his research, he revealed that risk disclosure has a negative effect on bank performance. Meanwhile, Prameswari and Meiranto, (2019), Kusumastuti and Ghozali, (2020) found that risk disclosure has a positive effect on banking performance.

Govindarajan (1986) suggests that reconciling the differences in the results of previous studies can be resolved through a*contingency approach*. Contingency theory explains the existence of situational factors that can affect one variable with another. Contingency theory can be used to analyze the design and management accounting system to provide information that companies can use for various purposes. Where there is some involvement of existing variables, one of which is the moderating variable. In this study using the Sharia Supervisory Board (DPS) as a moderating variable. The existence of a Sharia Supervisory Board (DPS) can reduce *agency* problems that arise between principals and agents. DPS plays a role in assisting the board of commissioners as the principal to supervise the financial reporting prepared, so that DPS is very important in controlling an entity. With the existence of DPS, it is hoped that it can supervise management if they commit various acts of fraud, including in terms of risk disclosure that is not transparent to the public so that this can have an impact on bank performance. Bank performance can be said to be effective if the performance has achieved the goals and standards set by the company.

The quality of DPS in carrying out its role can be seen from several indicators such as the existence of DPS, the number of DPS members, the expertise of DPS members, the qualifications of the Doctoral degree of DPS members (Neifar *et al*, 2020). With good DPS supervision, the board can perform effectively so that it has an impact on performance. And when it is also good at supervision, risk-related disclosures at the bank will also be more transparent. Where if the high level of risk disclosure carried out by the company, the bank's performance will also increase. Conversely, when the level of corporate risk disclosure is low, the company's performance will decrease. In research (Neifar *et al*., 2020) shows that DPS moderates the influence of the effectiveness of the board of commissioners and risk transparency on performance. Furthermore, Grassa & Matoussi (2014), Nomran (2018) and (Mollah & Zaman, 2015) show that the sharia supervisory board has a positive impact on performance. Meanwhile, in Azizah & Erinosi's research, (2020) found that the sharia supervisory board had a negative effect on performance.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Agency theory (Jensen & Meckling, 1976) explains that opportunistic management behavior can be avoided through effective supervision. One effective supervisory mechanism is carried out by the board of commissioners. The board of commissioners is tasked with determining various general policies, carrying out supervision, control and guidance of the bank. In addition, the board of commissioners has the role of supervising the board of directors' policies in running the company and providing advice to the board of directors. The effectiveness of the Board of Commissioners is highly dependent on the size or number, independence of the board and board meetings.The size of the board of commissioners is very influential on decision making and carried out by the board of commissioners. With the board of commissioners, it is hoped that it can improve banking performance with its strict supervision. Board independence as one of the *Corporate Governance* mechanisms which also serves to improve board supervision and monitoring and consequently improve bank performance. Meetings of the board of commissioners, where the board that often meets or holds meetings will carry out its obligations diligently which can be beneficial to stakeholders (Yatim *et al.*, 2006), the more often the frequency of meetings is carried out, the more and faster the board of commissioners gets information about company developments which of course can improve performance.

Neifar, (2020) found that the effectiveness of the board of commissioners affects the performance of Al- Saidi and Al-Shammari, (2013), Rachdi and Ben Ameur, (2011) found that board size can improve performance. Bukhair and Rahman, (2015), Al Manaseer et al, (2012) found that board independence has a positive effect on company performance. Liang *et al.*, (2013) and Ntim and Osei, (2011) found that the number of board meetings has a positive and significant effect on bank performance. Based on the description above, the first hypothesis in this study is:

H1. The effectiveness of the Board of Commissioners has a positive effect on Bank performance

Agency theory also states that agency problems will decrease as the level of information asymmetry decreases. Risk disclosure is considered to be one way for companies to issue accountability and can maintain shareholder trust. Broader risk disclosure can reduce information asymmetry and ensure shareholders can fully assess company performance Oliveira *et al*. (2011). Risk disclosure as a monitor, discipline, and remove ineffective management systems, this can certainly improve company performance (Riskanah & Juliarto, 2018). prameswari and Meiranto, (2019), Kusumastuti and Ghozali, (2020), Heryantama and Syafruddin, (2019) found risk disclosure has a positive effect on performance. Based on the description above, the second hypothesis in this study is

H2. Risk Disclosure has a positive effect on Bank performance.

