

Analysis of the effect of GCG quality on the financial performance of Islamic banks

Flowurrence Wibawanti Dewany¹

¹ STIE Perbanas Surabaya, Nginden Semolo Street 34-36, Surabaya, 60118, East Java, Indonesia

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ABSTRACT

This research aims to know the effect of the quality of Good Corporate Governance implementation on the rate of return, measured using Return on Assets (ROA), the risk of financing, measured using Non Performing Financing (NPF), and capitals measured using Capital Adequacy Ratio (CAR) on Islamic Banks in Indonesia. The sampling technique used in this research is purposive sampling method with the limitation of Islamic Banks registered in Bank Indonesia, publish annual report and disclose reports of Good Corporate Governance from 2010 to 2013. The result shows that the quality of Good Corporate Governance implementation on Islamic banks in Indonesia is categorized good, based on the composite mean value of 1.70676. The quality of Good Corporate Governance implementation has no effect on the rate of return and the risk of financing, but it has an effect on the capital.

ABSTRAK

Penelitian ini bertujuan untuk mengetahui pengaruh kualitas pelaksanaan Good Corporate Governance (GCG) pada rate of return yang diukur dengan menggunakan Return on Assets (ROA), risiko pembiayaan yang diukur dengan menggunakan Non Performing Financing (NPF), dan modal yang diukur dengan menggunakan Capital Adequacy Ratio (CAR) pada Bank Islam di Indonesia. Teknik sampling yang digunakan dalam penelitian ini adalah metode purposive sampling terbatas pada Bank Islam yang terdaftar di Bank Indonesia, dan telah menerbitkan laporan tahunan serta mengungkapkan laporan GCG dari 2010 sampai dengan 2013. Hasil penelitian menunjukkan bahwa kualitas pelaksanaan GCG pada Bank-bank Islam di Indonesia dikategorikan baik, berdasarkan nilai rata-rata gabungan dari 1,70676. Kualitas pelaksanaan GCG tidak berpengaruh pada rate of return dan risiko pembiayaan, tetapi berpengaruh pada modal.

1. INTRODUCTION

Along with the development of Islamic business, the Islamic banking in Indonesia is experiencing its rapid growth. Public appeal in performing economic activities based on the Islamic principles makes the Islamic banking become one way to do transactions in accordance with the Islamic principles. Islamic banks themselves have a purpose to promote and develop the application of Islamic principles in financial and banking transaction as well as other business. The main principle of Islamic banks is to prohibit usury in all transactions and to perform all trading activities as well as to make a deal by way of profit sharing. In a study

conducted by Bank Indonesia, one of the factors that determine the occurrence of the crisis in Southeast Asia is the weak implementation of corporate governance system (Dewayanto 2010: 105). The weak implementation of corporate governance has been the trigger for the emergence of financial fraud in the company's business.

The impact of global financial crisis stemming from the United States in 2007 began to be felt worldwide. The crisis has spread to the developing countries, including Indonesia in 2008. The Indonesian economy has been depressed which is characterized by the slackness of economic growth in Indonesia. Supreme Mortgage Crisis or better

* Corresponding author, email address: ¹ flowurrence.dewany@gmail.com.

known as the 2008 global crisis was centered in New York, United States. The global financial crisis resulted in the closing of Lehman Brothers. This issue raises the intensity of the higher volatility in global financial markets.

Sudarsono (2009) argued that the banking world also couldn't be separated from the global financial crisis. The financial crisis has led Bank Indonesia to raise the BI rate to curb inflation caused by the falling of the value of rupiah (IDR) against the dollar. The increase in the BI rate is responded by the massive rate of conventional bank interest rate. But the rise in interest rates does not affect Islamic banks directly. Trading system (*bai'*) in Islamic banks, where the margin payments are based on fixed rate in which the contract-based provisions cannot be changed at any time like interest.

