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Unlocking Financial Performance Through Islamic Corporate Governance and Islamic Social Reporting

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ABSTRACT

Despite the rapid growth of Islamic banking, the effectiveness of Islamic Corporate Governance (ICG) and Islamic Social Reporting (ISR) in improving financial performance remains inconclusive. This research aims to examine the influence of ICG and ISR on the financial performance of Islamic Commercial Banks (ICBs) in Indonesia. The research uses a quantitative approach, drawing on secondary data from annual reports and financial statements. The sample was selected through purposive sampling, and data were analyzed using panel data regression in Stata. Financial performance is proxied by Return on Assets (ROA), with variable controls including bank age, bank size, NPF, OER, CAR, and FDR. The data are analyzed using panel data regression with the Panel Corrected Standard Errors (PCSE) approach to address issues of heteroscedasticity and autocorrelation. The research results show that ICG has a positive and significant effect on financial performance (b = 0.926; p = 0.027), while ISR does not have a significant effect (b = -0.594; p = 0.187). The findings suggest that ICBs should prioritize strengthening the quality of ICG, particularly the effectiveness of Sharia governance, transparency, and supervisory mechanisms, as these directly impact profitability. Meanwhile, ISR should be transformed from a compliance-oriented disclosure into a strategic value-creation instrument that enhances stakeholder trust and contributes to long-term financial sustainability.

Keywords: Financial Performance; Islamic Banks; Islamic Corporate Governance; Islamic Social Reporting; Return on Assets

JEL Classification: G21; G34; M14; Z12

INTRODUCTION

The banking industry in Indonesia plays a very strategic role in maintaining the stability of the national financial system while also supporting economic growth through financial intermediation functions. Therefore, a bank's ability to maintain healthy financial performance depends not only on profitability but also on effective governance, transparency, and control mechanisms that sustain operational stability and uphold public trust, the primary foundation for the sustainability of the banking industry. The Islamic banking sector has experienced rapid global growth over the past decade, with assets reaching approximately USD 1.9 trillion across more than 300 Islamic financial institutions in 50 countries (Aryani & Assegaf, 2026). This growth is driven by increasing awareness among Muslim and non-Muslim consumers of Sharia-based financial principles, as well as a commitment to financial justice and social sustainability. However, with the expansion of this sector, significant challenges related to corporate governance and transparency in social reporting have emerged in Islamic banking institutions. The implementation of Islamic Corporate Governance (ICG) and Islamic Social Reporting (ISR) is becoming increasingly critical not only for ensuring compliance with Sharia principles but also for building stakeholder trust and enhancing long-term financial performance.

Islamic banking in Indonesia has developed into one of the most dynamic financial sectors, with 14 Islamic Commercial Banks (ICBs) registered with the Financial Services Authority (OJK) that collectively manage significant assets and serve millions of Muslim customers. Nevertheless, Indonesia still faces substantial challenges in optimally implementing ICG and ISR standards. Research shows that corporate governance practices in Indonesian Islamic banking still exhibit structural weaknesses, including limited board diversity, infrequent meetings, and inconsistent application of Sharia principles across all operational aspects (Billah & Fianto, 2021; Darma & Afandi, 2021). Furthermore, the level of ISR disclosure in Indonesian IBs is still varied and has not yet fully adopted the international standards set by the Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). Variations in the implementation of ICG and ISR can affect the effectiveness of internal supervision, operational transparency, and, ultimately, the financial performance of Islamic banking.

The selection of ICG and ISR as independent variables is grounded in theoretical and empirical considerations identifying them as fundamental elements of Islamic banking governance. ICG plays a role in integrating Sharia principles into governance structures by optimizing the Sharia Supervisory Board's functions, transparency, and internal control mechanisms, thereby enhancing Sharia compliance, operational efficiency, stability, and financial performance. Meanwhile, ISR reflects the commitment of Islamic banks to social responsibility and spiritual values in alignment with the objectives of *maqashid al-Sharia*, although disclosure levels remain relatively low and have yet to show optimal development. These variables were chosen because they have not been extensively examined within a single research model in the context of Indonesian Sharia Commercial Banks over a sufficient observation period; consequently, this study is expected to provide new empirical evidence valuable for policy development and strategic decision-making.

This research specifically aims to test, analyze, and empirically prove the influence of ICG proxied through the Good Governance Business Sharia (GGBS) items created by the National Committee on Governance Policy (KNKG), as well as the influence of ISR disclosure proxied through ISR Disclosure on the financial performance of ICBs in

Indonesia measured using Return on Assets (ROA). Through the integration of comprehensive internal control variables, including bank age (Age), company size (Size), financing quality (Non-Performing Financial Ratio or NPF), capital adequacy (Capital Adequacy Ratio or CAR), cost efficiency (Operational Efficiency Ratio or OER), and liquidity aspects (Financing to Deposit Ratio or FDR).

Despite the growing body of literature on ICG and ISR, several important research gaps remain. First, previous empirical studies have reported inconsistent findings regarding the effects of ICG and ISR on the financial performance of Islamic banks, leaving the relationship inconclusive. Second, existing studies predominantly examine governance and social reporting in isolation or rely on conventional governance proxies, such as board characteristics or audit committee attributes, which do not adequately capture the distinctive principles of Sharia governance. Third, limited research simultaneously incorporates comprehensive measures of ICG and ISR within a single empirical framework while controlling for key bank-specific characteristics. Finally, evidence from Indonesian ICBs covering the post-pandemic period remains relatively scarce. Addressing these gaps is important for providing more robust evidence on whether ICG and ISR serve as strategic drivers of financial performance in ICBs.

The novelty of this study lies in the development of a comprehensive empirical framework that simultaneously integrates the GGBS-based ICG index and the ISR disclosure index to examine their effects on the ROA of Indonesian ICBs during 2021–2025. Unlike previous studies that rely on conventional governance proxies or examine governance and social reporting separately, this study employs comprehensive Sharia-specific measurements. It incorporates a broad set of bank-specific control variables, thereby providing a more accurate assessment of the contribution of ethical-religious governance mechanisms to bank profitability.