Fiedler, (1967) suggests leadership depends on the situation. The effectiveness of the board of commissioners in supervising and providing advice to directors that can affect the performance of sharia banks is situational. The same also applies to the ability of risk disclosure that can help *stakeholders* to understand the risk profile. The conditional that has an impact on the effectiveness of the board of commissioners and risk transparency is the sharia supervisory board (DPS).

Neifar, (2020) showed that DPS moderates the positive effect of the effectiveness of the board of commissioners on bank performance. Furthermore, Grassa & Matoussi (2014), Nomran (2018) and (Mollah & Zaman, 2015) showed that the Islamic supervisory board also moderates the positive effect of risk information on performance. Thus, the following hypothesis is proposed:

H3. DPS moderates the relationship between board effectiveness and bank performance.

H4. DPS moderates the relationship between risk transparency and bank performance.

RESEARCH METHOD

The sample of this research is 14 sharia banks in Indonesia with observations for 5 years (70 observations). The variables used in this study are bank financial performance, board effectiveness, risk transparency, and the quality of the sharia supervisory board. Bank performance is measured by the profitability ratio using *Return On Asset* (ROA). The effectiveness of the board of commissioners is measured using related indicators, namely activity, size, and independence. Activity is measured using the number of meetings and the attendance rate of the board of commissioners. Score 1 is given to banks that have less than 4 board meetings a year and less than 70% board attendance or no information, score 2 is given to banks that have between 4 to 6 board meetings a year and 70% to 80% board attendance and score 3 to banks that have more than 6 board meetings a year and more than 80% board attendance. Furthermore, banks will score 1 if the board consists of less than 5 members or more than 16 members or there is no information, score 2 if the board consists of 11 to 15 members, 3 if the board consists of 5 to 10 members.

Finally, the bank will score 1 if the number of independent commissioners is less than 30% or there is no information, score 2 if the number of independent commissioners is between 30% and 50% and 3 if the number of independent commissioners is more than 50%. Risk transparency is measured by comparing the amount of risk information disclosed and risk information that should be disclosed for aspects of credit risk, market risk, liquidity risk, operational risk, compliance risk, strategic risk, legal risk, and reputation risk. DPS quality by using an index that includes aspects of existence, number of members, financial expertise and DPS qualifications.

This study uses hierarchical multiple linear regression analysis to test the direct relationship of board effectiveness and risk transparency to bank performance and the moderating impact of the Sharia Supervisory Board (DPS) on the direct relationship. The regression model used in this study is:

$\mathrm{KB} = \alpha + \beta_1\,\mathrm{EDK\ SCORE} + \beta_2\,\mathrm{TR\ SCORE} + \mathcal{E}$ ……………………… (1)

$KB = \alpha + \beta_1\,\mathrm{EDK\ SCORE} + \beta_2\,\mathrm{TR\ SCORE} + \beta_3\,\mathrm{DPS\ SCORE} + \beta_4\,\mathrm{DPS\ SCORE} * \mathrm{EDK\ SCORE} + \beta_5\,\mathrm{DPS\ SCORE} * \mathrm{TR\ SCORE} + \mathcal{E}$ ……………………… (2)

Explain :

KB: Bank Performance
α : Constant
ß : Regression Coefficient
EDK SCORE : Total Board of Commissioners Effectiveness Score
DPS SCORE : Total Score of Sharia Supervisory Board
TR SCORE : Total Risk Transparency Score
ß1- ß5 : Coefficient of explanatory variables
Ɛ : Residual variable or prediction error

RESEARCH RESULTS AND DISCUSSION

Descriptive Statistics

Descriptive statistics in this study describe *Return On Equity* (ROA), namely net income divided by total bank assets, the effectiveness of the board of commissioners measured using a score index, risk transparency measured by risk disclosure of 8 items, where each disclosed item is given a score of 1 and not disclosed 0, and the Sharia Supervisory Board (DPS) measured using a score index. Descriptive statistics on the research are presented in Table 1.