In increasing public confidence towards the Islamic banks requires the implementation of the principles of Good Corporate Governance (GCG). According to Andriyan and Supatmi (2010), the implementation of Good Corporate Governance (GCG) can help Islamic Bank to improve the quality of financing, the quality of the Bank's assessment, the quality of business decision-making, infrastructure and can be used as the guidelines for the assessment of early detection system toward the high-risk business area, products, and services.

According to Cahaya Ekaputri (2014), in order to improve the bank's performance and minimize the risk, Islamic Banks are required to carry out their business activities based on the principles of Good Corporate Governance (GCG) to protect the interests of stakeholders. Regulation on governance has been unveiled by Bank Indonesia, as stipulated in Bank Indonesia Regulation (PBI) No. 11/33/PBI/2009 on the implementation of Good Corporate Governance for Islamic Banks and Islamic Business Unit, and Bank Indonesia Circular Letter (SE) No. 12/13 / DPbS on the implementation of Good Corporate Governance on Islamic Banks and Islamic Business Unit.

In improving the quality of the implementation of GCG, Islamic Banks are required to conduct self-assessment comprehensively so that the flaws can be promptly detected. Each year, Islamic banks are required to publish the results of Self Assessment Report on the implementation of the Governance included in the Annual Report or GCG Report. Self Assessment Report on GCG is the results of the assessment of governance implementation conducted by each bank, both in

composite value and composite predicate, which is the final result of the report of the implementation of governance principles.

The factors that affect the quality of the implementation of GCG are return rate, risk of financing, and capital. Dhaniel Sham & Taufik Najda (2012) stated that the quality of GCG implementation does not affect the rate of return on Islamic banks in Indonesia which is measured using the ratio of return on assets (ROA) and the quality of GCG implementation has negative effect on the risk of financing on Islamic banks in Indonesia. It is also reinforced by Cahaya Ekaputri (2014) in his research that indicates that the GCG implementation is able to reduce the risk of financing on Islamic banks. In addition to the rate of return and risk of financing, capital is one of the factors that can be affected by the quality of GCG implementation on Islamic banks in Indonesia. Ika Permatasari & Retno Novitasary (2014) stated that the composite value of GCG has no effect on CAR. That is because the management of the fund is less optimal resulting in the availability of capital is very high.

So far, there have been many studies on Good Corporate Governance (GCG) that use conventional banks as the research objects, whereas the research with the topic of good corporate governance on Islamic banking is still very limited. Moreover, in the case of Islamic banking in Indonesia, the implementation of GCG was just effectively implemented and reported in 2010 so that there are only a few researches that use Islamic banking as the research object.

From the above description, the researchers is interested in researching on the Effect of the Quality of Good Corporate Governance (GCG) implementation on the Rate of Return, Risk of Financing, and Capital on Islamic Banks in Indonesia.

2. THEORETICAL FRAMEWORK AND HYPOTHESIS

Agency Theory

The concept of agency theory is based on the problems that arise when the management of a company is separated from its ownership. Company is a mechanism that provides the opportunity for various stakeholders to contribute in the form of capital, expertise and labor in order to maximize long-term profits (Jansen and Mecklin 1976).

Islamic Bank

Muhamad (2014: 5) described that Islamic bank is a bank that is based on the principles of partner-

ship, fairness, transparency and universal and conduct banking business based on Islamic principles. The activities of Islamic banks are the implementation of Islamic economic principles as follows:

1. Prohibit usury in any forms,
2. Do not recognize the concept of time-value of money,
3. The concept of money as a measuring tool, not as a commodity,
4. Do not allow to use speculative activities,
5. Do not allow to use two prices for one object, and
6. Do not allow two transactions in one contract.