In terms of practical implications, the study's findings indicate that improving the financial performance of ICBs depends not merely on adherence to Sharia principles but largely on the effective implementation of ICG. Consequently, bank management needs to enhance governance quality by optimizing the role of the Sharia Supervisory Board (SSB), improving supervisory effectiveness, and ensuring transparency and accountability in strategic decision-making. Conversely, the lack of a significant impact from ISR suggests that current ISR practices remain focused on meeting reporting obligations (compliance) rather than directly generating economic value. This situation highlights the need to transform ISR into an integral part of a value-creation-oriented business strategy, thereby not only strengthening stakeholder legitimacy and trust but also making a tangible contribution to ICBs' performance and competitiveness.

LITERATURE REVIEW

Theoretical Review

Research on the relationship between ICG, ISR, and the financial performance of Islamic banking is based on several complementary fundamental theories, namely agency theory, stewardship theory, stakeholder theory, legitimacy theory, and Sharia governance theory. The relationships among ICG, ISR, and the financial performance of ICBs are multidimensional and complementary. Agency theory posits that effective governance is essential to minimize conflicts of interest between management and owners, enhance oversight quality, and ensure the efficient management of corporate resources to achieve organizational objectives. Furthermore, stakeholder theory broadens the corporate orientation beyond shareholder interests to encompass the fulfillment of all stakeholders' rights and expectations through transparent, accountable, and responsible governance practices. In this context, ISR serves as a vital instrument that reflects the ICBs' commitment to disclosing its social and environmental responsibilities and its Sharia compliance as a form of public accountability. Meanwhile, legitimacy theory holds that organizational survival hinges on securing social legitimacy by aligning its operations with societal values, norms, and expectations. Consequently, the effective implementation of ICG and high-quality ISR disclosure serves not only as a mechanism for regulatory and Sharia compliance but also as a means to bolster institutional reputation; enhance trust among investors, customers, regulators, and the public; and ensure long-term business sustainability. Thus, the integration of these three theories provides a robust conceptual framework demonstrating that ICG and ISR are strategic governance instruments capable of driving value creation, strengthening organizational legitimacy, mitigating information asymmetry and agency risks, and ultimately supporting the sustainable enhancement of financial performance and competitiveness for ICBs. This also enables the development of a more comprehensive framework for analyzing the dynamics of the relationship among ICG, ISR, and financial performance in the Islamic banking ecosystem.

ICG and ISR are rooted in Islamic epistemology, which places the principle of *Tawhid* (the oneness of Allah) as the main foundation of all economic activities and organizational governance. In this perspective, the company is viewed as a trust (*amanah*) that must be managed according to Sharia through the principles of *Shura* (consultation), trustworthiness (*amanah*), justice (*'adl*), excellence (*ihsan*), public interest (*maslahah*), and stewardship (*khilafah*), so that the company's accountability is not only horizontal to shareholders and stakeholders but also vertical to Allah SWT (Salman, 2023). Therefore, ICG aims not only to reduce agency conflicts, as in conventional governance, but also to ensure that the company's decision-making, oversight, and management processes align with Sharia values through Sharia governance mechanisms and the SSB.

At the same time, ISR is a manifestation of that accountability through the transparent disclosure of social, environmental, economic, and Sharia compliance information as a form of accountability to Allah (*hablum minallah*) and society (*hablum minannas*). ISR was developed as an enhancement of CSR because it is considered more capable of representing the objectives of Sharia (*maqashid al-Sharia*), which are to preserve religion (*din*), life (*nafs*), intellect (*'aql*), lineage (*nasl*), and wealth (*mal*), while also realizing welfare (*falah*) through fair, ethical, transparent, and sustainable business practices (Jihadi et al., 2021). Thus, ICG functions as a governance mechanism that ensures compliance with Sharia principles, while ISR serves as a reporting instrument that communicates the implementation of these values to all stakeholders, making both components complementary in realizing an ICG oriented toward sustainability, justice, and the welfare of the community.

Previous research conducted by Jati et al. (2020), Jihadi et al. (2021), and Wijayanti et al. (2023) has shown that the relationship between corporate governance, social responsibility, and financial performance remains a subject of debate, making the effectiveness of implementing governance mechanisms and social reporting mechanisms not universally generalizable. The impact of these two mechanisms on company performance is greatly influenced by industry characteristics, regulatory environments, implementation quality, and the institutional context in which the company operates. Therefore, further research is needed in sectors with specific governance characteristics, including the Islamic banking industry (Wiratama & Prasetio, 2025). Effective corporate governance is increasingly recognized as a strategic factor in creating sustainable organizations, as it not only strengthens transparency, accountability, and decision quality but also ensures that financial performance aligns with the implementation of social responsibility and the company's sustainability goals (Gita & Prasetio, 2024).

Hypotheses Development

The Relationship Between ICG and Financial Performance

ICG is a governance system designed to ensure that all operational activities of Islamic banks not only adhere to Good Corporate Governance (GCG) principles but also fully comply with Sharia regulations. Unlike corporate governance in conventional financial institutions, ICG has a unique characteristic in the form of the SSB, which is responsible for overseeing compliance with Sharia principles, issuing fatwas on products and business activities, and ensuring that all operational activities are free from elements of *riba*, *gharar*, *maysir*, and practices that contradict Islamic law. Therefore, ICG not only functions as a supervisory mechanism to reduce agency conflicts but also as an instrument to maintain Sharia integrity, enhance transparency, strengthen accountability, and build stakeholder trust in Islamic banks (Minaryanti & Mihajat, 2024; Tashkandi, 2023; Tumewang et al., 2025).

