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Corporate Governance and Non Performing Financing on Sharia Bank Profitability

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Abstract:

This study aims to examine impact of Corporate Governance and Non Performing Financing on sharia bank profitability. The unit analysis of this research is Sharia Banks in Indonesia which have been registered in the Financial Services Authority (OJK) period 2013 to 2017. This research was done on 13 Islamic commercial banks by using quantitative-descriptive approach. The results of this research showed that Corporate Governance that represented by institutional ownership has negative effect and insignificantly on profitability. Board meeting has positive affect and significant on profitability. Board size and audit committee size have positive effect and significant on profitability. However, Non Performing Financing has a negative effect and significant on profitability.

Introduction

Banks serve important role in driving economics of a country, particularly in making people prosperous. Recent rapid development of Sharia Bank goes along with the increase of community needs on banking products that comply with Islamic Sharia principles. Similar to conventional banks, Sharia banks also take aim on profit oriented objectives. The development of Sharia banking in Indonesia also create competitive atmosphere among such banks particularly to draw community's trust to become their customers. Thus the Sharia banks have to be able to maintain their customer trust, the higher the trust the more transactions made in the banks. Customer trust can be acquired by demonstrating good financial performance. Financial performance may reflect the healthiness of a bank, mainly its profitability performance.

The healthiness and financial performance of bank mean the capability of the a bank to carry out banking operations normally and to satisfy all its obligations properly in manners according to applicable banking regulations (Kasmir, 2018). Suryani, (2011) suggests that profitability is the most accurate indicator to measure a bank performance.

One of the benefits to apply good corporate governance is it helps the company's organ to focus on performance improvement (Manaseer, Al-Hindawi, Al-Dahiyat, & Sartawi, 2012) . Corporate governance is a structure, process, culture, and system to create successful operational condition for an organization (Keasey, Wright, Keasey, & Wright, 1993).

In Bank Indonesia Regulation No. 11/33/PBI/2009 and Bank Indonesia Circular No. 12/13/DPbS/2010 concerning the Implementation of Good Corporate Governance for BUS and UUS, the implementation of GCG that meets sharia principles is reflected by the implementation of tasks and responsibilities of Board of Commissaries and Board of Directors, completeness and implementation of committee tasks and work unit in performing internal control function, implementation of tasks and responsibilities of Sharia Supervisory Board (DPS), application of compliance, internal audit, and external audit function, maximum limit of fund distribution, and transparency in financial and non-financial condition.

Non Performing Financing (NPF) is an instrument of performance assessment in a sharia bank as assessment interpretation on productive assets, particularly in non-performing financing assessment. Non

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Performing Financing (NPF) is the ratio used to measure bank capability in covering the risk of debitor failure to return the credit Suhartatik & Kusumaningtias, (2013) suggest that Non Performing Financing (NPF) can be measured via comparison between non-performing financing with the total financing. Bank Indonesia set fort the tolerance rate for bank healthiness is NPF maximum rate of 5%. Based on Sharia Banking statistics data released by Financial Services Authority (OJK) on non performing financing/NPF ratio of sharia general bank per per December 2017 is 4.77%, this figure is still below the the provision set forth by BI. This will become an alert for Sharia general bank due to its approaching maximum rate set by BI. While Sharia Business Unit (UUS) is more controlled below the level of 2.11%, and its number is less than Sharia general bank. Hermina & Suprianto, (2016) wrote the NPL ratio shows the capability of bank management in managing non-performing loan/financing on loan/financing provided by the bank.

Negative impact of high level of failure on non-performing financing to the bank includes the loss of opportunity to earn revenue from distributed financing, and adversely affect the bank profitability in form of decreased profit. Study by Ferdyant, ZR, & Takidah, (2014) shows the risk of negatively significant influence to the Sharia Banking profitability where the higher Non Performing Loan (NPF) is, the lower the Return on Asset (ROA) earned. Study by Suwarno & Muthohar, (2018) shows NPF has positive insignificant influence on financial performance (ROA) of sharia general bank in Indonesia in 2013-2017. Adyani, Rahma, & Sampurno, 2012 suggests that the higher the NPF ratio is, the lower the profitability of sharia general bank proxied with Return on Asset. While Santoro (2011) and Nainggolan (2010) find the higher the NPF ratio is, the higher the profitability of sharia general bank proxied with Return on Asset..