According to Law No. 21 of 2008 concerning Islamic Banking, Islamic Banking is defined as the bank that runs its business based on Islamic Principles. Based on its type, Islamic Banking consists of Islamic Bank and Islamic Rural Financing Bank

Habib Nasir and Hasanudin (2004: 74), in *Ensiklopedia Ekonomi dan Perbankan Syariah* (Encyclopedia of Economics and Islamic Banking) argue that Islamic Banking is the bank that can provide services in the payment traffic that conforms to Islamic law. It can be concluded that Islamic bank is intermediary institution that works based on the ethics and value system of Islam, free of interest (*riba*), free of all the activities that are non productive such as gambling (*maysir*), free of dubious things (*gharar*) and concentrate only on lawful activities (*halal*).

Good Corporate Governance (GCG)

Hessel Nogi S. Tangkilisan (2003: 11) stated that Good Corporate Governance (GCG) is a system and structure that manage the company with the objective of enhancing shareholder value as well as allocating some parties who have interest in the company (stakeholders) such as creditors, suppliers, business associations, consumers, workers, government and wider community.

Brigham and Erhardt (2005) in Dewayanto (2010) defined good corporate governance as a set of rules and procedures that ensure managers to apply the principles of value-based management. While according to the World Bank, GCG is a rule, standards and organizations in the field of economics that govern the behavior of company owners, directors and managers as well as the details and elaboration of the duties and authority and its accountability to investors (shareholders and creditors). GCG is needed to create a market that is transparent, efficient and consistent based on legislation. The implementation of GCG re-

quires three interrelated pillars. These three pillars are the state and its apparatus as regulators, the business community as market participants and the role of communities as users of the product.

M. Umer Chapra and Habib Ahmed (2008: 13) argued that without the implementation of effective GCG, Islamic banks would be difficult to be able to strengthen its position, to expand the network and to show its performance more effectively. The need of GCG for Islamic Bank becomes more serious in line with the increasing complexity of the problems encountered, where these problems would erode the bank's ability to confront the challenges in the long term.

The Effect of the Quality of GCG Implementation on the Rate of Return

The result of the research conducted by Dhaniel Syam & Taufik Najda (2012) shows that the quality of GCG implementation does not affect the rate of return on Islamic bank in Indonesia. If the implementation of GCG on Islamic bank is successfully applied in accordance with the rules of Bank Indonesia (BI), the implementation of GCG is able to increase the rate of return (Daniel and Taufik 2012)

The Effect of the Quality of GCG Implementation on the Risk of Financing

The result of the research conducted by Dhaniel Syam & Taufik Najda (2012) shows that the quality of GCG implementation has negative effect on the risk of financing on Islamic Banks in Indonesia. This study shows that the implementation of GCG is able to reduce the risk of financing. The research conducted by Cahaya Ekaputri (2014) also shows the same result that the implementation of GCG can reduce the risk of financing. The stipulation of the rule by Bank Indonesia concerning the implementation of GCG is aimed at reducing the risk of the banking company. If the implementation of GCG on Islamic Bank is successfully applied in accordance with the rules of Bank Indonesia (BI), the implementation of GCG is able to reduce the risk of financing.

The Effect of the Quality of GCG Implementation on Capital

The research by Ika Permatasari & Retno Novitasary (2014) showed that GCG has no effect on Capital Adequacy Ratio (CAR). Banks with a very high CAR value becomes unfavorable for the bank itself. This may indicate that there is a problem in the management of funds in the bank. The size of