Theoretically, the effective implementation of ICG is expected to improve the quality of decision-making, strengthen the monitoring function over management, minimize moral hazard risk, and reduce Sharia non-compliance risk. Good governance also enables Islamic banks to manage operational and reputational risks more effectively, thereby increasing operational efficiency, improving asset quality, and driving profitability growth as reflected in financial performance indicators such as ROA and Return on Equity (ROE). Additionally, the strong implementation of ICG is believed to enhance the institution's credibility in the eyes of investors, depositors, regulators, and the general public, thereby strengthening the competitiveness and sustainability of Islamic banks in the long term (Lestari et al., 2025a; Quttainah & BenSaid, 2025; Rahim et al., 2024).

The relationship between ICG and financial performance has become one of the most dominant research themes in the literature on Islamic bank governance over the past two decades. The latest bibliometric study shows that the influence of Sharia governance on financial performance is one of the main research clusters that continues to develop, in line with the increasing attention to the effectiveness of Sharia governance in creating economic value and maintaining the sustainability of the Islamic finance industry (Quttainah & BenSaid, 2025; Tumewang et al., 2025). A number of empirical studies provide evidence that the ICG mechanism can improve the financial performance of Islamic banks. Khan and Zahid (2020) developed the ICG Index by integrating corporate governance mechanisms and SSB characteristics, and found that ICG quality has a positive and significant impact on the financial performance of Islamic banks in Asia. The research also shows that the characteristics of the SSB exert a stronger influence than conventional corporate governance mechanisms in enhancing the profitability of Islamic banks. Kateb et al. (2025) found that the effectiveness of the Board of Directors, Audit Committee, and SSB positively influenced the ROA and ROE of Islamic banks in the Middle East, North Africa, and Southeast Asia (MENASA) region, indicating that strong governance can enhance the efficiency and financial performance of Islamic banking institutions. Research by Tashkandi (2023) also confirms that the Sharia supervisory mechanism, along with the corporate governance mechanism, is an important determinant that enhances the financial performance of Islamic banks in the Gulf Cooperation Council (GCC) countries.

These positive findings are also reinforced by recent research on 111 Islamic banks across 24 countries, which shows that corporate governance characteristics, such as

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board size, the presence of a Sharia committee, and ownership structure, are significantly related to improvements in both ROA and ROE. Similarly, Rahim et al. (2024) found that the disclosure of Sharia governance, particularly transparency and the effectiveness of the Sharia committee, is an important factor contributing to improved financial performance of Islamic banks in Malaysia and the GCC countries. Other research also shows that the independence of the Audit Committee positively contributes to the financial performance of Islamic banks in the MENA region, although some characteristics of the SSB exhibit varying influences depending on the implementation of AAOIFI standards and the institutional characteristics of each country (Kateb et al., 2025).

In addition to empirical research, various literature reviews and systematic reviews provide strong support for that relationship. Research by Minaryanti and Mihajat, (2024) states that the implementation of Sharia governance through the SSB, internal Sharia audit, Sharia compliance, and internal control mechanisms is an important factor that can enhance the financial performance of Islamic banks, while also becoming a new paradigm in the development of Sharia governance in the future Meanwhile, Tumewang et al. (2025) identified that the relationship between Sharia governance and financial performance is one of the main research themes in the international literature, and concluded that strengthening Sharia governance is an important prerequisite for the sustainability and competitiveness of Sharia financial institutions. These findings are further reinforced by the latest bibliometric study, which shows that effective Sharia governance can enhance profitability through increased Sharia compliance, improved risk management, enhanced corporate reputation, and growth in investor and customer trust in Sharia banks (Quttainah & BenSaid, 2025).

However, not all studies yield consistent findings. Some studies found that the quality of ICG has not yet shown a significant relationship with the financial performance of Islamic banks in the GCC countries, indicating that the mere existence of governance structures is not sufficient to enhance profitability unless accompanied by effective implementation, high-quality human resources, and a supportive institutional and regulatory environment. The differences in the research results indicate that the effectiveness of ICG is not only determined by the presence of governance mechanisms but is also influenced by the quality of implementation, the level of compliance with AAOIFI standards, institutional characteristics, and the regulatory conditions in each country (Kateb et al., 2025; Tumewang et al., 2025). However, given the dominance of empirical evidence that ICG can enhance supervisory effectiveness, strengthen compliance with Sharia principles, increase transparency, improve operational efficiency, and drive profitability growth in Islamic banks, this research argues that better implementation of ICG will improve the financial performance of Islamic banks in Indonesia. Thus, the proposed research hypothesis is as follows.

H1: ICG has a significant positive impact on the financial performance of ICBs.

The Relationship Between ISR and Financial Performance

ISR is a form of social responsibility disclosure grounded in Sharia principles, thereby enhancing the conventional CSR concept. Unlike CSR, which generally focuses on economic, social, and environmental aspects, ISR also emphasizes the spiritual dimension by disclosing compliance with Sharia principles, such as zakat, *qardh al-hasan*, halal product certification, employee welfare, environmental protection, community responsibility, and governance practices aligned with Islamic values. Thus, ISR serves not only as a communication medium between the company and its stakeholders but also as a form of accountability to Allah SWT and society in the realization of the goals of *maqashid al-Sharia*. More comprehensive ISR disclosure is expected to enhance the legitimacy of the company, strengthen its reputation, reduce information asymmetry, increase investor and customer trust, and create a competitive advantage that ultimately impacts the financial performance of Islamic banks (Al-Sartawi, 2020; Jati et al., 2020; Platonova et al., 2018).

The relationship between ISR and financial performance has become a rapidly developing topic in the Islamic finance literature. Conceptually, broader ISR disclosure reflects the company's commitment to transparency, accountability, and Sharia-based social responsibility, thereby enhancing stakeholder trust, strengthening customer loyalty, improving the company's image, and reducing reputational risk. These conditions can further enhance operational efficiency, increase investment opportunities, and strengthen business sustainability, ultimately reflected in improved company profitability. From the perspectives of legitimacy and stakeholder theories, companies that meet stakeholders' social and spiritual expectations will gain greater legitimacy, thereby increasing their opportunities to achieve better financial performance (Platonova et al., 2018; Susbiyani et al., 2023).

