



The role of Islamic corporate governance in enhancing social and financial performance: evidence from Indonesia's Islamic bank sector

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Abstract

Purpose - This study examines how Islamic corporate governance affects the social and financial performance of Islamic banks in Indonesia.

Method - The study uses panel regression on time-series and cross-sectional data from Indonesian Islamic banks. Four ICG proxies are used: independent sharia board, sharia board size, sharia board competence, and sharia board gender. Social and financial performance are measured by corporate social responsibility disclosure and return on assets, respectively. Financial stability is included as a moderating variable. Analysis is conducted in Stata 17.

Result - The results show that certain ICG dimensions significantly influence both social and financial performance. Additionally, financial stability amplifies ICG's positive impact on performance, underscoring the importance of a stable financial environment for enhancing governance effectiveness.

Implication - The findings offer meaningful insights into governance mechanisms and inform policy on strengthening Sharia board roles within Islamic financial institutions.

Originality - This study is among the first to incorporate financial stability as a moderating variable in the ICG-performance relationship in Indonesia.

Keywords: Islamic corporate governance; Financial performance; Social performance; Financial stability; Sharia board

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Introduction

The global Islamic banking sector has grown rapidly over the past two decades and is now part of the international financial system. By the end of 2023, global Islamic banking assets exceeded USD 2.2 trillion, driven by rising demand for ethical and Sharia-compliant financial services (Islamic Financial Services Board, 2024). The development of Islamic banking in Indonesia has continued to grow, supported by government policy and rising public awareness. As of December 2024, the Islamic banking industry's total assets amounted to IDR 980.30 trillion, a 9.88% increase from the previous year, and its market share expanded to 7.72% (Otoritas Jasa Keuangan, 2024). However, the market share of Islamic banks is still relatively small compared to conventional banks, which makes governance and performance even more important (Yasin et al., 2026).

In this context, evaluating Islamic banks requires measuring both financial and social performance. Financial performance indicates the bank's ability to generate returns, while social performance, as reflected in CSR disclosure, indicates the bank's accountability to broader stakeholders. (Mollah et al., 2017). While the relationship between corporate governance and financial and social performance has been studied, the outcomes have largely been examined separately (Al-Asfour, 2025; Mallin et al., 2014; Platonova et al., 2018). This will provide a more comprehensive view of the effectiveness of governance in Islamic banking by considering both outcomes within a single framework. Also, financial stability may affect the extent to which governance mechanisms influence financial and social outcomes by creating favorable financial and operational conditions. (Mamatzakakis et al., 2023; Safiullah, 2021). Therefore, this study analyzes the impact of corporate governance mechanisms on financial and social performance and the moderating role of financial stability in Islamic banks in Indonesia.

The distinctive feature of Islamic banks is their dual responsibility to achieve not only financial goals but also broader socio-economic objectives aligned with *maqasid shariah*—the preservation of faith, life, intellect, lineage, and wealth. Islamic banks are expected to generate profits while ensuring social justice, ethical investment, and equitable wealth distribution (Dusuki et al., 2007). Through instruments such as profit-and-loss sharing, *zakat*, and CSR disclosure, Islamic financial institutions are uniquely positioned to advance sustainable development and social welfare (Zafar & Sulaiman, 2020). Consequently, the performance of Islamic banks should be evaluated using both financial indicators and their contributions to social objectives.

However, achieving these goals requires a robust governance framework rooted in Islamic principles. Islamic Corporate Governance (ICG) plays a critical role in upholding accountability, transparency, and Sharia compliance. The presence and quality of the Sharia Supervisory Board (SSB) are essential to ensuring that banking operations adhere

to Islamic values (Buallay, 2019). Yet cases of fraud and governance failures in Indonesian Islamic banks, such as those reported by (ACFE, 2020), highlight the urgency of strengthening ICG mechanisms. In this context, evaluating the effectiveness of ICG, particularly the role of the SSB, becomes vital to ensuring that Islamic banks can fulfill their dual mandate in a stable and trustworthy manner (Hassan et al., 2017).

