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Analysis of the Influence of Sharia Business Risk on the Financial Performance of Sharia Banking with Islamic Corporate Governance as a Moderating Variable

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Abstract

This study aims to examine the impact of credit risk (NPF), liquidity risk (FDR), and capital adequacy risk (CAR) on the financial performance of Islamic banks (ROA), with Islamic Corporate Governance (ICG) as a moderating variable. The research data consists of 12 units of analysis, focusing on Islamic commercial banks registered with the Financial Services Authority (OJK) of the Republic of Indonesia for the period 2016-2020. The data were analyzed using Moderate Regression Analysis (MRA) with IBM SPSS 26 as the tool. The study's results indicate that credit risk (NPF) does not have a positive and significant effect on the financial performance of Islamic banks (ROA). In contrast, liquidity risk (FDR) and capital adequacy risk (CAR) do not have a positive effect but has a significant impact on the financial performance of Islamic banks (ROA). Islamic Corporate Governance (IKI) does not significantly and positively moderate the effect of credit risk on the economic performance of Islamic banks. However, Islamic Corporate Governance can moderate the impact of liquidity risk and capital adequacy risk on the financial performance of Islamic banks positively and significantly.

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INTRODUCTION

Islamic banking has an important role in supporting economic growth based on Islamic values by offering appropriate products and services with sharia principles. In its operations, sharia banking faces various business risks that can influence financial performance, including risk credit, risk liquidity, and risk capital adequacy (Chapra, 2008). Risk business in Islamic banking becomes more complex because of the existence of prohibitions on interest (riba), uncertainty (gharar), as well as speculation (maysir) in transaction finance (Dusuki & Abdullah, 2007).

The financial performance of Islamic banking is often measured by various indicators, one of which is Return on Assets (ROA), which reflects the level of bank profitability in generating profits from its total assets (Beck, Demirgüç-Kunt, & Merrouche, 2013). Suboptimal risk management, especially credit risk as measured by Non-Performing Financing (NPF), liquidity risk as measured by Financing to Deposit Ratio (FDR), and capital adequacy risk as measured by Capital Adequacy Ratio (CAR), can have a negative impact on the financial performance of Islamic banking, which in turn affects the competitiveness and sustainability of this industry amidst global competition (Ahmed, 2011; Songling, Ishtiaq, & Anwar, 2018).

This study offers a novel contribution by exploring the influence of Islamic Corporate Governance (ICG) as a moderating variable in the relationship between sharia business risk and the financial performance of Islamic banking. Islamic Corporate Governance (ICG) plays an important role in ensuring that Islamic banking operates in accordance with good Sharia principles and can increase transparency and accountability in risk management, which is ultimately expected to improve financial performance (Farook, Hassan, & Lanis, 2011a). This study is different from previous studies that focus more on analyzing the influence of risk factors without considering the role of sharia management that can moderate the relationship.

One of the important findings in Dewi (2020) research shows that the Capital Adequacy Ratio (CAR) has a positive and significant effect on ROA with a regression coefficient of 0.076, which means that the higher the CAR ratio, the greater the positive effect on the profitability of Islamic banking. However, this study introduces a new dimension by adding the role of ICG in managing this influence, given the large amount of evidence showing that ICG plays a role in improving operational risk management and increasing the effectiveness of internal supervision (Al-Tamimi, 2012).

This study uses Agency Theory, which describes the relationship between shareholders (principals) and managers (agents) in the context of Islamic bank management (Jensen & Meckling, 1976). This theory is relevant to risk management because it explains the potential for conflicts of interest that can affect decision making related to risk management and financial performance. In addition, Good Governance Theory is also used to analyze the role of ICG in increasing transparency and accountability of Islamic banking in managing business risks (Farook et al., 2011a).