Various empirical studies provide evidence supporting this positive relationship. (Platonova et al., 2018) found that the disclosure of CSR in line with AAOIFI standards in Islamic banks in the GCC region has a positive and significant impact on financial performance in both the current and subsequent periods, indicating that social activities aligned with Islamic values can create long-term economic benefits for Islamic banks. The findings are consistent with research by Jihadi et al. (2021), which shows that ISR has a positive and significant impact on company value, indicating that Sharia-based social disclosures receive a positive response from investors and enhance the company's economic value. Susbiyani et al. (2023) also proved that ISR is a company's strategy for obtaining legitimacy with investors, where ISR disclosure can increase the company's value through enhanced transparency, accountability, and stakeholder trust. The results show that the economic benefits of ISR are reflected not only in an increase in the company's market value but also in the potential to enhance profitability by strengthening its relationships with stakeholders.

On the other hand, several studies indicate that the implementation of ISR remains influenced by governance quality and company characteristics. Research on Islamic banks in Pakistan found that company size, profitability, company age, and board size are important determinants of ISR disclosure, indicating that companies with greater resource capacity tend to engage in broader and higher-quality social disclosures (Hussain et al., 2021). Research in Malaysia also shows that corporate governance characteristics, such as SSB size, audit quality, and the audit committee, significantly influence the level of ISR disclosure, making governance quality an important factor in promoting the social transparency of Sharia-compliant companies. These results are reinforced by the research of Jati et al. (2020), which found that the Islamic Governance Score positively affects ISR in Indonesian Islamic banks, indicating that the implementation of good Sharia governance encourages companies to disclose social responsibility more comprehensively. Other research also shows that ISR is influenced by financial performance and reinforced by ICG mechanisms, particularly through the activities of the Board of Commissioners, Audit Committee, and SSB, thereby enhancing the effectiveness of ISR disclosure through governance quality (Wairooy & Haryono, 2023).

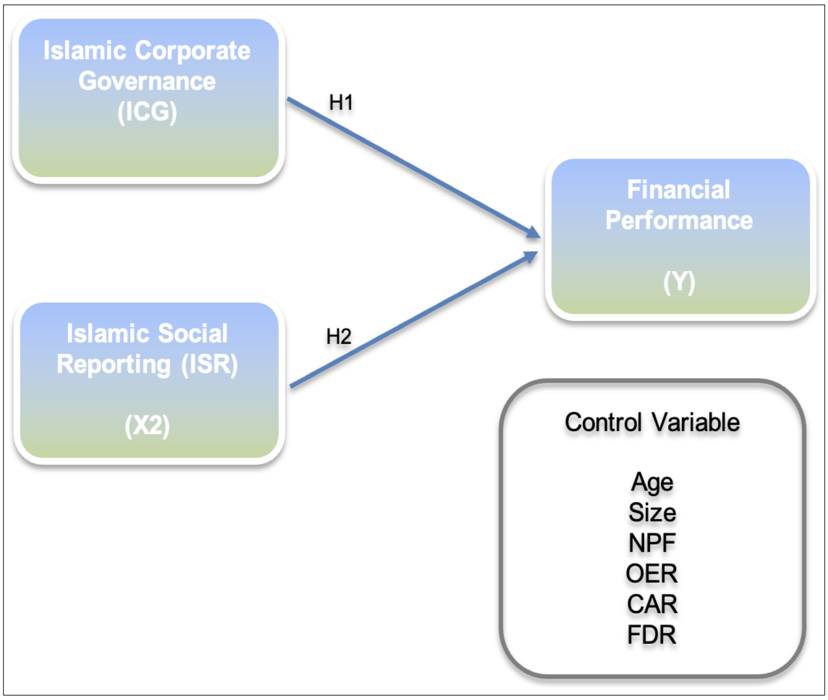
Nevertheless, some studies still find different results. Al-Sartawi (2020) reported that Sharia disclosure has not yet shown a significant positive relationship with company value and even showed a negative relationship with social performance in several Islamic Financial Institutions in the GCC region. These findings indicate that the economic benefits of Sharia-based disclosure have not been optimally realized if the implementation of social responsibility is still viewed as a compliance cost and has not yet been fully integrated into the company's business strategy. Furthermore, research conducted by Adema et al. (2023) shows that profitability does not affect the level of ISR disclosure in Indonesian Islamic banks, indicating that the implementation of ISR is influenced not only by the company's financial condition but also by management's commitment to Sharia values and social responsibility.

Although there are still inconsistencies in research results, most empirical evidence shows that ISR can enhance corporate legitimacy, strengthen reputation, increase transparency and stakeholder trust, and create long-term economic value that contributes to improved financial performance. Therefore, this study argues that the higher the level of ISR disclosure, the better the financial performance of Islamic Banks in Indonesia. Based on theoretical arguments and prior research findings, the proposed research hypothesis is as follows:

H2: ISR has a significant positive impact on the financial performance of ICBs

Conceptual Framework
The study framework model is depicted in Figure 1.

Figure 1. Research Framework



RESEARCH METHOD

Research Approach
This research uses a quantitative approach to empirically test the influence of ICG and ISR on the financial performance of Indonesian Islamic banks. The quantitative approach was chosen because it enables objective testing of causal relationships between

variables through statistical analysis of secondary data from annual reports and financial statements of Islamic banks. In this study, ICG and ISR are treated as independent variables, while financial performance, proxied by ROA, is the dependent variable. To enhance the internal validity of the research and minimize potential bias from other factors that may affect financial performance, this study includes several control variables: bank age, bank size, NPF, OER, CAR, and FDR. The operationalization of variables is shown in Table 1.