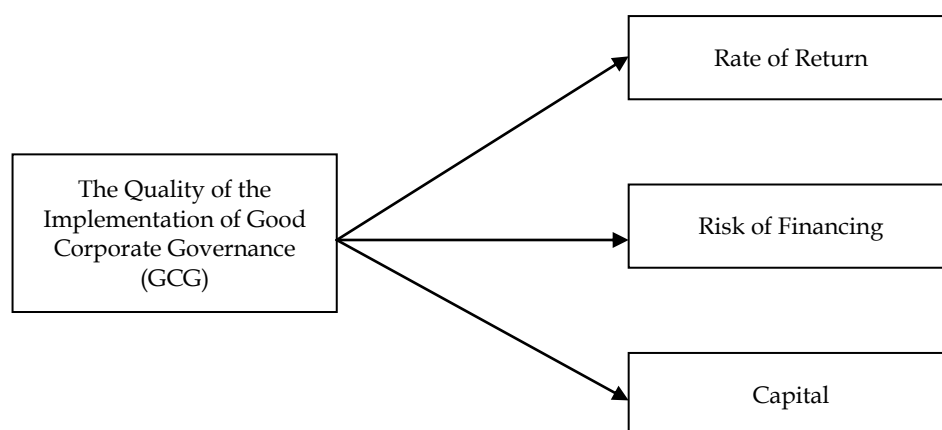


Figure 1
Research Framework

the CAR value indicates the level of the bank's sensitivity to the public interest. If the CAR value is getting higher, the bank is increasingly sensitive to the public interest. However, if the CAR value is low, this indicates that the bank's sensitivity to the public is low. If the implementation of GCG on Islamic Bank is successfully applied in accordance with the rules of Bank Indonesia (BI), the implementation of Good Corporate Governance (GCG) is able to increase bank capital.

Based on the description above and research framework in Figure 1, the research hypothesis can be prepared as follows:

H₁ : The quality of GCG implementation affects the rate of return

H₂ : The quality of GCG implementation affects the risk of financing

H₃ : The quality of GCG implementation affects the capital

3. RESEARCH METHOD

Research Design

Based on the type of research used, this research is using quantitative research, that is the research that use many numbers starting from data collection, data interpretation and the appearance, Sedarmayadi & Syarifudin Hidayat (2002: 31-34). The object of the research is Islamic Banks in Indonesia. Data used in this research is secondary data that is created and published on the company website of Islamic banking companies in Indonesia and Bank Indonesia website. Secondary data in this study are statistical data of Bank Indonesia, company's annual report, and disclosure of GCG report from 2010 to 2013.

Research Variables

The dependent variables are the rate of return,

risk of financing, and capital and independent variable consisting of the quality of GCG implementation.

Operational Definition

The dependent variables are represented by the symbol Y and the independent variables are represented by the symbol x.

Dependent Variable (Y)

The dependent variables are the rate of return measured using Return on Assets (ROA), risk of financing measured using the ratio of Non Performing Financing (NPF), and capital measured using Capital Adequacy Ratio (CAR).

Rate of Return

According to Tandelilin (2001: 125), rate of return is a result obtained from an investor by investing in a prescribed period and will gain a profit on the investment in the future. The calculation of the rate of return is usually done using ratio analysis. The ratio used in this study is the Return on Assets (ROA). The formulation used by Muhammad (2014: 259) is:

$$ROA = \frac{\text{Net Profit}}{\text{Total Assets}} \times 100\% \quad (1)$$

Risk of Financing

Risk of financing is the risk of loss with respect to the borrower cannot or will not fulfill the obligation to repay the loaned funds in full at the maturity date. The calculation of risk of financing is using ratio analysis. The ratio analysis used in this study is Non Performing Financing (NPF). The formulation used by Muhammad (2014: 256) is:

$$NPF = \frac{\text{Non Performing Loan (KL,D,M)}}{\text{Total Loan}} \times 100\% \quad (2)$$

Table 1
The Factors of GCG Implementation on Islamic Bank

No.	Factor	Weight (%)
1.	The implementation of task and responsibility of the Board of Commissioners	12.5
2.	The implementation of task and responsibility of the Board of Directors	17.5
3.	The completion and implementation of task of the committee	10
4.	The implementation of task and responsibility of Islamic Supervisory Board	10
5.	The implementation of Islamic principles in fund raising activities and distribution of funds as well as the service	5
6.	The handling of conflict of interest	10
7.	The implementation of the compliance function of the bank	5
8.	The implementation of internal audit function	5
9.	The implementation of external audit function	5
10.	The maximum limit of funds distribution	5
11.	Transparency of financial and non financial condition, GCG implementation report and internal reporting	15
	Total	100

Source: Bank Indonesia Circular Letter No: 12/13/DPs of 2010.

