

## **The Influence of Islamic Capital Structure, Governance on Risk and Soundness of Sharia Banking**

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### ***Abstract***

*Objective: This study aims to determine the effect of capital structure, governance on the risk and soundness of Islamic banking. Methodology: This research is a quantitative research. The sample in this study was 10 Islamic banking institutions in Indonesia which were analyzed for 10 years from 2011-2020 while the data used in this study were primary data and secondary data. The primary data used in this study was used by using a questionnaire in various management parties related to the health of Islamic Banks with the ANGELS approach. While the secondary data in the study is the data of Islamic banking financial statements for 10 years. Results: The results showed that the capital structure had a positive effect on the health of Islamic banks, while governance and risk had a significant positive effect on the health of Islamic banks. Originality: The originality of this research is an assessment of the health of Islamic banks measured using ANGELS this is because the CAMELS and RGEC methods have often been used by Islamic banks as an assessment of the health of Islamic banks. This research contributes to the importance of capital structure, governance and risk management for Islamic banks in Indonesia so that the health of Islamic banks improves.*

**Key words:** *Islamic Capital Structure, Governance, Risk and Soundness of Sharia banking*

### **1. INTRODUCTION**

Banking is a subsystem in the economy of a country that has a large enough role. Even in the daily life of modern society, most people do not escape the use of services, especially in the Sharia banking sector which aims to improve the Indonesian

economy. The role of Sharia banks as a collector of funds from the public is also a form of savings that has an impact on increasing the economy and equitable distribution of community welfare (Indriastuti & Ifada, 2015:2 and Alamsyah, 2015:3). Sharia banks as banking with Islamic law as a source of economic improvement and funding aimed at community development that avoids usury and is aimed at mobilizing to develop the economy in Indonesia in a fair and equitable manner (Asad, 2011:13; Nengseh, 2015:9). Full attention to Bank Indonesia which is believed to bring benefits that will have an influence on economic growth and be more useful in accordance with the needs of the community (Alamsyah, 2015:2; Sukardi, 2012; and Raharjo, 2011:6).

According to (Sabrina & Huda, 2012:16) the basic problems that become the basis for obstacles to Sharia banking are: (1) faced with the weak quality of Sharia bank performance; (2) weaknesses in the field of organization and management of human resources in Sharia banking; (3) management of financial performance in Sharia banking; (4) weak asset management quality management (5) lack of attention to sensitivity to market risk (sensitivity to market risk). The capital structure used in Sharia banking is different from conventional banks, the capital structure in Sharia banking prioritizes Islamic concepts originating from the profit loss sharing system which is the main guideline for the concept of Sharia banks to advance the concept of monetary economy in the economy. Islam (Hoque & Liu, 2021). Islamic capital structure in Sharia banking is very important to the health of Sharia banks because it is related to the proportion of equity and liability funding of Sharia banks (Kayed, 2014).

The Islamic capital structure is used to determine the extent to which the percentage of Sharia bank funding for financing to its customers is between providing long-term financing with own capital. Long-term financing of Sharia banks is used to carry out a profit-loss sharing financing system for its customers, the profits obtained are based on profit-loss sharing between Sharia banks and customers. Sharia banking governance also needs to be considered according to PBI NO. /8/14/PBI/2006. Stated that banks must apply the principles of openness, accountability, responsibility, independence and fairness. According to POJK No. 55/POJK.03/2016 concerning the determination of governance for commercial banks states that with the increasingly complex risks faced by banks, the practice of good governance for Sharia banks will also increase. Improving the quality of governance is one of the efforts to strengthen the internal condition of Sharia banks. Good governance will later improve the soundness of Sharia banks.

Sharia banks in assessing their health can use ANGELS which is one of the alternative health assessment systems in sharia banking with conceptual principles (Triyuwono, 2011) using the ANGELS approach as a construction concept for health assessments. Sharia banks based on Islamic ethics that function as an assessment of performance in achievement goals of an organization. The ANGELS concept consists of (Amanah management, Non-Economic wealth, Give Out, Earnings, Capital and Assets, Liquidity and Sensitivity to market and economics wealth) (Triyuwono, 2011:10 and Indriastuti & Ifada, 2014:311 and Nurkholis & Kamayanti, 2015:14). Several empirical studies have found that banking strategy has a significant effect on banking health (Hung, 2012: 4 Cosmin, 2013: 8 and Gardo & Klaus, 2020: 10). This is also emphasized by Lee, 2013: 12 The banking industry needs to implement good management practices and strategies to minimize the risks that often occur in banks so

that they can be addressed immediately. Furthermore, by the previous research (Saima et al., 2021: 5) who explains that by conducting a capital structure mediating the risk relationship will improve the company's performance.