Table 1. Operationalization of Variables

	Variable	Description	Scale
Dependent Variables			
1	ICG – GGBS	42 items of the ICG Index by KNKG (2011) $GGBS = \frac{\sum of\ item\ disclosed}{Total\ items}$	Nominal
2	ISR	43 items of the ISR index developed by Haniffa (2002) and Othman et al., (2009) $ISRD = \frac{\sum of\ items\ disclosed}{Total\ items}$	Nominal
Independent Variable			
1	ROA	$ROA = \frac{Net\ Income}{Total\ Assets}$ x 100%	Ratio
Control Variables			
1	Bank Age	The age of the bank began when it was established as an ICB	Nominal
2	Bank Size	LN Total Assets	Nominal
3	Non-Performing Financial Ratio (NPF)	$NPF = \frac{Total\ Non\ Performing\ Finansing}{Total\ Financing\ Disbursed}$ x 100%	Ratio
4	Operational Efficiency Ratio (OER)	$OER = \frac{Total\ Operational\ Costs}{Total\ Operating\ Income}$ x 100%	Ratio
5	Capital Adequacy Ratio (CAR)	$OER = \frac{Total\ Capital}{Risk-Weighted\ Assets}$ x 100%	Ratio
6	Financing to Deposit Ratio (FDR)	$FDR = \frac{Total\ Financing}{Total\ Third\ Party\ Funds}$ x 100%	Ratio

The ICG Index employed in this study is adapted from the GGBS guidelines developed by the KNKG (2011), while the ISR Index is adopted from the framework proposed by Haniffa (2002) subsequently refined by Othman et al. (2009). The disclosure level of both indices is measured using a binary content analysis approach. For each disclosure item, a score of 1 is assigned if the information is explicitly disclosed in the bank's annual report, whereas a score of 0 is assigned if the item is not disclosed. The disclosure score for each index is then calculated by dividing the total number of disclosed items by the total number of applicable disclosure items, thereby producing a standardized disclosure index ranging from 0 to 1. A higher index value indicates a more comprehensive level of disclosure regarding ICG and ISR practices. The complete list of disclosure items used to measure the ICG and ISR indices is presented in Tables 2 and 3, respectively.

Table 2. Indicators of ICG

No.	Dimension	Indicator
1		Names of the board of commissioners

2	Structure and Work Mechanism of the Board of Commissioners	Status of the board of commissioners (independent or non-independent)
3		Explanation of the functions and working mechanisms of the board of commissioners
4		Number of board of commissioners meetings
5		The number of board of commissioners meeting attendees
6		Mechanism and criteria for self-assessment regarding the performance of board members
7		Explanation regarding the supporting committees of the board of commissioners, including: Names of the members of each committee
8		Explanation of the functions and working mechanisms of each committee
9		The number of meetings held by each committee
10		The number of committee members' meeting attendance
11		Mechanism and criteria for committee performance evaluation
12		Committee task implementation report
13	Structure and Work Mechanism of the SSB	Names of SSB members
14		The number of meetings held by the SSB
15		The number of attendance of the SSB members in the meeting
16		Mechanism for self-assessment of the performance of each member of the SSB
17		Criteria for self-assessment of the performance of each member of the SSB
18	Structure and Mechanism of Work of the Board of Directors	Names of board members
19		The positions of each board member
20		The function of each board member
21		Decision-making mechanism
22		Delegation of authority mechanism
23		The number of meetings held by the board of directors
24		Number of board members' attendance
25		Mechanism and criteria for evaluating board members
26		Statement regarding the effectiveness of system implementation: Implementation of the Compliance Function
27		Statement regarding the effectiveness of system implementation: Internal audit
28		Statement regarding the effectiveness of system implementation: External audit
29	Provision of Funds to Related Parties	Maximum credit distribution limit and the principle of prudence
30	Transparency of Financial and Non-Financial Conditions	Sharia financial performance report
31		Transparency report on Islamic bank products
32		Report on changes to risk management, internal control systems, and information technology systems used as GCG guidelines to Bank Indonesia
33		Implementation of the obligation to pay zakat and CSR
34		The implementation of the function as a recipient and distributor of social funds in the form of zakat, infaq, shadaqah, and wakaf

35	Other Information	Vision
36		Mission
37		Company values
38		Disclosure of controlling/majority shareholders
39		Disclosure of profit-and-loss-sharing-based investors
40		Policies and amounts of remuneration for the board of commissioners, SSB, and board of directors
41		Transaction with a party that has a conflict of interest
42		The results of the GGBS implementation reported in the annual general meeting

Source: KNKG (2011)

Table 3. Indicators of ISR

No.	Theme	Indicator
1	Finance & Investment	*Riba* activities: identity activities and % profit contribution
2		*Gharar* activities: identity activities and % profit contribution
3		Zakat: method used, amount, and beneficiaries
4		Policy on Late Repayments and Insolvent Clients/Bad Debt written-off
5		Current Value Balance Sheet (CVBS)
6		Value Added Statement (VAS)
7	Products & Services	Nature of products/services: identify activities and % of profit contribution
8		Halal status of the product
9		Product safety and quality
10		Customer complaints/incidents of non-compliance with regulation and voluntary codes (if any)
11	Employees	Nature of work: working hours, holidays, and other benefits
12		Education and training / human capital development
13		Equal opportunities
14		Employee involvement
15		Health and safety
16		Working environment
17		Employment of other special-interest groups (i.e., handicapped, ex-convicts, former drug addicts)
18		Higher echelons in the company perform the congregational prayers with lower and middle level managers
19		Muslim employees are allowed to perform their obligatory prayers during specific times and fasting during Ramadan on their working day
20		Proper place of worship for the employees
21	Society	*Sadaqa*/donation: amount and beneficiaries
22		*Waqf*: type and value
23		*Qard Hassan*: amount and beneficiaries
24		Employee volunteerism
25		Education-school adoption scheme: scholarship
26		Graduate employment
27		Youth development
28		Underprivileged community
29		Children care
30		Charities/gifts/social activities