Islamic Corporate Governance (ICG) is an emerging framework that integrates Islamic ethical principles with conventional governance structures, particularly in Islamic financial institutions (Jan et al., 2021; Shibani & De Fuentes, 2017). While sharing common objectives with conventional corporate governance—such as accountability, transparency, and efficiency—ICG distinguishes itself through its foundational reliance on Sharia principles and values. In ICG, governance mechanisms not only aim to protect shareholders' interests but also uphold the moral and ethical dimensions of business conduct. A central component of this governance structure is the Sharia Supervisory Board (SSB), which is responsible for ensuring that all banking operations, services, and financial products comply with Islamic jurisprudence (Buallay, 2019). The SSB also plays a proactive role in issuing fatwas and guiding Islamic financial institutions in developing Sharia-compliant innovations (Jan et al., 2021). Thus, ICG provides a multidimensional approach that blends regulatory compliance with religious accountability (Khan & Zahid, 2020).

The conceptual foundation of ICG is deeply rooted in key Islamic values such as shura (consultation), amanah (trust), adl (justice), and ihsan (excellence). These values reinforce ethical conduct in governance, obliging Islamic financial institutions to pursue not only profit but also broader societal welfare in alignment with the objectives of maqasid shariah (Alhammadi et al., 2022; Mergaliyev et al., 2021). This dual mandate emphasizes both financial performance and social responsibility. However, recent incidents of fraud and governance failure in Islamic banking—including in Indonesia—highlight the insufficient implementation of ICG despite its theoretical promise (ACFE, 2020; Rini, n.d.). These challenges underscore the urgent need to reinforce Islamic governance practices, particularly in developing countries, by strengthening the role of the Sharia Supervisory Board and embedding Islamic ethical values into the operational fabric of Islamic banks (Hasan & Asutay, 2019). Such efforts are essential not only to ensure Sharia compliance but also to sustain public trust and support the long-term development of the Islamic financial sector.

Despite the rapid growth of Islamic banking, persistent governance challenges continue to undermine the sector's credibility and effectiveness—particularly in Indonesia, where inconsistencies in the implementation of Islamic Corporate Governance (ICG) are frequently observed (Hasan & Asutay, 2019; Rini, n.d.). Cases of fraud and financial misconduct involving Islamic banks, such as those reported by the

Association of Certified Fraud Examiners (ACFE, 2020), reveal weaknesses in oversight and suggest that Sharia Supervisory Boards (SSBs) are not always effective in ensuring compliance with Sharia principles (Buallay, 2019). Moreover, while corporate governance is widely recognized for its role in influencing financial and social performance (Hassan et al., 2017; Sun, 2015), empirical evidence on the specific impact of ICG in achieving both financial profitability and Corporate Social Responsibility (CSR) objectives within Islamic banking remains limited—particularly in the context of developing economies (Harun et al., 2020; Jan et al., 2021). This research gap is especially relevant in Indonesia, where scholarly inquiry into the role of ICG in enhancing both financial and social outcomes is still underdeveloped, despite growing stakeholder demand for ethical and transparent Islamic financial practices.

Although numerous studies have examined the impact of corporate governance on firm performance, the majority have focused on conventional frameworks and financial metrics, with limited attention to Islamic Corporate Governance (ICG) and its unique ethical and religious dimensions (Hassan et al., 2017; Khan & Zahid, 2020). Moreover, while Corporate Social Responsibility (CSR) has gained scholarly interest, social performance in Islamic banks is often measured using general indicators without reference to *maqasid*-based shariah constructs that reflect the foundational objectives of Islamic finance (Dusuki et al., 2007; Jan et al., 2021; Rini, n.d.).

This lack of an integrated approach to measuring both financial and social performance undermines efforts to evaluate the holistic value delivered by Islamic financial institutions. In addition, much of the empirical literature is based on data from developed countries, leaving significant gaps in the understanding of governance dynamics in emerging economies such as Indonesia, where Islamic banks face both rapid growth and ongoing challenges in governance implementation (Hasan & Asutay, 2019; Rini, n.d.). These limitations highlight the need for a more comprehensive investigation into how ICG influences both financial profitability and socially responsible outcomes, particularly within the Indonesian context, where such dual accountability is increasingly demanded by stakeholders.