The results of the study (Triyuwono, 2011) state that the effect of the ANGELS measurement on Sharia banking is that this concept can conflict with the concepts being practiced such as trust management, accountability to nature and God, indirect participants, mental and spiritual well-being and economic well-being. Furthermore, research conducted by (Indriastuti & Ifada, 2014) the results of this study explain that the assessment of bank health using ANGELS has a good influence on the health of Sharia banks. The latest in research related to the research topic is by assessing the health of Islamic banks using ANGELS. Several strategies for assessing the health of Islamic banking used in Indonesia include using CAMELS, RGEC and ANGELS Barbara & Khairunisa (2019). CAMELS has been recognized for a long time as a sharia bank sound system. 6/10/PBI/2004. CAMELS factors consist of Capital, Asset Quality, Management, Income, Liquidity and sensitivity to market risk Elamer et all, (2020). Furthermore, RGEC as a system for assessing the health of Islamic banks as stipulated in Indonesian bank regulations number 13/1/PBI/2011. RGEC factors consist of risk profile, good corporate governance, income and sources of capital. According to research www does not describe the overall health of the bank. Health bank using angels is expected to be more comprehensive than the camel and rgec methods. Angels consist of trust management, non-economic wealth, gifts, capital and assets, liquidity and sensitivity to markets and economic wealth.

This research is expected to have a contribution to how the influence of Islamic capital structure, governance on the risk and health of Islamic banking. In particular, the contribution of this research is to provide an overview and understanding of ownership studies of Islamic bank business groups to improve the health of Islamic banking and fulfill the needs of customers to be able to compete in the banking industry in accordance with Islamic law.

## **2. THEORETICAL BASIS**

Agency theory explains that in a company there are two parties that interact. These parties include the owners of the company as (shareholders) and managers in the company. Shareholders are called principals while managers are described as people who are authorized by shareholders to run the company which are referred to as agents (Dincer & Gencer, 2015 and Feng & Hui, 2021). Contract agreements carried out by Sharia banks have worldly and ukhrawi consequences because the contract agreements are carried out based on Islamic law. Often customers as agents dare to violate agreements and agreements that have positive law, but this is not the case if the contract agreement has accountability until yaumul qiyammah (Antonio, 2011:35).

Contract agreements made by Islamic banks have worldly and ukhrawi consequences because the contract agreements are carried out based on Islamic law. Often customers as agents dare to violate agreements and agreements that have positive law, but this is not the case if the contract agreement has accountability up to yaumul qiyammah (Antonio, 2001: 35). The essential benefit of an Islamic business contract is to guarantee the benefits of both partners or parties to the contract. When the contract or production process faces problems such as the principal agent problem caused by an imbalance of information and moral hazard, this will be easily minimized in the form of an Islamic contract. So it can be said that if in Islamic economics Islamic

companies implement contracts designed and approved by sharia, then the principal-agent problem will be minimized so that the community will benefit from the principal welfare motive.

Sharia enterprise theory is a theory development based on the example of zakat which has a balance value. The balance value possessed by this theory has consequences that cause this theory not only to focus on the interests of investors (individuals), but also to consider other parties who contribute, so that this theory is considered to have a high sense of care for stakeholders at large. The stakeholders in question include God, humans, and nature. The Islamic capital structure used by Islamic banking is a very important factor to note, this is related to the development and progress of Islamic financial institutions while maintaining public trust (Hoque & Liu, 2021). In Islamic banking, the source of capital acquisition can be obtained from several sources including the founders and shareholders. Shareholders place their capital in Islamic banks in the hope of obtaining future profits. Islamic capital is given an illustration that capital is not only material in the form of money which can later be used to gain profits for the owners of capital but everything that is needed by Islamic banks such as energy, skills, abilities and human skills. Islamic capital is the amount of money or assets given by the provider to the mudharib for business purposes.