31		Sponsoring public health/recreational projects/sports/cultural events
32	Environment	Conservation of environment: description and amount spent
33		Endangered wildlife
34		Environmental pollution
35		Environmental education
36		Environmental products/process related
37		Environmental audit / independent verification statement / governance
38		Environmental management system policy
39	Corporate Governance	Sharia compliance status
40		Ownership structure: number of Muslim shareholders and its shareholdings
41		Board structure: Muslim vs non-Muslim
42		Forbidden activities: monopolistic practice; hoarding necessary goods; price manipulation; fraudulent business practice; gambling
43		Anti-corruption policies

Source: Haniffa (2002), Othman et al. (2009)

Population and Sample
The population in this study comprises all ICBs in Indonesia listed in the OJK's Islamic Banking Statistics, totalling 14 banks. The sampling technique used is purposive sampling, a method of selecting the sample based on specific criteria aligned with the research objectives. The criteria used are banks that publish complete annual reports during the research period. Banks that do not meet these criteria are excluded from the research sample. Thus, the sample comprises ICBs with complete data, enabling consistent support for the analysis and resulting in more accurate and reliable research findings.

Table 4. Sample Mapping of ICBs in Indonesia

No.	Description	Number of Banks
1	Population: ICBs in Indonesia listed on the OJK website (excluding Islamic banking units and Islamic rural banks)	14
2	Banks that do not publish their annual reports completely and consecutively during the 2021-2025 research period	(1)
3	Final sample	13
4	Research period 2021-2025	5 years
5	Total observation	65

As shown in Table 4, the sample selection process details the population composition and the final number of observations used in this study. Based on the selection process, a total of 65 data points were obtained for the analysis.

Data Collection
The research data were obtained from the annual reports and financial statements of ICBs, published on each bank's official website during the research period. All variables were measured using information available in the annual reports and financial statements, yielding objective, consistent, and reliable data to support the research analysis.

Data Testing and Analysis

The research data were processed and analyzed using STATA software. The analysis was conducted in stages, including descriptive statistics to characterize the data; model selection tests for panel data regression using the Chow Test, Hausman Test, and Lagrange Multiplier Test; and classical assumption tests to assess model validity. Next, hypothesis testing is conducted using panel data regression, with control variables including bank age, bank size, NPF, OER, CAR, and FDR.

RESULTS

Descriptive Statistics Test

Table 5. Statistic Descriptive Test Result

Variables	N	Minimum	Maximum	Mean	Standard Deviation
ROA	65	-10.850	11.430	1.206	3.417
ISR	65	0.372	0.674	0.601	0.043
ICG	65	0.667	0.833	0.739	0.040
Age	65	1.000	34.000	13.077	8.220
Size	65	28.138	33.754	30.612	1.155
NPF	65	0.000	0.095	0.024	0.019
OER	65	41.200	428.400	96.923	60.576
CAR	65	18.700	390.500	40.430	52.553
FDR	65	0.000	173.270	82.271	22.235

Based on Table 5, it can be seen that the total number of data points (N) for all variables is 65. The minimum value of the ROA variable is -10.85, the maximum value is 11.43, the mean value is 1.206, and the standard deviation is 3.417. The minimum value of the ISR variable is 0.372, the maximum value is 0.674, the mean value is 0.601, and the standard deviation is 0.043. The minimum value of the ICG variable is 0.667, the maximum value is 0.833, the mean value is 0.739, and the standard deviation is 0.04. The minimum value of the bank age variable is 1, the maximum value is 34, the mean value is 13.077, and the standard deviation is 8.22. The minimum value of the bank size variable is 28.138, the maximum value is 33.754, the mean value is 30.612, and the standard deviation is 1.155. The minimum value of the NPF variable is 0; the maximum is 0.095; the mean is 0.024; and the standard deviation is 0.019. The minimum value of the OER variable is 41.2, the maximum value is 428.4, the mean value is 96.923, and the standard deviation is 60.576. The minimum value of the CAR variable is 18.7, the maximum value is 390.5, the mean value is 40.43, and the standard deviation is 52.553. The minimum value of the FDR variable is 0, the maximum value is 173.27, the mean value is 82.271, and the standard deviation is 22.235.

Model Selection Test

Table 6. Model Selection Test Result

Model Selection Test	Probability	Selected Model
Chow Test	0.0000	FEM
Hausman Test	0.0003	FEM

Based on Table 6, it can be seen that the Chow test probability value is 0.0000 < 0.05, so the Fixed Effect Model (FEM) is better than the Common Effect Model (CEM), or the selected model is the FEM. Then, the Hausman test was conducted, and the probability value was 0.0003 < 0.05, so the FEM is better than the Random Effect Model (REM); the selected model is the FEM. Therefore, the Lagrange multiplier test was not conducted, and the best model is the FEM.

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Classic Assumption Test

Table 7. Classic Assumption Test Result

Classic Assumption Test	Indicator	Result	Description
Normality	Skewness and kurtosis tests for normality	0.4584	Normally Distributed
Multicollinearity	VIF ISR	1.39	No multicollinearity
	VIF ICG	1.58	
	VIF Age	1.74	
	VIF Size	2.12	
	VIF NPF	1.56	
	VIF OER	3.15	
	VIF CAR	4.03	
	VIF FDR	1.38	
Heteroskedasticity	Modified Wald test for groupwise heteroskedasticity in fixed effect regression model	0.0000	Heteroscedasticity Occurs
Autocorrelation	Wooldridge test for autocorrelation in panel data	0.0226	Autocorrelation Occurs

Based on Table 7, the p-values for the skewness and kurtosis tests of normality are 0.4584 > 0.05, indicating that the data are normally distributed. All variables have VIF values < 10.00, so the model does not exhibit multicollinearity and passes the multicollinearity test. The p-value of the modified Wald test for groupwise heteroskedasticity in the fixed-effects regression model is 0.0000 < 0.05, indicating the model exhibits heteroskedasticity and fails the test. The p-value of the Wooldridge test for autocorrelation in panel data is 0.0226, which is < 0.05, so the model exhibits signs of autocorrelation and fails the test.