Capital

Capital of the Bank is represented by the Capital Adequacy Ratio (CAR). CAR is used by Bank Indonesia to classify the health of banks. According to Ismail (2010), CAR indicates the degree of compliance of a bank with the regulations that serve and protect the public interest. In addition, CAR shows the level of sensitivity of the bank to the public interest. The higher the value of the CAR is, the higher the sensitivity of the bank to the public interest. However, if the value of CAR is getting low, this indicates that the sensitivity of the bank to the public is low.

According to Sofyan Safri Harahap (2007: 307), the formula used to calculate CAR is as follows:

$$CAR = \frac{\text{Stock holders Equity}}{\text{Total Risk Weighted Assets (ATMR)}} \times 100\% . \quad (3)$$

Independent Variable

In this study, the independent variable is the quality of Good Corporate Governance (GCG) implementation. It can be measured by the composite value of the level of the quality of the implementation of Good Corporate Governance (GCG) report of the company. In the Islamic Bank is required to conduct a comprehensive self-assessment so that the flaws can be promptly detected.

Based on the suitability of the implementation of Good Corporate Governance (GCG) aspect, Islamic Bank is measured by a composite value of the level of the quality of the implementation of Good Corporate Governance (GCG) report of the company with the assessment factors that have been assigned by Bank Indonesia in Circular Letter No. 12/13/DPbS dated 30 April 2010, which

covers the 11 factors as shown in Table 1.

Population, Sample, and Sampling Technique

The population in this study is the entire Islamic Banks in Indonesia from 2010 to 2013. The method used is purposive sampling. It is a sampling technique, which is done deliberately with the intention to obtain representative samples in accordance with the criteria and limits specified. In general, the criteria used to select the sample are:

1. Islamic Banks which are registered in Bank Indonesia from 2010 to 2013
2. Islamic Banks which publish annual reports from 2010 to 2013
3. The Islamic Banks disclose Good Corporate Governance (GCG) report from 2010 to 2013

Based on the above criteria, the number of samples that meet the requirement is 34 samples.

Data Analysis Technique

The data analysis technique used in this study has the following stages:

Descriptive Analysis

Descriptive statistics provide a picture or description of the data seen from the mean value, standard deviation, variance, maximum, minimum, sum, range, kurtosis and skewness (skewed distribution). In this study, the writers describe descriptive statistics such as mean, maximum, minimum, and standard deviation (Imam Ghazali 2011: 19).

Normality Testing

Normality testing aims to test whether in the regression model, the dependent variable and the

Table 2
Summary of the Results of Simple Regression Test

Regression Equation	Sig
ROA = 1.115 - 0.112X + e	0.732
NPF = 1.654 + 0.683X + e	0.257
CAR = -12.080 + 20.035X + e	0.009

Source: Result of Data Analysis.

independent variable have a normal distribution or not. A good regression model has a normal or nearly normal data distribution. In this study, the data normality test is performed using the Kolmogorov-Smirnov test in one direction. If the statistical value of Z is not significant, the data are concluded to be normally distributed (Imam Ghazali 2011: 160).

Regression Analysis

Simple regression analysis is a study of the dependence of the dependent variable on one or more independent variables. If it is written in the form of equations, the simple regression model is $y = a + bx$, where y is the dependent variable, x is the independent variable, a is the estimator for the intercept or constant (α), b is the estimator for regression (β).

- a. Testing the effect of the quality of GCG on the rate of return with the equation:

$$y = a + bx + e. \quad (4)$$

Where

y = ROA

x = Quality of GCG implementation.