Several previous studies support the importance of risk management in improving the financial performance of Islamic banking. Dewi (2020) found that CAR has a positive effect on ROA, indicating that banks with higher capital ratios are more able to manage operational risk more effectively. In addition, research by Al-Tamimi (2012) highlighted the role of the Sharia Supervisory Board (SSB) in improving the effectiveness of risk management in Islamic banking. Farook, Hassan, & Lanis (2011b) also emphasized the importance of ICG in ensuring that Islamic banks operate in accordance with sharia principles, which can help improve financial performance in a more transparent and accountable manner.

This study aims to analyze the effect of sharia business risk on the financial performance of Islamic banking, focusing on three main aspects: credit risk (NPF), liquidity risk (FDR), and capital adequacy risk (CAR). In addition, this study explores the role of Islamic corporate governance as a moderating variable that can improve the relationship between business risk and financial performance. Thus, this study is expected to contribute to the development of more effective risk management strategies and improve the quality of sharia governance applied in the Islamic banking industry.

METHOD

The population in this study is Islamic Commercial Banks (BUS) registered with the Financial Services Authority (OJK) in the 2016-2020 period. The number of Islamic Commercial Banks registered with the OJK is 14 BUS. The sample determination was carried out using the purposive sampling method, where only BUS, which publishes annual reports through the official OJK website, was used as samples. Based on these criteria, 2 BUS did not meet the criteria and 12 other BUS met the criteria, so the number of samples obtained was 12 BUS. The observation period used in this study was 5 years (2016-2020), with a total analysis unit of 60 (12 BUS × 5 years of observation) . The results of the sample selection are presented in the following table:

Table 1. Sample Selection Process

No	Criteria	Does Not Meet Criteria	Enter Criteria
1	Sharia Commercial Banks registered with the Financial Services Authority (OJK)		14
2	Islamic General Banks that publish annual reports via the official OJK website for Islamic General Banks 2016-2020	(2)	12
	Number of Companies		12
	Observation year		5
	Unit of analysis		60

Source: Secondary data processed, 2023

Based on previous theories and research, the estimation model built in this study is as follows:

$$Y_{it} = \alpha + \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \beta_4 X_{1it} * Z_{it} + \beta_5 X_{2it} * Z_{it} + \beta_6 X_{3it} * Z_{it} + e_{it}$$

$$ROA_{it} = \alpha + \beta_1 NPF_{it} + \beta_2 FDR_{it} + \beta_3 CAR_{it} + \beta_4 NPF_{it} * LNICG_{it} + \beta_5 FDR_{it} * LNICG_{it} + \beta_6 CAR_{it} * LNICG_{it} + e_{it}$$

The definition of Capital Adequacy for each variable is presented in the following table:

Table 2. Definition of Variable Capital Adequacy

Variables	Definition	Measurement	Source
Dependent Variable			
Financial Performance (ROA)	Return on Assets is an overall measure of profitability calculated by dividing net income by average total assets.	$ROA = \frac{\text{Laba bersih setelah pajak}}{\text{Total aset}} x100\%$	(Ruvenda, Ahmad, & Nasution., 2022)
Independent Variables			
Credit risk (NPF)	Non-Performing Financing (NPF) is a ratio that compares the amount of financing experiencing problems or bottlenecks with the amount of financing distributed by financial institutions.	$NPF = \frac{\text{Kredit macet}}{\text{Pembiayaan yang disalurkan}} x100\%$	(Melinda, Hidayati, & Sari, 2021)
Liquidity Risk (FDR)	The FDR ratio is a ratio that assesses bank liquidity by dividing the amount of financing provided by third party funds.	$FDR = \frac{\text{Total pembiayaan}}{\text{Total dana}} x100\%$	(Iqbal, Arifin, & Rahman, 2018)
Capital Adequacy Risk (CAR)	*Capital Adequacy Ratio* (CAR) is a capital ratio showing the bank's ability to provide funds for business development purposes and accommodate the risk of losses resulting from the bank's operational activities.	$CAR = \frac{\text{Modal}}{\text{Aset terimbang menurut rasio}} x100\%$	(Nafasati, Prabowo, & Haryanto, 2021)
Moderating Variables			
Islamic Corporate Governance	A system that includes structures and processes used to direct, manage and control a business transparently and concerning Islamic principles.	2011 KNKG GGBS Index	(Romadhonia, Sulastri, & Nasution 2019)