Given the growing importance of Islamic Corporate Governance (ICG) in ensuring accountability and Sharia compliance of Islamic financial institutions, this study critically examines its role in enhancing the financial and social performance of Islamic banks. While prior research has acknowledged the impact of corporate governance on financial outcomes (Hassan et al., 2017; Mollah & Zaman, 2015), the dual objective of Islamic banks to generate profit while fulfilling socio-religious mandates, such as those rooted in *maqasid shariah*, remains insufficiently explored—particularly in developing contexts like Indonesia (Hasan & Asutay, 2019; Rini, n.d.). Accordingly, this study addresses two central research questions: (1) How does Islamic Corporate Governance influence the

financial performance of Islamic banks? and (2) In what ways does ICG affect the attainment of Islamic banks' social objectives? By responding to these questions, the study aims to offer an integrative understanding of how ICG mechanisms, including the Sharia Supervisory Board, can support the sustainable, ethical, and profitable operations of Islamic banking institutions within emerging financial systems.

This study contributes to the literature and practice of corporate governance in Islamic banking in several important ways. In theory, it extends previous empirical studies by considering corporate governance in terms of dual financial and social performance outcomes and by including financial stability as a moderating variable. This approach provides a more complete understanding of governance and performance in Islamic banking institutions, which is not fully addressed by conventional models of governance (Buallay, 2019; Hasan & Asutay, 2019). By incorporating the role of the Sharia Supervisory Board and the social performance indicators, this research enriches the discourse on how ICG mechanisms can simultaneously drive profitability and fulfill socio-ethical mandates. Practically, the study offers policy-relevant insights for regulators, bank management, and Sharia Supervisory Boards (DPS) in designing governance structures that are both effective and compliant with Islamic principles, particularly for mitigating the risks of misconduct and aligning corporate actions with stakeholder expectations (Jan et al., 2021; Rini, n.d.). Contextually, the focus on Indonesia—one of the largest and fastest-growing Islamic banking markets globally—provides valuable empirical evidence from a developing country perspective that remains underrepresented in existing governance literature (Khan & Zahid, 2020). This underscores the study's relevance not only in advancing scholarship but also in shaping governance practices within emerging Islamic financial systems.

Literature Review

Agency Theory

Agency theory, as formulated by Meckling & Jensen (1976), conceptualizes the firm as a nexus of contracts between principals—such as shareholders—and agents, typically managers, who are delegated decision-making authority. The central tenet of the theory is the divergence of interests between principals and agents, wherein agents may act opportunistically to maximize their own utility rather than that of the principal (Buallay, 2019; Hill & Jones, 1992). To mitigate such behavior, principals may establish incentive mechanisms, bear monitoring costs, and require agents to incur bonding costs to align interests. These agency problems become more pronounced when information asymmetry allows managers to manipulate or selectively disclose financial reports, thereby misleading stakeholders and increasing agency costs (Zainuldin & Lui, 2020).

Such conditions necessitate robust governance structures to reduce opportunism and protect the principal's interests.

In the context of Islamic banking, the agency problem becomes even more complex due to the dual objectives of financial performance and adherence to Islamic ethical principles. Unlike conventional financial institutions, Islamic banks operate under profit-and-loss-sharing schemes that widen the information gap between principals and agents, thereby exacerbating monitoring challenges (Farag et al., 2018). The implementation of Islamic Corporate Governance (ICG), particularly through the presence of a Sharia Supervisory Board (SSB), is vital in mitigating these agency issues. The SSB plays a critical role in ensuring compliance with Sharia law, promoting transparency, and enhancing managerial accountability (Buallay, 2019). However, empirical evidence from Indonesia indicates that ICG practices are not yet fully institutionalized (Astuti et al., 2019), raising concerns about their effectiveness in curbing managerial opportunism. Thus, this study posits that those specific elements of ICG—such as board independence, size, competence, and gender diversity—may significantly influence both corporate social responsibility (CSR) and financial performance outcomes in Islamic banks.

Stakeholder Theory

Stakeholder theory provides a broader and more inclusive framework than agency theory by recognizing that corporations are accountable not only to shareholders but also to a diverse set of stakeholders, including employees, customers, suppliers, creditors, communities, and regulatory bodies (Hill & Jones, 1992). This perspective redefines the organization as a network of implicit and explicit contracts among resource holders, in which management is responsible for balancing competing stakeholder interests to sustain long-term corporate value. Unlike the shareholder-centric focus of agency theory, stakeholder theory emphasizes ethical obligations, fairness, and responsiveness to all parties affected by corporate decisions, particularly during periods of disruption or disequilibrium (Donaldson & Preston, 1995; Stoelhorst & Vishwanathan, 2024). This multidimensional responsibility is especially relevant to Islamic banking institutions, which are grounded in the ethical principles of Sharia, which inherently prioritize social welfare, justice, and mutual benefit.