Panel Data Regression Analysis

Based on the result of the classical assumption test, the Modified Wald Test indicates the presence of groupwise heteroskedasticity, while the Wooldridge Test indicates the presence of first-order autocorrelation in the panel data. These conditions do not render the FEM, which has been selected through the Chow and Hausman Tests, invalid. However, they can cause the standard errors produced by conventional estimation to be inefficient, potentially resulting in less accurate statistical tests.

According to Caesaria and Majidah (2025), if there is a violation of the heteroskedasticity and autocorrelation assumptions simultaneously, the Panel Corrected Standard Errors (PCSE) method can be used. The PCSE was first presented by Beck and Katz (1995), proposing a framework that aggregates data from clusters to estimate error variance. The PCSE method is an estimation technique in panel data analysis used to correct standard errors in regression models when classical assumptions, such as heteroskedasticity and autocorrelation, are violated, ensuring that hypothesis testing with the PCSE method remains valid and unbiased (Girma et al., 2025; Zidi & Hamdi, 2024). Therefore, this study uses the PCSE approach to produce standard errors that are more robust to heteroskedasticity and autocorrelation, making the test statistics, p-values, and confidence intervals more reliable without altering the estimated coefficients of the selected FEM model. Thus, the interpretation of the research results remains based on the FEM model specification, while parameter significance testing is conducted using standard errors corrected with the PCSE approach.

Table 8. Summary of Panel Data Regression Analysis

	Coefficient	PCSE	Z	P Value
Constant	1.199	0.186	6.43	0.000***
ISR	-0.594	0.451	-1.32	0.187
ICG	0.926	0.418	2.22	0.027**
Age	-0.662	0.292	-2.27	0.023**
Size	0.681	0.392	1.74	0.082*
NPF	0.142	0.501	0.28	0.778
OER	-1.515	1.026	-1.48	0.140
CAR	1.516	0.770	1.97	0.049**
FDR	-0.803	0.587	-1.37	0.171
Wald Chi Square		26.65		
Probability Wald Chi Square		0.0008		
R Square		0.3163		

Note: *** P < 0.01, ** P < 0.05, * P < 0.1

$$ROA_{it} = 1.199 - 0.594\ ISR_{it} + 0.926\ ICG_{it} - 0.662\ Age_{it} + 0.681\ Size_{it} + 0.142\ NPF_{it} - 1.515\ OER_{it} + 1.516\ CAR_{it} - 0.803\ FDR_{it} + e_{it}$$

Based on Table 8, the probability value for the ICG variable is 0.027, which is significant at the 5% (0.05) significance level, and the coefficient is positive at 0.926. Therefore, H1 is accepted, indicating that ICG positively affects ROA. Meanwhile, the probability value of the ISR variable is 0.187, which is not significant at the 1% (0.01), 5% (0.05), and 10% (0.10) significance levels. Therefore, H2 is rejected, indicating that ISR does not affect ROA. The Wald Chi-Square probability value is 0.0008 < 0.05, so it can be concluded that ISR and ICG together affect ROA. The R-squared value is 0.3163 or 31.63%. This coefficient of determination indicates that the independent variables, ISR and ICG, explain 31.63% of the variance in ROA, with the remaining 68.37% attributable to other variables not included in this research model.

DISCUSSION

H1: ICG has a significantly positive impact on the ROA of Indonesian ICBs

The results of the hypothesis testing show that ICG has a positive and statistically significant relationship with the financial performance of ICBs in Indonesia, as proxied by ROA. This finding indicates that banks with higher levels of ICG implementation tend to have better profitability than those with lower ICG implementation. Thus, the first hypothesis of the study is accepted and provides empirical evidence that the quality of Sharia governance is one of the factors associated with improvements in the ROA of ICBs in Indonesia. However, the results of this study show a statistical relationship and do not directly indicate a cause-and-effect relationship, considering that this research uses an observational panel data approach.

The positive relationship can be explained by the effective implementation of ICG, which has the potential to strengthen the quality of governance by enhancing oversight functions, transparency, accountability, and adherence to Sharia principles. In the context of ICBs, the presence of the SSB, internal control mechanisms, and the application of the GGBS principles enable the decision-making process to be conducted more prudently and in accordance with Sharia principles. These conditions have the potential to reduce agency conflicts, mitigate Sharia non-compliance risk, enhance operational efficiency, and strengthen the trust of investors, regulators, and customers in Islamic banking institutions. Therefore, banks that implement Sharia governance more effectively tend to have greater capacity to manage resources and maintain more stable financial performance. This interpretation is in line with the concepts of agency theory, stakeholder theory, and Sharia governance, which place governance as an important mechanism in creating organizational efficiency while also building stakeholder trust.

The results of this study are consistent with the findings of Isbah et al. (2024). The findings of Khan and Zahid (2020), which demonstrate that the ICG Index positively affects the performance of Islamic banks in Asia, are supported by Billah and Fianto (2021), who show that ICG characteristics simultaneously contribute to improved performance of Islamic banks in Indonesia and Malaysia. Similar findings were reported by Darma & Afandi (2021), Pangerang et al. (2025), and Wibowo (2022), who concluded that effective ICG implementation can enhance profitability and strengthen the financial performance of Islamic banks. The findings of this study are also in line with recent literature reviews asserting that ICG has evolved into a strategic mechanism oriented not only toward Sharia compliance but also toward value creation and the sustainability of Sharia financial institutions' performance. The literature shows that strengthening elements such as Sharia board governance, audit and risk management, and sustainability-based governance are important factors in improving the performance of Islamic banks (Lestari et al., 2025b, 2025a). Nevertheless, several previous studies have shown different results. Mukhibad et al. (2020) found that several attributes of the SSB and the board of commissioners have no impact, and some even have a negative impact on performance, as measured by the *Maqashid Sharia* Index. Furthermore, Kateb et al. (2025) reported that not all Sharia governance mechanisms contribute positively to the performance of Islamic banks in the MENA region, as their effectiveness is highly influenced by the governance characteristics and institutional context of each country.