Based on the above explanation, study on Sharia bank profitability remains interesting, the growing development of Sharia transaction shall be balanced with healthy Sharia financial institution, this study employs mechanism variables of good corporate governance (institutional ownership, proportion of independent commissioners, commissioners and audit committee meeting frequency). The object of the study is Sharia general bank listed in Indonesia Stock Exchange in the period of 2013 to September 2018.

Literature Review and Hypothesis Development

Profitability shows the performance of a company to earn profit that may influence the investment decision making. This means that the better the financial performance the company investor has, the higher the trust it obtains to disclose its social responsibility, high profitability level of the company will improve competitiveness among companies (Dendawijaya, 2009).

Determinant of bank profitability falls into two main categories: The first is internal factor, the second is external factor. Internal determinant is factors controlled by management. This shows variations among banks in management policy and decision related to the source and use of fund, capital, liquidity, and cost (Manaseer et al., 2012)

In general, there area for types of main analysis to assess the probability level including (Kasmir, 2018) : Net Profit Margin (NPM), Return On Assets (ROA), Earning Per Share (EPS), Return On Equity (ROE).

The good corporate governance is a concept that can be taken as instrument to measure the success of an organization (Rahman and Safitri, 2018). Forum for Corporate Governance in Indonesia (FCGI) defines Corporate Governance as a series of rule defining relation between shareholders, managers, creditors, government, employees, and other internal and external stakeholders associated with the rights and responsibilities, or system in which the company is directed and controlled. Corporate Governance aims at creating value added to the stakeholders. Good Corporate Governance (GCG) is a system that manage and control the company to bring value added to all stakeholders (Monks, A.G., & Minow, 2011). Hidayat, 2010 suggests that corporate governance is a series of regulation that coordinate the shareholders, company managers, creditors, government, employees, and internal and external stakeholders to achieve the company’s objectives.

PBI No. 11/33/PBI/2009 describes that the implementation of Good Corporate Governance (GCG) is an effort to protect stakeholders interest improve compliance to applicable laws and regulations as well as ethic values generally applied in sharia banking industry. Good Corporate Governance usually refers to a set of mechanism that influence the decision to make by manager upon separation of ownership and controls of which some controls lie on the function of the board of directors, institutional shareholders, and control from market mechanism (Larcker et. al. in Wardhani, 2006).

Denis and McConnel (2003), suggest two mechanisms in corporate government as follows: 1). Internal Governance Mechanism, i.e. a. Boards of Directors, b) Ownership Structure, and 2. External Governance Mechanism : a) The Takeover Market, b) The Legal/Regulatory System.

According to Bank Indonesia dictionary, Non Performing Loan (NPL) or Non Performing Financing (NPF) is non-performing credit that is classified as substandard, doubtful, and bad credits. The term of NPL is used for general bank and NPF for sharia bank. Non Performing Financing (NPF) can be measured via comparison between non-performing financing with the total financing (Suhartatik & Kusumaningtias, 2013). NPL ratio shows the capability of bank management in managing non-performing loan on loan provided by the bank. NPL is the percentage of total non-performing loan to total credit issued by the bank. High NPL ratio will increase the cost, potentially brings financial loss to the bank. This is the reason NPL ratio to be negative variable, since the higher the non-performing loan, the higher the potential loss to bank or the lower the probability is (Hermina & Suprianto, 2016).

Dwi (2018) shows that CAR, NPF, ROA, ROE, BOPO and FDR simultaneously have a significant effect on GCG dependent variables in Sharia commercial banks in 2010-2013. Rahman and Safitrie (2018) shows that CG which is proxied by an independent board has a positive positive effect on profitability (ROE), CG proxied by an independent board has a negative effect on NPF and NPF has no effect on profitability (ROA). Study by Akbar (2018) shows that Non Performing Financing (NPF), Financing-to-Deposit Ratio (FDR), Modal Adequacy Ratio (CAR), and Good Corporate Governance (GCG) are not significant to financial performance. Disclosure of GCG, SSB, temporary syirkah funds, and NPF affects profitability (Mukhibad & Khafid, 2018).