- b. Testing the effect of GCG quality on the risk of financing with the equation:

$$y = a + bx + e. \quad (5)$$

Where

y = NPF

x = Quality of GCG implementation.

- c. Testing the effect of GCG quality on the capital with the equation:

$$y = a + bx + e. \quad (6)$$

Where

y = Capital

x = Quality of GCG implementation

Hypothesis Testing

Hypothesis testing is done to see whether there is a significant relationship between the independent variables and the dependent variables. This test is performed using t test. The t-test is done to see whether the independent variable (x , namely the quality of GCG implementation that is included in the model, has an influence on the dependent variable (y) namely the rate of return, the risk of financing and capital.

Data and Data Collecting

This study uses secondary data, the research data obtained indirectly. Secondary data were obtained from the annual report. The data taken include ROA, NPF and CAR, whereas for the disclosure of Good Corporate Governance (GCG) report of the company is taken from the BI circular letter published on the website of Islamic Banks from 2010 to 2013. The research method used is the method of documentation. The documentation research method is a technique of collecting data through learning, doing analysis and processing the data on the data relating to the variables studied.

4. DATA ANALYSIS AND DISCUSSION

Data Analysis

Simple Regression Testing

The regression model has a constant value of 1.115, which means that if the value of the quality of GCG implementation = 0, the value of ROA will be 1.115. The coefficient value of x (b) is -0.112 indicating that the quality of GCG implementation (x) has negative effect on ROA (Y_1). This means that if the variable of the quality of GCG implementation is improved 100%, there will be a decrease in the dependent variable ROA by 11.2% (see Table 2).

The regression model has a constant value of 1.654, which means that if the value of the quality of GCG = 0, the value of NPF will be 1.654. The coefficient value of x (b) is 0.683 indicating that the quality of GCG implementation (x) has positive effect on NPF (Y_2). This means that if the variable of the quality of GCG implementation is improved 100%, there will be an increase in the dependent variable of NPF by 68.3%.

The regression model has a constant value of -12.080, which means that if the value of the quality of GCG implementation = 0 (no), the value of CAR will be -12.080. The coefficient value of x (b) is 20.035 indicating that the quality of GCG implementation (x) has positive effect on CARs (Y_3). This means that if the variable of the quality of GCG implementation is improved 100%, there will be an increase in the dependent variable of CAR by 2003.5%

Hypothesis Testing

1. The result of the t test is 0.732. It can be concluded that $0.732 > 0.05$, which means that H_0 is accepted and H_1 is rejected. In other words, the quality of GCG does not have significant effect on ROA.
2. The result of t test is 0.257. It can be concluded that $0.257 > 0.05$, which means that H_0 is accepted and H_1 is rejected. In other words, the quality of GCG does not have significant effect on NPF.
3. The result of t test is 0.009. It can be concluded that $0.009 < 0.05$, which means that H_0 is accepted and H_1 is rejected. In other words, the quality of GCG has a significant effect on CAR.

The Effect of the Quality of GCG on Islamic Banks

In the descriptive analysis, it can be seen that the mean value of the quality of the Good Corporate Governance (GCG) implementation on Islamic Banks from 2010 to 2013 is 1.70676. So it can be said that the quality of the Good Corporate Governance (GCG) implementation on Islamic Banks in Indonesia is good. In addition, the category of excellence on the quality of the Good Corporate Governance (GCG) implementation is obtained by PT. Bank Muamalat Indonesia in 2012. None of Islamic Banking in Indonesia got unfavorable predicate. This is reflected in the mean value obtained from the result of self assessment carried out by Islamic Banks in Indonesia with the highest value of 2.525, with the predicate of good enough and the lowest value of 1.150 with the predicate of excellent.

The implementation of Good Corporate Governance (GCG) on Islamic Banks is expected to increase public confidence in Islamic Banks, to maintain the growth of Islamic financial services industry and to stabilize the financial system. The success of the Islamic financial services industry in implementing GCG will put Islamic financial institutions on a level of playing field, which is parallel with other international financial institutions.