In this regard, stakeholder theory justifies evaluating both financial and non-financial performance—such as Corporate Social Responsibility (CSR)—as indicators of effective governance. Islamic banks are expected not only to generate returns for shareholders but also to fulfill their fiduciary duties toward the broader ummah (community), thereby reinforcing the moral and ethical foundations of Islamic finance. The presence of Sharia Supervisory Boards (SSBs), a unique feature of Islamic Corporate Governance (ICG),

aligns well with stakeholder theory by serving as internal governance mechanisms that ensure transparency, social accountability, and Sharia compliance (Buallay, 2019). Empirical studies, such as those by Sun (2015) and Zhang et al. (2020), support the assertion that robust governance structures positively influence CSR disclosure, thereby strengthening stakeholder trust. Hence, integrating stakeholder theory into the governance framework of Islamic banks supports the development of hypotheses concerning about the role of ICG components—such as board independence, size, competence, and gender diversity—in enhancing both CSR engagement and financial outcomes.

Islamic Corporate Governance

Islamic Corporate Governance (ICG) is a governance framework grounded in the principles of Sharia that mandates ethical conduct, accountability, transparency, and social justice in financial and business practices (Franzoni & Ait Allali, 2024; Gusrianti & Violita, 2021). Unlike conventional governance models that focus primarily on maximizing shareholder value, ICG incorporates religious obligations and stakeholder-centric values, promoting broader social and moral responsibilities. A central mechanism within ICG is the Sharia Supervisory Board (SSB), which ensures that Islamic financial institutions operate in compliance with Islamic law, particularly in avoiding interest-based transactions, promoting risk-sharing, and upholding ethical behavior (Buallay, 2019). The SSB serves both advisory and supervisory roles, helping Islamic banks navigate the complexities of Sharia compliance while enhancing corporate integrity and stakeholder trust. Empirical findings suggest that robust governance mechanisms, including the effective role of the SSB, contribute to greater CSR engagement and overall financial soundness (Sun, 2015; Zhang et al., 2020).

However, the full implementation of ICG in certain jurisdictions, such as Indonesia, remains an ongoing challenge. Astuti et al. (2019) found that despite formal structures in place, Indonesian Islamic banks have not yet fully adopted or operationalized ICG principles, particularly in ensuring the independence, competence, and diversity of Sharia boards. Factors such as limited regulatory enforcement, a lack of professional capacity within SSBs, and varying interpretations of Sharia standards contribute to inconsistencies in governance practices. These shortcomings may weaken the credibility and effectiveness of Islamic financial institutions, particularly in achieving both financial and social objectives. Thus, this study investigates how specific characteristics of the SSB—namely, independence, size, competence, and gender diversity—affect both CSR engagement and financial performance, thereby providing empirical insights into the operationalization of ICG in the Indonesian context. [Figure 1](#) presents the research model.

Hypotheses Development

ICG and Social Performance

Islamic Corporate Governance (ICG) focuses on aligning corporate governance with Sharia principles to foster ethical practices, accountability and social justice. The Sharia Supervisory Board (SSB), as a fundamental ICG mechanism, plays an important role in ensuring that Islamic financial institutions comply with Islamic law in their financial operations and corporate social responsibility (CSR). Based on stakeholder theory (Hill & Jones, 1992), Islamic banks are expected to satisfy the interests of a wide range of stakeholders, including the community, through transparent and socially responsible behavior. Therefore, it is expected that effective ICG will improve Islamic banks' accountability to their stakeholders and encourage the implementation and disclosure of socially responsible activities. Empirical studies indicate that the quality of governance practices has a significant effect on CSR engagement. For example, Harun et al. (2020) and Zhang et al. (2020) found that good corporate governance is associated with higher CSR disclosure, indicating that governance mechanisms may align corporate behavior with stakeholder interests. Likewise, Zhang et al. (2020) found a positive relationship between strong governance structures and voluntary CSR disclosure, suggesting that strong governance may lead to greater social responsibility.