Source: Compiled from various sources, 2023

Based on previous theories and research, the hypothesis in this study is as follows:

The Risk and Return Theory states that banks with high credit risk will face the potential for significant losses. The decline in financing quality reflected in the increasing NPF ratio will affect the bank's net profit, leading to a decrease in Return on Assets (ROA) (Siregar, & Fitriani, 2020; Melinda, Hidayati, & Sari, 2021). A study by Hakim, & Mawardi. (2019) shows that a high NPF ratio can reduce bank profitability, and poor credit risk management has a negative impact on ROA. Therefore, increasing NPF tends to reduce the financial performance of Islamic banks (Tandelilin, 2010).

H1: Credit risk (NPF) has a negative and significant effect on the financial performance of Islamic banks (ROA).

Liquidity Theory shows that banks that can manage liquidity well through a high FDR ratio have a greater capacity to provide financing without sacrificing financial stability. This can improve the bank's overall performance, which is reflected in ROA (Iqbal, 2018). Research by Iqbal, Arifin, & Rahman (2018) shows that banks with high FDR ratios have a greater ability to provide profitable financing. With good liquidity management, banks can maximize profit potential, which increases ROA.

H2: Liquidity risk (FDR) has a positive and significant effect on the financial performance of Islamic banks (ROA).

Banking Finance Theory explains that the Capital Adequacy Ratio (CAR) is the leading indicator for banks to assess how strong their capital position is in facing the risk of loss. Banks with high CAR are better able to absorb losses and maintain financial stability, ultimately contributing to increasing ROA (Nafasati, Prabowo, & Haryanto, 2021). Aziz, & Darwanis (2019) show that high CAR provides more confidence to customers and investors. With sufficient capital, banks can better manage risks and optimize their business operations, leading to increased ROA.

H3: Capital adequacy risk (CAR) has a positive and significant effect on the financial performance of Islamic banks (ROA).

Corporate Governance Theory emphasizes that good governance will reduce risk, improve resource management, and improve financial performance. In the context of Islamic banking, implementing good Islamic Corporate Governance (ICG) will help reduce the negative impact of credit risk on bank performance (Romadhonia, Sulastri, & Azhari, 2019). Afandy, Usman, & Zoraya (2021) revealed that implementing ICG can improve supervision of financing management practices and risk mitigation, which in turn can reduce the negative impact of credit risk (NPF) on the performance of Islamic banks. Good ICG will improve the decision-making process, improving the bank's financial performance.

H4: Islamic Corporate Governance is able to positively and significantly moderate the influence of sharia business risk (credit risk (NPF)) on sharia bank performance (ROA).

Islamic Governance Theory focuses on the principles of transparency, accountability, and risk management in order to maintain the operational integrity of Islamic banks. Islamic Corporate Governance (ICG) is expected to improve the bank's liquidity management strategy and its impact on financial performance (Romadhonia, Sulastri, & Azhari, 2019). Properly implemented ICG can optimize resource management, including liquidity. This will improve operational efficiency and help Islamic banks maintain profitability despite facing high liquidity risks, as explained by Romadhonia, Sulastri, & Azhari, (2019).

H5: Islamic Corporate Governance is able to positively and significantly moderate the influence of sharia business risk (liquidity risk (FDR)) on sharia bank performance (ROA).

Corporate Governance Theory in the Islamic context shows that strong ICG can improve capital management and reduce uncertainty, thereby improving bank financial performance. Thus, ICG is expected to strengthen the positive relationship between CAR and ROA (Romadhonia et al., 2019). Better capital management through the implementation of ICG allows banks to optimize the use of capital in developing their businesses and reduce the risk of losses. This supports the improvement of the overall performance of Islamic banks, as found by Romadhonia, Sulastri, & Azhari (2019).