Table 1. Descriptive Statistics

Variabel	Minimum	Maximum	Mean	Std. Deviation
ROA	-0.1689	0.1080	0.0027	0.0406
EDK_SCORE	6.0000	9.0000	6.8857	0.8434
TR_SCORE	5.0000	8.0000	7.7857	0.7782
DPS_SCORE	0.0200	0.0400	0.0309	0.0063

Table 1 shows that the average return on assets of Indonesian Islamic banks is 0.27% with the lowest value being minus 16.88% and the highest being 10.8%. This indicates that the performance of Islamic banks is quite varied with a relatively low average level. The effectiveness of the Board of Commissioners (EDK) of Indonesian Islamic banks on average shows quite effective as indicated by a score of 6.89 out of a maximum score of 9. Risk Transparency (TR) of Indonesian Islamic banks on average is also quite high as indicated by 7.79 out of a maximum of 8. Meanwhile, the quality of the Sharia Supervisory Board (DPS) on average is relatively very low with 3.08%.

Hypothesis Testing Results

The results of hypothesis testing are presented in table 2 which includes the test of model fit, determination, and the relationship between variables. The results of testing the suitability of the model show that the F value for model 1 and model 2 is 114.558 and 74.319 respectively with a significance level below 1%. Meanwhile, the R square for both models shows that the ability of the independent variables to explain the dependent variable in this study exceeds 80%. This indicates that the model used in the study has met the requirements of a good model.

Table 2. Hypothesis Testing Results

Variabel	Koef. β	t	Sig.	Koef. β	t	Sig.
Konstanta	-0.148	-12.824	0.000	0.019	0.212	0.833
EDK_Skor	-0.001	-0.974	0.335	-0.004	-0.12	0.905
TR_Skor	0.039	15.105	0.000	0.03	5.726	0.000
DPS_Skor	-0.148	-12.824	0.000	0.008	0.107	0.915
EDK_Skor X DPS_Skor				-0.006	-0.168	0.867
TR_Skor X DPS_Skor				0.019	0.212	0.833
R Square	0.806			0.830		
Adj R. Square	0.799			0.819		
F	114.558			74.319		
Sig	0.000			0.000		

The results of testing the effect of the effectiveness of the board of commissioners on financial performance show that the regression coefficient*(β1)* on the EDK score of -0.001 shows a negative direction with a significance value greater than 0.05 the variable effectiveness of the board of commissioners on the performance of Islamic banking**.** The results of the study are not in line with research conducted by Neifar, (2020) which found evidence that the effectiveness of the board of commissioners has a positive effect on performance. However, in line with research by Mollah & Zaman, (2015), found that indicators of the effectiveness of the board of commissioners, namely board size, board independence, have no impact at all on performance. And the number of board meetings has a negative effect on performance (Kusumastuti and Ghozali, 2020). The results of this study are not in line with agency theory where according to Jensen and meckling (1976), it states that the existence of a board of commissioners as one of the company's *corporate governance* mechanisms is expected to overcome agency problems by managers so as to improve the performance of Islamic banking. Because of the existence of an effective board of commissioners, namely making manager actions *align* with the interests of company owners. The size, independence, and effectiveness of the board of commissioners that have not been able to resolve agency problems that occur between the *principal* (owner) and the *agent* (manager) which should reduce the behavior of managers who want to benefit themselves.

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The results of testing the effect of risk transparency on financial performance show that the regression coefficient*(β2)* on the TR Score of 0.039 shows a positive direction with a significance value of less than 0.05, which means that there is an influence of the risk transparency variable on the performance of Islamic banks because the significance value is less than 0.05. The results of this study are in line with the results of research conducted by Prameswari and Meiranto, (2019), Kusumastuti and Ghozali, (2020) which proved to find that risk disclosure has a positive effect on banking performance. Based on agency theory, disclosure is considered a monitoring mechanism and is one way to mitigate agency problems, where managers disclose relevant information to help investors monitor managers' actions in carrying out their duties and assess managers' ability to manage company resources in their interests. So this research is in line with *agency* theory which reveals the relationship between owners and management in which information asymmetry arises because the management*(agent*) has more information and understands information about the actual condition of the company compared to the principal (shareholder), allowing management to act in their interests. Therefore, disclosure is an important factor that can reduce conflicts between agents and principals.