Governance in this case includes several indicators, including: independence, transparency, responsibility, and efficiency. Independence means being independent, is a key element or main element in the implementation of governance in a company. Independence means that managers are tasked with monitoring or supervising and controlling the management of opportunistic behavior (Zulfikar & Tuzun, 2021). The greater the level of independence of a company, the more effective the supervision of the implementation of corporate governance in the form of information transparency (Indriawati, 2018). In general, public companies get greater external pressure than private companies, especially pressure on transparency so that generally public companies will focus on short-term financial results generated. In addition, companies with public ownership will make every effort so that company behavior is in line with existing norms in society to legitimize their business activities and avoid bad press due to the low level of disclosure of social responsibility (responsibility) of a company by not forgetting the interests of several stakeholders. Alsaleh & Rahim 2021).

Islamic banking in running its business is faced with risks on a micro and macro scale. Economic recession and business competition, technological advantages, supplier errors, political intervention are potential risks that will be faced by Islamic banks. Risk exists when there is a possibility that the outcome of an event is unknown. Risk is also a change in the movement of unexpected outcomes (Cosmin & Nitu 2013 and Chien, 2013). The State Bank of Pakistan document defines financial risk in banking organizations with the possibility that the outcome of an activity "could bring up adverse impact" (Cosmin & Nitu 2013). This will result in direct losses to the bank's income or capital or to the position of the bank's ability to achieve its business objectives. This will also affect the bank's ability to conduct its business or to gain profits and opportunities to expand its business reach.

### **3. RESEARCH METHODS**

According to Nazir, (2003: 54) what is called research design and design are all processes needed in planning and implementing research. The research design related to the research topic uses a quantitative approach according to Solimun,

(2002:82). Quantitative approach is a science and art related to the procedures and methods of data collection, data analysis and interpretation of the results of the analysis in order to obtain information to obtain conclusions using generalizations. This can be seen from a typological point of view in this study also using explanatory research, namely research on the relationship between variables and other variables. Based on the explanation that has been explained, the conclusion of the type of explanatory research in this study is to explain the influence of Islamic capital structure, governance on the risks and health of Islamic banking.

This study uses primary data which is a source of research data obtained directly from the original source and specifically collected by researchers to answer the researcher's questions, the primary data from this study is a questionnaire (Nazir, 2013: 108). This study uses secondary data is a source of research data obtained by researchers indirectly. Secondary data is generally in the form of evidence, historical records or reports compiled in published archives. Secondary data from this study is in the form of Sharia bank financial statements.

#### 4. DISCUSSION

##### 4.1. Sharia Bank Overview

The government replaces Law no. 7 of 1992 concerning Banking with Law no. 10 of 1998. The law stipulates that banks operate fully in sharia and open a special sharia branch or by opening a special sharia branch. This is the beginning of a period in the banking world which we call the dual banking system. The sharia banking development team views that the enactment of the law is the right momentum for conversion. Therefore, the sharia banking development team immediately prepared the system and infrastructure, so that business activities changed from conventional banks to banks operating based on sharia principles under the name of Pt. Sharia Bank as stated in the Notary Deed: Sutjipto, SH, No. 23 on September 8, 1999.

##### 4.2. Data Analysis

Model 1

ANOVA<sup>a</sup>

Model	Sum of Squares	Df	Mean Square	F	Sig.
1 Regression	1161.381	2	580.691	13.753	.000 <sup>b</sup>
Residual	6966.905	165	42.224		
Total	8128.286	167			

a. Dependent Variable: Kesehatan Perbankan (Y2)

b. Predictors: (Constant), Tata Kelola (X2), Struktur Modal Islam (X1)

Based on the regression results, it can be seen that the regression residual significance value is 0.000, this indicates that each variable is interconnected between the Islamic capital structure variable as a variable (X1) and governance as a variable (X2) and banking health (Y2) has a constant predictor value.

**Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	75.317	2.191		34.378	.000
	Islamic Capital Structure (X1)	4.232006	.000	.376	5.220	.000
	Governance (X2)	-2.277	3.389	-.048	-.672	.503

a. Dependent Variable: Bank Health (Y)

Model path coefficient 1:

Referring to the results of the regression model 1 in the coefficient table, it can be seen that the significance value of the two Islamic capital structure variables (X1) = 0.000 is smaller than 0.05. This result shows that the X1 variable has a significant effect on Y. While governance (X2) = 0.503 greater than 0.05 this result indicates that the X2 variable has no significant effect on Y, because the significant value of 0.503 is greater than 0.05.

**Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.378 <sup>a</sup>	.143	.132	6.49797

a. Predictors: (Constant), Governance (X2), Islamic Capital Structure (X1)

The value of R Square contained in the summary table is 0.143, this shows that the contribution between the influence of Islamic capital structure (X1) and governance (X2) variables on Y is 14.3% while the rest is 85.5%. Is the contribution of other variables that are not included in the study. Meanwhile, to find the value of e can be used with the formula  $e = (1-0.143)$  so that the value of e is 0.93.

Model 2

**ANOVA<sup>a</sup>**

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	15.217	3	5.072	2.117	.100 <sup>b</sup>
	Residual	392.989	164	2.396		
	Total	408.206	167			

a. Dependent Variable: Risk (Y1)

b. Predictors: (Constant), Bank Health (Y2), Governance (X2), Islamic Capital Structure (X1)

Based on the regression results, it can be seen that the regression residual significance value is 0.408, this indicates that each variable is interrelated between the Islamic capital structure variable as a variable (X1) and governance as a variable (X2) and banking health (Y2) has a constant predictor value.

**Coefficients<sup>a</sup>**

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	4.625	1.491		3.101	.002
1 Islamic Capital Structure (X1)	4.671008	.000	.019	.224	.823
Governance (X2)	.749	.809	.071	.927	.355
Risk (Z)	-.041	.019	-.183	-2.208	.029

a. Dependent Variable: Risk (z)

Based on the output of regression model 2 in the table coefficient section, it is known that the significance value of the three variables Islamic capital structure (X1) is 0.376, this shows that Islamic capital structure has an effect on risk (z). while the value of the governance variable (X2) is 0.48, this indicates that governance has an effect on risk (z). while the value of Sharia banking Health is 0.029, this indicates that the risk does not affect the health of Sharia banking because the value is greater than 0.05.

**Model Summary**

R	R Square	Adjusted R Square	Std. Error of the Estimate
.193 <sup>a</sup>	.037	.020	1.54799

a. Predictors: (Constant), Kesehatan Perbankan (Y2), Tata Kelola (X2), Struktur Modal Islam (X1)

Based on the R square value contained in the model summary table, it is 0.037, this indicates that the contribution of X1, X2 and Y to Z is 37% while the rest is 63%. Is a contribution from other variables that are not examined for the value of e of 0.98.

## 5. CLOSING

The conclusion of the article shows that the Islamic capital structure has an effect on the health of Sharia banking, this is because the value is 0.00 which indicates that the value of the variable x1 is smaller than the significance value of 0.05 so that this identifies that the Islamic capital structure will affect the health of Sharia banking. Furthermore, governance (X2) shows that there is no effect on the health of Sharia banking, this is evident from the test using a regression of 0.505. This indicates that governance management has no effect on the health of Sharia banking. Furthermore, in testing the relationship between risk and the health of Sharia banking, it shows that the value of the variable Z = 0.029, this indicates that the risk does not affect the health of Sharia banking because the value is greater than 0.05.

There are limitations in this study, including limitations in this study related to secondary data, this is because the number of Sharia banking in Indonesia registered with the OJK is 14 Sharia banks, so the study uses times series data in obtaining secondary data in Sharia banking. In this study, there are still many research gaps as described in the hypothesis (Bringham and Douston, 2006) the greater the capital

required, the cost of capital will also increase, if the cost of capital increases, the company's profit will decrease so that performance also decreases. This is also confirmed by research from (Rustendi, 2011) regarding the analysis of bank soundness based on capital adequacy, asset quality, earning, management, profitability and liquidity partial results of hypothesis testing only management has a significant effect on bank soundness while simultaneously capital adequacy . Thus, it is necessary to support further studies to examine the relationship between Islamic capital structure and the health of Sharia banking.

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