H6: Islamic Corporate Governance is able to positively and significantly moderate the influence of sharia business risk (capital adequacy risk (CAR)) on sharia bank performance (ROA).

Before conducting panel data regression analysis with the Moderated Regression Analysis (MRA) approach, this study first tests the classical assumptions which are an important step to ensure the validity of the regression analysis results. This classical assumption test is carried out to check whether the data used meets the requirements for linear regression, as well as to ensure that the model built does not produce bias or misinterpretation (Ajija, 2011; Ghozali, 2016).

1. Normality Test, is used to check whether the residual data from the regression model follows a normal distribution. One method used is the Jarque-Bera Test or can also use graphs such as QQ plots. If the residual model is normally distributed, then the normality assumption can be said to be met.
2. Multicollinearity Test, is conducted to ensure that there is no high correlation between independent variables that can cause bias in the estimation of the regression coefficient. This is done by examining the Variance Inflation Factor (VIF). If the VIF value for each independent variable is less than 10, then multicollinearity is not a problem in the model.
3. Heteroscedasticity Test, is used to test whether the error variance (residual) is constant across all observation levels. The Breusch-Pagan Test or the White Test can be used to detect heteroscedasticity. If heteroscedasticity is found, the model must be improved, for example by using a robust regression model.
4. Autocorrelation Test, is conducted to check whether there is a relationship between errors (residuals) in different observations. The Durbin-Watson test is often used to detect autocorrelation. Durbin-Watson values approaching 2 indicate no autocorrelation.

In this study, panel data regression method is used to analyze the relationship between predetermined variables. The approach used is Moderated Regression Analysis (MRA) with panel data. MRA allows to test the interaction between independent variables and moderating variables to see how moderating variables (in this case, Islamic Corporate Governance) can moderate the influence of independent variables (credit risk, liquidity risk, and capital adequacy risk) on the financial performance (ROA) of Islamic banks. This panel data regression combines time series data and cross-section data, which provides advantages in analyzing long-term effects and inter-bank effects in one period. In this analysis, the Fixed Effect Model (FEM) or Random Effect Model (REM) is selected based on the results of the Hausman test to determine the model that is more appropriate to the characteristics of the data. This model allows for a more comprehensive and accurate analysis, so that it can take into account variations that exist both between time and between banks. In general, by using MRA in panel data regression, this study can explore not only the direct influence of independent variables on the financial performance of Islamic banks, but also the moderated impact of Islamic Corporate Governance, thus providing a deeper understanding of the dynamics occurring in Islamic banking.

RESULT AND DISCUSSION

Descriptive statistical analysis in this study was used to determine the mean, maximum, minimum and standard deviation values of the research data. The results of the descriptive statistical analysis are presented in the following table:

Table 3. Descriptive Statistical Analysis

Descriptive Statistics					
	N	**Minimum**	**Maximum**	**Mean**	**Std. Deviation**
NPF (Independent Variable)	60	.0032	.1194	.032919	.0252309
FDR (Independent Variable)	60	.3916	.9572	.769835	.1437729
CAR (Independent variable)	60	.1123	.3143	.190414	.0477885
ROA (Independent variable)	60	-.0125	.0190	.006149	.0065907
ICG (Moderation variable)	60	.8000	1.0000	.913181	.0573239
Valid N (listwise)	60				

Source: Processed data, 2024

The results of the descriptive statistical analysis show that the variables analyzed have moderate variations. For NPF (Non-Performing Financing), the average ratio of non-performing financing in the Islamic banks studied was around 3.29%, with quite significant variations, indicating differences in credit risk management between banks. In the FDR (Financing to Deposit Ratio) variable, the average ratio of financing to third party funds reached 76.98%, reflecting the tendency of Islamic banks to maintain a balance between financing provided and funds collected. CAR (Capital Adequacy Ratio) shows an average capital adequacy ratio of 19.04%, with variations indicating differences in capital readiness between banks. Furthermore, ROA (Return on Assets) has a low average value, which is 0.62%, indicating that the Islamic banks analyzed generally face challenges in achieving high levels of profitability. Finally, in the ICG (Islamic Corporate Governance) variable, the average Islamic corporate governance index shows a fairly high figure, namely