The moderation test results show that the interaction variable between DPS Score and EDK Score has a positive regression coefficient of 0.008 and a significance value greater than 0.05, which means that the Islamic supervisory board does not moderate the relationship between the effectiveness of the board of commissioners on bank performance. The second moderation test results show that the DPS Score_TR Score variable has a regression coefficient of -0.006 and a significance value greater than 0.05, which means that the Islamic supervisory board does not moderate the relationship between risk transparency and performance.

The results of this study are not in line with*agency* theory and*contingency* theory. Agency theory put forward by Jensen and Meckeling which states that the existence of a sharia supervisory board as one of the company's *corporate governance* mechanisms is expected to overcome agency problems and can minimize fraudulent actions by managers. With the existence of a sharia supervisory board in overseeing bank activities, managers should try harder to improve the performance of Islamic banking in accordance with sharia principles. Based on the results of testing the first hypothesis which shows that the effectiveness of the board of commissioners has not shown any agency conflicts that cause information asymmetry. Thus, the effectiveness of the board of commissioners has not been able to become a monitoring mechanism that can improve the performance of Islamic banking. This makes the moderating variable of the sharia supervisory board in this study unable to strengthen or weaken the effect of the effectiveness of the board of commissioners on the performance of Islamic banking. Furthermore, in contingency theory, it is explained that the inconsistency in research results is due to the assumption that there are other situational factors that may interact with each other in influencing the independent variable on the dependent variable.

However, the results of this study indicate that the sharia supervisory board is not an influencing variable, there may be other variables outside of the research variables. The results of this study do not support research (Neifar *et al*., 2020) which shows that DPS is able to moderate the relationship between the effectiveness of the board of commissioners on performance. However, the results of this study are in line with the research of Azizah & Erinosi, (2020) which found that the sharia supervisory board has a negative effect on performance.

The results of this study are not in line with agency theory and contingency theory. Agency theory in Jensen and Meckling explains that agency conflicts arise when managers do not provide all the information needed by the owner. To ensure that managers report information that should be required the role of *corporate governance* that can protect the rights of owners to information that should be obtained, one of which is the supervisory mechanism of the sharia supervisory board. However, in this study, the sharia supervisory board has not been able to resolve agency problems that occur between the principal (owner) and agent (manager) which should reduce the behavior of managers who want to benefit themselves. Thus, the sharia supervisory board has not been able to become a monitoring mechanism related to the disclosure of risk information on companies that can have an impact on the performance of Islamic banking. This can be due to the activities of the sharia supervisory board which include approving new products, supervising operational activities to comply with sharia principles and advising the board of directors in order to carry out the company's operational activities in accordance with sharia principles. It can be said that the sharia supervisory board does not have a direct relationship with risk disclosure in the company so that the sharia supervisory board is unable to strengthen or weaken the relationship of risk disclosure to the performance of Islamic banks. Furthermore, contingency theory says that the inconsistency of research results is due to the assumption that there are other situational factors that may interact with each other in influencing the independent variable on the dependent variable. However, in this study DPS was not able to show as a moderating variable for the relationship between risk disclosure and bank performance, there may be other variables outside the research variables. The results of this study do not support research (Neifar et al., 2020) which shows DPS moderates the relationship between operational risk transparency and performance. However, the results of this study are in line with the research of Azizah & Erinosi (2020) which shows that the sharia supervisory board has a negative effect on performance.

CONCLUSION

This study aims to examine: (1) the effect of the effectiveness of the board of commissioners and risk transparency on bank performance and (2) examine the moderating role of the sharia supervisory board on the effect of the effectiveness of the board of commissioners and risk transparency on bank performance. The results of the study concluded that: (1) the effectiveness of the board of commissioners does not affect performance, (2) risk transparency has a positive effect on performance, (3) the sharia supervisory board does not moderate the relationship between the effectiveness of the board of commissioners on performance, (4) the sharia supervisory board moderates the relationship between risk transparency on performance.

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