Different results from previous studies make researchers want to do research again with some differences in variables from previous studies. Referring to the research objective, which is to examine the effect of good corporate governance proxied by institutional ownership, independent commissioners and audit committees on company performance and NPF variables on company performance, the research hypotheses proposed are as follows

H1 = There is positive influence of Institutional ownership to sharia profitability
H2 = There is positive influence of the board meeting to profitability
H3 = There is positive influence of Independent board size to profitability
H4 = There is positive influence of Audit committee to profitability
H5 = There is negative influence of NPF to profitability

Method

The researcher uses the method of multiple linear regression analysis because this study examines the relationship of two or more independent variables where previously the classical assumptions were made in the first stage. Profitability shows the performance of a company to generate profits so that it can affect investment decision making. This means that the better the financial performance of a company's investors, the higher the trust it has to express its social responsibility. The measure of profitability in this study uses Return On Assets (ROA). The ROA formula used in this study refers to the determination of Bank Indonesia as the central bank.

Institutional ownership is measured by using a comparison between the number of shares owned by institutions and the number of shares outstanding (Ale, 2014). the frequency of board of commissioners' meetings is measured by the number of special board meetings held for one year (Yatim et al, 2006). The proportion of the independent board of commissioners is measured by dividing the number of independent boards of commissioners by the total members of the board of commissioners, as a study conducted by Juniarti and Agnes (2010). An effective audit committee is able to improve the quality and credibility of the audited annual financial statements and assist the board of directors in advancing the interests of shareholders (Prastiti and Meiranto, 2013). The size of the audit committee is measured by counting the number of audit committees in a company's annual report.

NPL is a ratio used to measure the ability of banks to cover the risk of credit repayment failure by debtors (Suhartatik & Kusumaningtias, 2013).

Results and Discussion

Descriptive statistics test results

Descriptive statistics analysis provide description of data viewed from minimum value, maximum value, mean, and deviation standard of data.

Table 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Institutional ownership	41	90.31	100.00	98.7885	2.53442
the board meeting	41	3.00	36.00	15.3902	8.80874
Independent board size	41	50.00	100.00	65.4893	12.49038
Audit committee	41	2.00	8.00	3.7317	1.36060
NPF	41	.00	4.85	2.7341	1.61517
Profitability	41	-2.36	2.63	.6205	1.05213
Valid N (listwise)	41				

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Source: The result of the study data processing (2019)

Descriptive Statistics output shows the number of respondents (n) of 41. Minimum Institutional Ownership of 90.31 and maximum of 100, with mean of 98.79. The frequency of the Board Meeting is minimum 3 times and maximum 36 times with mean of 15.39. Minimum board meeting of 50 and maximum of 100, with mean of 65.49. Minimum Audit committee of 2 and maximum of 8, with mean of 3.73. Minimum NPF of 0.00 and maximum of 4.85, with mean of 2.73. and minimum Profitability of -2.36 and maximum of 2.63, where the mean is 0.62.

Normality test result shows that the value of Asymp. Sig. (2-tailed) is higher than the significance level of 0,05 (0.052 > 0.05). Thus, conclusion can be taken that residual data on this regression model is distributed normally.

Classical assumption test results

Multicollinearity test result displaying correlation among independent variables does not relate to value above 0,9. This means that the independent variables are excluded from multicollinearity assumption. Durbin Watson autocorrelation test result shows Durbin Watson (DW) number of 2.083. This value will be compared with table value using significance value of 5% with 41 samples and 6 variables. Based on DW table with T=41 and K6 wil result in dl = 1.1891 and du 1.8493, thus 2.083 > 1.8493 and (4-d) or 1.917 > 1.8493, no positive and negative autocorrelation exists or in other words, there is no autocorrelation shown. Heteroscedasticity test result by showing scatter plot diagram shows random scattered plots above and below 0 on Y axis. This shows no heteroscedasticity in the regression model.