91.32%, which indicates that most banks have implemented good governance in accordance with Islamic principles. Overall, these data provide an overview of the dynamics of performance and risk management in Islamic banks, and show variations between banks in these aspects.

Based on the results of the classical assumption test that has been conducted, it can be concluded that the data in this study meets all the basic assumptions required for regression analysis, namely normality, no significant multicollinearity, no heteroscedasticity problems, no autocorrelation problems, and the relationship between variables is linear. Therefore, the regression model used is reliable and the results obtained from the regression analysis can be trusted for further hypothesis testing. The following is a table that presents the results of the classical assumption test:

Table 4. Classical Assumption Test

Classical Assumption Test	Test Results	Interpretation
Normality Test	Kolmogorov-Smirnov significance: 0.341	The results of the normality test show a significance value greater than 0.05, which means there is insufficient evidence to reject the null hypothesis that the data is normally distributed. The data of this study can be considered normally distributed.
Multicollinearity Test	VIF: NPF = 2.13, FDR = 1.87, CAR = 3.45	The results of the multicollinearity test show that the VIF value for all independent variables is below 10, which means that there is no significant multicollinearity between the independent variables in the regression model.
Heteroscedasticity Test	Significance > 0.05	The results of the heteroscedasticity test show that the significance value is greater than 0.05, which means that there is no problem of residual variance irregularity in the regression model, so the heteroscedasticity assumption is met.
Autocorrelation Test	Durbin-Watson: 1.85	The results of the autocorrelation test show that the Durbin-Watson value is in a reasonable range (1.5 - 2.5), which indicates that there is no autocorrelation problem in the data. This regression model is free from autocorrelation.

The results of hypothesis testing in this study are presented in the following table:

Table 5. Hypothesis Testing Results

Hypothesis	Regression Coefficient	Sig.	Alpha	Decision/ Result
Intercept	0.004	0.0132	0.002	Accepted
H1: Credit risk has a negative and significant effect on the financial performance of Islamic banks.	-0.095	0.538	0.05	Rejected
H2: Liquidity risk has a positive and significant effect on the financial performance of Islamic banks.	-0.047	0.002	0.05	Rejected
H3: Capital adequacy risk has a positive and significant effect on the financial performance of Islamic banks.	-0.099	0.042	0.05	Rejected
H4: *Islamic corporate governance* is able to negatively and significantly moderate the influence of credit risk on the financial performance of Islamic banks.	-0.166	0.327	0.05	Rejected
H5: *Islamic corporate governance* is able to positively and significantly moderate the influence of liquidity risk on the financial performance of Islamic banks.	0.049	0.003	0.05	Accepted
H6: *Islamic corporate governance* is able to positively and significantly moderate the influence of capital adequacy risk on the financial performance of Islamic banks.	0.144	0.008	0.05	Accepted

Source: Secondary data processed, 2024

$$ROA_{it} = 0{,}004 + 0{,}0095\ NPF_{it} - 0{,}047FDR_{it} + 0{,}099CAR_{it} - 0{,}166\ NPF_{it} * LNICG_{it} + 0{,}0049\ FDR_{it} * LNICG_{it} + 0{,}144CAR_{it} * LNICG_{it} + e_{it}$$

The Influence of Credit Risk on the Financial Performance of Islamic Banks

The results of the study indicate that credit risk as measured by Non Performing Financing (NPF) has a negative but insignificant effect on the financial performance of Islamic banks as measured by Return on Assets (ROA). This shows that although increasing credit risk tends to decrease profitability, the effect is not statistically strong enough to be considered significant. Thus, the first hypothesis (H1) in this study is rejected.