The result of this study is supported by the research conducted by Dhaniel Syam and Taufik Nadja (2012) stating that the good implementation quality is not the highest quality of the implementation of Good Corporate Governance (GCG). Islamic Banks receive a good rating if:

1. The entities express the material and relevant information as well as the process of decision making openly;
2. The function and the implementation of ac-

countability are clear;

3. The management of fund raising activities, distribution of funds and services are in accordance with the legislation in force;
4. Islamic Banks apply the principles of sound bank management with the implementation of the internal audit function, external audit and the audit of Bank Indonesia;
5. The Bank meets the rights of the stakeholders well including the handling of conflicts of interest;
6. The commissioner, the directors, the Islamic Supervisory Board (DPS) and the commissions have the competence and are able to act objectively and free from the pressure of any party;
7. There is a check and balance process in the implementation of the tasks of the Commissioners, the Directors, the Islamic Supervisory Board and commissions.

The seventh aspects are reflected in the implementation of all the factors of Good Corporate Governance (GCG). In general the whole Islamic Banks have implemented the eleventh factors of Good Corporate Governance (GCG) as stipulated by the Regulation of Bank Indonesia and there are only a few shortcomings in the application of the indicators of good corporate governance (GCG), particularly with regard to structural aspects of Good Corporate Governance (GCG) in terms of composition and independence of the Islamic supervisory board (DPS).

The Effect of the Quality of GCG Implementation on the Rate of Return

The testing of the first hypothesis (H_1) in this study is to test whether the quality of Good Corporate Governance (GCG) has an effect on the rate of return as measured by Return on Assets (ROA). From the result of hypothesis test, it is known that the quality of GCG implementation has no effect on the rate of return as measured using ROA. This study shows that the Islamic Banks still are not able to reduce the rate of return although the Banks have implemented the GCG properly and in accordance with the Circular Letter of Bank Indonesia. This is contrary to existing theories that theoretically the implementation of GCG is able to add value to the company that produce positive results for the company's performance, which in turn will increase the return (Hennie and Zamir 2011). This is because GCG has not been implemented massively, which means that even though the internal Islamic Bank has implemented GCG properly but the external environment has not

implemented GCG properly. Whereas the external parties such as governments, developers, customers, *mudorib* on the *mudhorobah* financing, the partners on the *musyarokah* financing, developers on the *istishna* financing give a major effect on the company and directly contribute to the company's rate of return.

This result is supported by the research by Dhaniel and Taufik (2012) and the research conducted by Cahaya Ekaputri (2014) stating that the quality of GCG implementation as measured by indicators set by Bank Indonesia does not affect the rate of return. This is probably due to the influence of corporate governance, which tends to be long-term, while the GCG implementation on Islamic Banks in Indonesia has just mandatorily effective since 2010. It is different from the research done by David and Wilopo (2011) which states that the GCG has an effect on the indicators of profitability in the banking sector companies as measured using ROA. This shows that better GCG will increase the level of profitability.

The Effect of the Quality of GCG Implementation on the Risk of Financing

The testing of the second hypothesis (H_2) in this study is to test whether the quality of GCG has an effect on the risk of financing as measured by Non Performing Financing (NPF). From the hypothesis test result it is known that the quality of GCG implementation has no effect on the risk of financing, as measured by the ratio of NPF.

This study shows that the Islamic Banks still are not able to reduce the risk of financing although the Banks have implemented GCG properly and in accordance with the Circular Letter of Bank Indonesia. This is because of the less optimal duties and responsibilities of the Risk Monitoring Committee that should have effectively evaluated the risk management policies and strategies drawn up by the management annually (Khan and Ahmed 2008). Evaluating the directors' accountability report on the implementation of risk management policy is also the responsibility of the Risk Monitoring Committee (Khan and Ahmed 2008).