The findings of this research provide theoretical and practical implications: ICG serves not only as a mechanism for compliance with Sharia principles but also as a strategic asset that contributes to value creation and organizational sustainability. These results reinforce the relevance of agency theory, stakeholder theory, and legitimacy theory in the context of Islamic banking, while also affirming that Sharia governance should be viewed as an instrument that strengthens stakeholder trust and supports the sustainable achievement of organizational goals. Therefore, the strengthening of ICG implementation should be directed toward enhancing the substantive effectiveness of governance, not merely fulfilling regulatory obligations, to create competitive advantages and strengthen the resilience and competitiveness of ICBs amid the dynamics of the financial industry.

H2: ISR does not have a significant impact on ROA of Indonesian ICBs

The results of the hypothesis testing indicate that ISR is not statistically significantly related to the financial performance of ICBs in Indonesia, as proxied by ROA. Therefore, the second hypothesis of the study is not supported. These findings indicate that the level of ISR disclosure during the observation period has not shown a significant correlation with the bank's profitability level. However, these results cannot be interpreted to mean that ISR is not important for the Islamic banking industry; rather, they show that the relationship between ISR disclosure and ROA has not been statistically proven in the context and period of this study.

The insignificance of the relationship between ISR and ROA can be explained by several possibilities. First, the economic benefits of disclosing social responsibility are generally long-term and are more evident in improvements in reputation, legitimacy, customer loyalty, and stakeholder trust than in short-term profitability. Second, the variation in the quality and depth of ISR disclosure among banks remains relatively limited, preventing it from producing measurable differences in ROA. Third, in the context of ICBs in

Indonesia, investor and customer decisions are likely still more influenced by fundamental factors such as operational efficiency, financing quality, and the bank's financial condition rather than the level of ISR disclosure. Therefore, the benefits of ISR are more likely to be reflected in the strengthening of non-financial value rather than a direct increase in profitability. This interpretation is also in line with the views of stakeholder theory and legitimacy theory, which position social disclosure as a mechanism for obtaining legitimacy and strengthening relationships with stakeholders.

The results of this study align with the view that the benefits of ISR are more pronounced in creating long-term value than in short-term profitability, so its impact on financial indicators such as ROA cannot always be directly observed. Moreover, investors and customers still tend to rely on profitability and operational efficiency indicators as the primary basis for assessing a bank's performance, rather than on the extent of ISR disclosure (Jihadi et al., 2021; Susbiyani et al., 2023).

However, the results of this study are inconsistent with several previous studies. Murtiyanti et al. (2022) demonstrated that ISR has a significant positive effect on the financial performance of Islamic banks prior to moderation by the NPF ratio, indicating that implementing Sharia-based social responsibility can enhance performance when supported by favorable operational conditions. These findings are consistent with previous research emphasizing that corporate governance and social responsibility are strategic instruments for supporting corporate sustainability; however, their impact on financial performance is not always direct and may vary with industry characteristics and regulatory environments (Wiratama & Prasetio, 2025).

Literature reviews also show that ISR is more often positioned as an instrument of accountability to stakeholders and Allah SWT rather than as a factor that directly improves financial performance (Jati et al., 2020; Wijayanti et al., 2023). This condition indicates that ISR plays a more significant role as an instrument for fulfilling ethical and sharia accountability and strengthening institutional legitimacy, rather than as a direct driver of short-term improvements in profitability.

These findings imply that the role of ISR in ICBs should not be evaluated solely based on its ability to generate short-term profitability. From a theoretical perspective, the results of this study reinforce stakeholder theory and legitimacy theory, which view ISR as a mechanism for building legitimacy, strengthening accountability, and enhancing stakeholder trust, even though its economic benefits are not always directly reflected in financial indicators such as ROA. From a practical perspective, these results indicate that the implementation of ISR should be directed toward improving the quality, materiality, and credibility of disclosures, so that it is not only oriented toward compliance with reporting obligations but also capable of creating strategic value for the organization through the strengthening of reputation, public trust, and the long-term sustainability of ICBs.

CONCLUSION

This research demonstrates that ICG has a positive and significant impact on the ROA of ICBs in Indonesia, indicating that implementing governance based on Sharia principles can enhance management effectiveness and profitability. Conversely, ISR does not have a significant impact on ROA, indicating that the disclosure of Sharia-based social responsibility has not yet had a direct effect on short-term profitability. These findings affirm that strengthening Sharia governance mechanisms is a more decisive factor in improving financial performance compared to the disclosure of social responsibility, although ISR still plays an important role in enhancing the accountability, transparency, and legitimacy of ICBs to stakeholders.

The findings of this research have practical implications: the improvement in the financial performance of ICBs depends not only on compliance with Sharia principles but primarily on the effectiveness of ICG implementation. Therefore, bank management needs to strengthen governance quality by optimizing the SSB's role, enhancing the effectiveness of oversight functions, and promoting transparency and accountability in decision-making. Meanwhile, the insignificant influence of ISR indicates that the disclosure of social responsibility has not yet created direct economic value. This condition suggests the need to transform ISR from merely a compliance reporting instrument into a component of business strategy integrated with value creation, so that the social benefits generated can make a tangible contribution to improving the financial performance and competitiveness of ICBs.

LIMITATION

This research has several limitations that need to be considered when interpreting its results. First, the measurement of ICG and ISR still relies on disclosure indices in annual reports, thus not fully reflecting the substantive quality of Sharia governance and social responsibility. Second, this research focuses only on ICBs in Indonesia, so the results cannot yet be generalized to other Sharia financial institutions or to different country contexts. Third, although several internal bank control variables have been used, this study has not included macroeconomic factors, regulations, and institutional conditions that could also potentially affect financial performance. Therefore, subsequent research is recommended to use quality-based measures, broaden the scope of research participants, and account for external factors to make the analysis results more comprehensive.

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DECLARATION OF CONFLICTING INTERESTS

The authors declare that they have no potential conflicts of interest regarding the study, authorship, and/or publication of this article.

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