This finding is in line with the research results of Suwarno, & Muthohar (2018); Alfian, & Laila (2018), which also stated that NPF has no significant effect on the financial performance of Islamic banks. This indicates that although NPF is an important indicator in reflecting the quality of bank financing, its direct effect on ROA can be minimized by good risk management factors or support from other financial variables.

In theory, a high NPF indicates weak financing quality, which can reduce bank income and increase the burden of loss provisions, thereby suppressing financial performance (Gitman & Zutter, 2012; Kusnandar, 2022). Therefore, although empirical results show an insignificant relationship, credit risk still needs to be a primary concern in the financial management of Islamic banks to maintain the stability and sustainability of their businesses.

The Influence of Liquidity Risk on the Financial Performance of Islamic Banks

The results of this study indicate that liquidity risk, as measured by the Financing to Deposit Ratio (FDR), does not have a positive and significant effect on the financial performance of Islamic banks, so the second hypothesis in this study is rejected. This insignificance indicates that an increase or decrease in the FDR ratio does not immediately affect financial performance as measured by Return on Assets (ROA). Theoretically, this can be explained through the Liquidity-Profitability Trade-off Theory, which states that there is a dilemma between maintaining liquidity and pursuing profitability. If banks focus on high liquidity, most of the funds will be stored in the form of liquid assets with low yields, thereby reducing profits. Conversely, focusing on profitability can increase liquidity risk if funds are allocated too aggressively to financing (Wastuti, 2022).

This study is in line with the findings of Aziz, & Darwanis (2019) who stated that FDR does not have a significant effect on the ROA of Islamic banks in Indonesia, because a high FDR ratio does not always guarantee high financing quality. When financing is not managed properly or is channeled to less productive sectors, the potential profit obtained is also low even though the volume of financing increases. A similar thing was also conveyed by Sutrisno and Riyadi (2020) who explained that banks need to maintain a balance between the level of liquidity and financing quality so that they do not only focus on the amount of financing distribution, but also on its efficiency and effectiveness in generating profits.

According to Iqbal (2018); Jan, et..al., (2019) FDR reflects the level of bank trust in distributing funds collected from third parties. This ratio is also an indicator of the vulnerability and ability of the bank to manage its funds productively. An FDR ratio that is too high has the potential to cause liquidity problems, while an FDR that is too low indicates that funds are not being utilized optimally. Therefore, the effect of FDR on ROA cannot be seen linearly, but depends on managerial conditions and financing efficiency .

The Influence of Capital Adequacy Risk on the Financial Performance of Islamic Banks

The results of this study indicate that capital adequacy risk, as measured by the Capital Adequacy Ratio (CAR), has a negative and significant effect on the financial performance of Islamic banks, as measured by Return on Assets (ROA). This finding indicates that the higher the CAR, the lower the bank's financial performance. Thus, the third hypothesis is rejected.

In theory, these results can be explained through the perspective of Trade-Off Theory, which states that increasing capital (capital buffer) can indeed strengthen the financial stability of banks in the long term, but in the short term it can reduce efficiency and profitability because funds that should be allocated for productive financing are actually "parked" as capital reserves. CAR that is too high can indicate that the bank is too careful or not optimal in utilizing its capital to generate profits, thus having a negative impact on ROA.

This study is supported by the findings of Siregar, & Fitriani (2020) which stated that CAR has a significant negative effect on ROA in Islamic commercial banks in Indonesia. This occurs because most of the bank's capital is not used productively, especially in less competitive market conditions. The same thing was also expressed by Hakim and Mawardi (2019), who stated that high CAR indicates excess capital that is not followed by an increase in efficient financing, so profitability decreases.

In practice, banks with high CAR levels do look safe in terms of capital resilience, but they can lose potential profits from investment or financing opportunities. Therefore, there needs to be a balance between capital adequacy and optimization of productive assets to ensure that banks remain capable of facing risks while creating stable profitability .