This study does not support the research conducted by Dhaniel Syam and Taufik Nadja (2012) which indicates that the quality of GCG implementation has an effect on the risk of financing on Islamic Banks in Indonesia. The GCG implementation developed by Bank Indonesia highly concerns on prudential principles where Islamic Banks are required to set up a Risk Monitoring Committee,

under the Board of Directors, whose task is to conduct an evaluation on the risk management policies. In addition, the Islamic Banks are required to conduct an evaluation on the suitability between the risk management policies and the implementation of the policies, and to evaluate the implementation of tasks of Risk Management Committee and Risk Management Unit. This study also does not support the research by Cahaya Ekaputri (2014) which states that the quality of GCG implementation is able to reduce the risk of financing on Islamic banks. The components of governance of Islamic Banks developed by Bank Indonesia by taking into account the prudential principles both in terms of Islamic principles and in terms of risk management have not been entirely implemented. It is due to the ineffectiveness of the Risk Monitoring Committee tasks independently, which means that the Risk Monitoring Committee has not carried out the duties objectively and free from pressure, including in relation to the risk management.

The Effect of the Quality of GCG Implementation on Capital

The third hypothesis (H_3) testing is to test whether the quality of Good Corporate Governance (GCG) has an effect on capital as measured using Capital Adequacy Ratio (CAR). From the hypothesis test result, it is known that the quality of the GCG implementation has an effect on capital as measured using CAR. It shows that if the Islamic Banks have implemented GCG properly and in accordance with the Circular Letter of Bank Indonesia, they are able to increase their capital. Based on the observation of the composite value of GCG on Islamic Banks, PT. Bank Muamalat Indonesia in 2013 had a composite value of 1.150, which means that the predicate of GCG quality is very good, and had the CAR value of 17.27%, which means that the CAR value of the Bank is very good because the $CAR > 12\%$ according to Circular Letter of Bank Indonesia No. 9/24 / DPbS 2007. Additionally, PT. Bank BCA Syariah in 2010 had a composite value of 2.1, which means that the predicate of the GCG quality is good, and has the highest CAR value of 76.39%, which means that the CAR value of the Bank is very good. Thus, it can be said that the quality of the GCG implementation has an effect on CAR.

This study does not support the research conducted by Ika Permatasari & Retno Novitasary (2014) that the composite value of GCG has no effect on CAR. This is due to the less optimal

management of funds, so that the availability of capital is very high.

5. CONCLUSION, IMPLICATION, SUGGESTION, AND LIMITATION

This study aims to determine whether there is an effect of the quality of the GCG implementation on the rate of return, risk of financing and capital on Islamic Banks from 2010 to 2013. From this study, it can be concluded that the quality of the implementation of GCG on Islamic Banks in Indonesia is at a good rating with the composite mean value of 1.7. This means that the quality of GCG implementation in Islamic Banks is good, and the GCG implementation on the Islamic Banks has been in accordance with the Circular Letter of Bank Indonesia No. 12/13/DPbS 2010. The quality of the implementation of GCG has no effect on the rate of return on Islamic Banks in Indonesia as measured using Return on Assets (ROA). The quality of the implementation of GCG has no effect on the risk of financing on Islamic Banks in Indonesia as measured using Non Performing Financing (NPF). The quality of the implementation of GCG has an effect on capital as measured using Capital Adequacy Ratio (CAR). The limitations in this study are (1) the period of investigation used is only four years since the implementation of GCG and its regulations were just implemented in 2010; (2) the variables used are only rate of return, risk of financing and capital. The limitations were also experienced by the researchers as to trace more reliable self-assessment conducted by the sample companies.

From the limitations mentioned above and the limitation in digging the necessary data, the researchers give suggestions for further researchers, among others: (1) For further research, it is expected to extend the period of the study, so that there will be more samples acquired and be able to produce better research. (2) For further research, it is suggested of adding more variables other than the rate of return, risk of financing and capital.

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