Model feasibility test reports

Table 2. Hasil Uji Koofisien Determinasi

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.567[a]	.322	.225	.92631	2.083

Source: The result of the study data processing (2019)

The Adjusted R Square is 0.225 that means 22.5% of Profitability variables in sharia bank can be explained by the variation of the five independent variables (Institutional Ownership, the Board of Commissioners Meeting Frequency, Independent Commissioners Proportion, Audit Committee Size, and NPF). While the remaining 0.775 is explained by other variables.

The calculated F test result is 3.321 and significance value is 0.015. Since the probability is far less than 0.05, the regression model can be employed to predict that Institutional Ownership, the Board of Commissioners Meeting, Independent Commissioners Proportion, Audit Committee Size, and NPF collectively influence the Probability.

Hypothesis test results

Table 3. T test

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	.733	6,076		.121	.905
	Institutional ownership	-.009	.065	-.021	-.133	.895
	the board meeting	.045	.018	.374	2,536	.016
	Independent board size	.009	.013	.113	.723	.475
	Audit committee	.065	.113	.084	.577	.568
	NPF	-.295	.094	-.453	-3,123	.004

Source: The result of the study data processing (2019)

T statistics test result in table 3 shows that of the five independent variables included in the regression model, Institutional Ownership variable comes with 0.895, Independent Commissioners Proportion 0.475 and Audit Committee Size 0.568, and the three variables are far above 0.05. While the Board of Commissioners Meeting Frequency and NPF are significant at 0.05.

Table 3 shows The result of hypothesis test. In the first hypothesis, Institutional Ownership shows the calculated t of -0.133 and significant value is 0.895 > 0.05 and it can be concluded that Institutional Ownership has negative and insignificance influence to profitability, thus the first hypothesis is rejected. The second hypothesis comes with t calculated value of 2.536 and significance value of 0.016 < 0.05 and it can be concluded that the board of commissioners meeting frequency brings positive and significant influence to the profitability or the second hypothesis acceptable. In the third hypothesis,come with the calculated t is 0.723 and the significance value is 0.475 > 0.05 and it can be concluded that independent commissioners proportion has positive and insignificant influence to profitability, thus the third hypothesis is accepted. In the fourth hypothesis, come with calculated t of 0.577 and the significance value is 0.568 > 0.005 with calculated t of 0.577 and it can be concluded that audit committee size has positive and insignificant influence to profitability, thus the fourth hypothesis is acceptable. In the fifth hypothesis,come with calculated t of -3.123 the significance value is 0.004 > 0.005 and it can be concluded that NPF has negative and significant influence to profitability, thus the fifth hypothesis is acceptable.

Conclusion

Based on regression analysis that has been carried out, the following conclusion can be taken:

1. Institution Ownership come with the calculated t of -0.133 and significant value is 0.895.It shows Institution Ownership has insignificant negative influence to the profitability of Sharia General Bank or the first hypothesis is rejected. This shows that the more the institutional ownership is, the lower the profitability is.
2. The Board of Commissioners Meeting comes with t calculated value of 2.536 and significance value of 0.016. It shows The Board of Commissioners Meeting has positive and significant influence to the profitability of Sharia General Bank or the second hypothesis acceptable. This suggests that the more the meeting held, the higher the profitability is.
3. The Independent Commissioners Proportion , come with the calculated t is 0.723 and the significance value is 0.475. It shows The Independent Commissioners Proportion has positive and insignificant influence to profitability of Sharia Bank in Indonesia thus the third hypothesis is accepted This result shows that the higher the proportion in Sharia Bank, the higher the profitability is.
4. The Audit Committee Size come with calculated t of 0.577 and the significance value is 0.568. It shows The Audit Committee Size has positive and insignificant influence to the profitability of Sharia General Bank thus the fourth hypothesis is acceptabl. This shows that the bigger the audit committee size is, the higher the profitability is.
5. The Non Performing Financing come with calculated t of -3.123 the significance value is 0.004. It shows The Non Performing Financing has negative and significant influence to the profitability of Sharia General Bank thus the fifth hypothesis is acceptable. This suggests that the lower the non-performing financing is, the higher the profitability is.

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