Islamic Corporate Governance Moderates the Effect of Credit Risk (NPF) on Islamic Banking Financial Performance (ROA)

Based on the results of hypothesis testing, it was obtained that the interaction variable between credit risk (NPF) and Islamic Corporate Governance (ICG) has a negative regression coefficient of -8.247 with a significance level of 0.402 (> 0.05). This shows that although the direction of the relationship between credit risk and financial performance (ROA) tends to be negative when moderated by ICG, the effect is not statistically significant. Thus, the hypothesis stating that Islamic Corporate Governance is able to positively and significantly moderate the effect of credit risk on the financial performance of Islamic banks is rejected.

This finding indicates that the existence of sharia-based governance has not been able to strengthen or weaken the negative influence of credit risk on the profitability of sharia banks. This could be caused by the implementation of ICG principles that have not been running optimally in all aspects of financing risk management or have not been effectively integrated into decision-making related to the quality of bank productive assets.

According to Antonio (2001); Tashkandi, (2022), ICG should act as an internal supervision system that maintains integrity and prudence in the management of Islamic bank financing. However, when this supervision mechanism does not run effectively or is not balanced with adequate managerial competence, its function in reducing the risk of non-performing financing (NPF) is not optimal (Kasmir, 2016).

In line with this, Alam et.al., (2011) in their research also showed that the influence of the sharia supervisory board and sharia governance principles on the financial performance of Islamic banks often depends on the level of independence, competence, and intensity of supervision applied in the organization. Therefore, the existence of ICG does not necessarily have a significant impact on the relationship between financing risk and financial performance if it is not accompanied by the implementation of strong and sustainable governance principles.

Islamic Corporate Governance Moderates the Effect of Liquidity Risk (FDR) on Financial Performance (ROA) of Islamic Banking

The results of the study indicate that Islamic Corporate Governance (ICG) plays a significant role in moderating the relationship between liquidity risk (FDR) and financial performance (ROA) in Islamic banking. The interaction coefficient value between FDR and ICG is 3.985 with a significance level of 0.002, which is below the critical limit of 0.05. This means that ICG has a positive and significant influence on strengthening the relationship between FDR and ROA. Thus, the hypothesis that Islamic Corporate Governance is able to positively and significantly moderate the effect of liquidity risk on the financial performance of Islamic banks is accepted.

This finding indicates that the implementation of good sharia governance principles in sharia banking organizations is able to strengthen the effectiveness of liquidity risk management, thereby increasing bank profitability. In this context, Islamic Corporate Governance functions as an internal control system that directs strategic decisions to remain in accordance with sharia principles and maintains a balance between the use of funds and the bank's ability to meet short-term obligations.

According to Zarkasyi (2008), Wibowo, (2022) good governance in an Islamic perspective emphasizes the principles of transparency, fairness, and responsibility, which if applied consistently can increase public trust and encourage bank operational efficiency. In addition, Farook, Hassan, & Lanis, (2011a; 2011b) also emphasized that the role of the sharia supervisory board and a strong control system are key factors in ensuring that managerial decisions in fund management (such as FDR) do not conflict with the principles of prudence and sharia. Thus, strengthening Islamic Corporate Governance is an important strategy in creating financial stability and positive performance of Islamic banks, especially in the context of liquidity risk management.

Islamic Corporate Governance Moderates the Effect of Capital Adequacy Risk (CAR) on Islamic Banking Financial Performance (ROA)

The results of this study indicate that Islamic Corporate Governance (ICG) moderates the relationship between capital adequacy risk (CAR) and financial performance (ROA) in Islamic banking with a significant influence. The interaction coefficient value between CAR and ICG is 0.00 which indicates a positive direction, while the significance value of 0.002, which is lower than 0.05, indicates that there is a significant influence of ICG in moderating the relationship between capital adequacy risk and financial performance. However, this very small coefficient value indicates that the influence of ICG in strengthening the relationship is not practically significant.

This finding illustrates that although statistically Islamic Corporate Governance moderates the relationship between CAR and ROA, the moderating effect tends not to be large enough to significantly impact Islamic banks' financial performance. One possible explanation is that capital adequacy risk as measured by the Capital Adequacy Ratio (CAR), although important, is not always followed by a direct impact on profitability if the bank already has strong internal controls and strict compliance with Islamic principles. Therefore, although ICG plays a role in ensuring better risk management, its effect on improving the financial performance of Islamic banks is not significant enough (Budi, et.al., 2019; Ferriswara, & Rahayu, 2022).

It is important to note that ICG contributes to maintaining stakeholder trust and ensuring that risk management is carried out responsibly and in accordance with sharia principles. This is in line with the view of Zarkasyi (2008), Mahardikasari (2019) who stated that the implementation of good ICG in the context of sharia can improve risk management in banks, including capital adequacy risk. However, the effectiveness of ICG in improving financial performance is highly dependent on other factors, such as the implementation of efficient managerial policies and a deep understanding of sharia principles in bank operations (Ben Abdallah, & Bahloul, 2022). Thus, the hypothesis that Islamic Corporate Governance is able to significantly moderate the effect of capital adequacy risk on the financial performance of sharia banks is accepted, although its influence is not large enough to practically increase bank profitability (Sukardi, Abdullah, & Dhiya, 2022).

Determination Coefficient Results

The results of the determination coefficient show an *Adjusted R Square value* of 0.430. This means that 43% The results of the regression analysis show an Adjusted R Square value of 0.430, which indicates that 43% of the Financial Performance (ROA) variable can be explained by the Sharia Business Risk variable (including credit risk, liquidity risk, and capital adequacy risk) and Islamic Corporate Governance (ICG) as a moderating variable. This means that these factors contribute significantly to explaining the financial performance of Islamic banks, although there is still around 57% variability in financial performance influenced by other factors not included in this research model.

This means that, although the variables used in this study provide sufficient explanation for the financial performance of Islamic banks, there are external factors or other variables that also have an influence, which may need to be considered in further research, such as macroeconomic conditions, banking regulations, or other internal factors such as managerial policies and technology used by banks.

CONCLUSION AND RECOMMENDATION

The results of this study indicate that credit risk (NPF) has a positive but insignificant effect on the financial performance of Islamic commercial banks (BUS), which means that although there is a relationship between these two variables, the impact is not strong enough to significantly affect financial performance. Liquidity risk (FDR) also does not show a positive and insignificant effect on the financial performance of BUS, which indicates that although the level of liquidity affects bank operations, it is not strong enough to affect the profitability of Islamic banks in the short term.

However, capital adequacy risk (CAR) is proven to have a positive and significant effect on BUS's financial performance, which means that the higher the capital adequacy, the better the bank's financial performance. This reflects the importance of adequate capital management to maintain the stability and profitability of Islamic banks, especially when facing market and operational risks.

On the other hand, Islamic Corporate Governance (ICG) is unable to positively and significantly moderate the influence of credit risk and capital adequacy risk on BUS financial performance, which indicates that the management of sharia corporate governance in this case has not provided a significant impact in improving the relationship between these risks and financial performance. However, ICG managed to positively and significantly moderate the influence of liquidity risk on BUS's financial performance, which indicates that good corporate governance practices can strengthen the relationship between sufficient liquidity and the financial performance of Islamic banks.

Based on these findings, the recommendation for further research is for researchers to use proxies or other factors that may affect the financial performance of Islamic banks, such as disclosure of Islamic corporate responsibility, inflation, interest rates, and third-party funds. In addition, this study only uses data from Islamic commercial banks (BUS), so it is recommended that further research include data from Islamic business units, which are also part of Islamic banking, to obtain a more comprehensive picture.

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