The effectiveness of CSR implementation in Islamic banking is believed to be affected by certain specific features of the SSB. For example, board independence improves monitoring and reduces agency conflicts, thereby promoting more ethical and transparent CSR practices (Meckling & Jensen, 1976). This increased monitoring can incentivize managers to incorporate stakeholder interests and increase accountability for social activities. Board size has a positive relationship with diversified perspective and improved monitoring ability, and competence ensures the board members have the necessary Sharia and financial expertise to implement CSR strategies effectively. Gender diversity is also associated with more extensive CSR programs, which is a reflection of broader representation and inclusiveness (Chang et al., 2021; Yarram & Adapa, 2021). These attributes are consistent with the agency and stakeholder theories, since they help to align the actions of managers with the interests of a broader set of stakeholders (Harjoto et al., 2015). Prior studies also show that the corporate and Shariah governance mechanisms are relevant to the performance and governance of Islamic banks (Astuti et al., 2019; Buallay, 2019). This is consistent with the argument that a stronger ICG can improve its social responsibilities. Based on the above considerations and empirical evidence (Astuti et al., 2019; Buallay, 2019; Sun, 2015), the following hypothesis is proposed:

Ha1: Islamic Corporate Governance has a significant positive effect on Social Performance.

ICG and Financial Performance

Islamic Corporate Governance (ICG), rooted in Sharia principles, provides a distinctive ethical foundation for managerial oversight in Islamic banking. Unlike conventional governance models, ICG embeds moral obligations that extend beyond profitability, focusing also on justice, accountability, and stakeholder welfare. According to agency theory, proper governance mechanisms are essential to reduce agency conflicts arising from divergent interests between managers (agents) and shareholders (principals) (Meckling & Jensen, 1976). In Islamic banking, the Sharia Supervisory Board (SSB) plays a central role in internal control, mitigating such conflicts by ensuring that all financial and operational decisions comply with Islamic ethical standards (Buallay, 2019). As Islamic financial institutions grow more complex, effective governance has become increasingly important for enhancing financial performance indicators, including return on assets (ROA).

Several empirical studies have emphasized the influence of ICG characteristics on financial performance. Umiyati et al. (2020) demonstrate that effective implementation of ICG—particularly through the SSB—positively affects the financial outcomes of Islamic banks. Similarly, Khan & Zahid (2020) found that Sharia board attributes, such as independence, size, competence, and diversity, significantly enhance performance metrics across Asian Islamic banks. Independent Sharia boards are likely to provide more objective and unbiased monitoring, thereby reducing managerial opportunism and improving decision-making aligned with the bank's strategic goals (Alam & Miah, 2021). A larger board size can broaden knowledge and enable better oversight, while competence ensures that board members possess both financial and Sharia expertise necessary to guide performance-driven policies (Farag et al., 2018). Furthermore, gender diversity on the board may contribute to better governance outcomes by incorporating varied perspectives, which can improve problem-solving and risk oversight.

From the stakeholder theory perspective (Hill & Jones, 1992), financial performance is not solely a result of internal efficiencies, but also of maintaining long-term trust and relationships with various stakeholders. The integration of ethical governance structures in Islamic banking is expected to improve stakeholder confidence and market perception, thereby enhancing financial outcomes. Building upon these theoretical and empirical insights, this study posits the following hypothesis:

Ha2: Islamic Corporate Governance has a significant positive effect on Financial Performance.

The Moderating Role of Financial Stability

The integration of social responsibility into the corporate agenda in Islamic banking is not a choice but a religious and moral responsibility in line with the principles of Maqasid al-Shariah. Islamic Corporate Governance (ICG) through board independence, competence, and Sharia-compliant oversight is a pivotal driver in achieving this dual objective. However, the ICG's capacity to effectively steer social performance might depend on the bank's financial stability, which is defined as the bank's ability to maintain healthy financial circumstances, manage risks, and continue its operations free from undue financial strain (Lassoued, 2018).

Financial stability relieves the pressure to make short-term decisions and enables boards to focus on sustainable and ethical goals, including Corporate Social Responsibility (CSR). Those banks which are sound financially have more resources and organisational capacity to undertake CSR activities, and lower financial pressure allows governance mechanisms to focus on long-term stakeholder interests (Islam et al., 2021). Adel et al. (2019) posit that financially healthy firms are more likely to disclose CSR than financially distressed firms because of stronger internal governance mechanisms and lower information asymmetry.

According to agency theory, governance mechanisms are more effective to the extent that resource constraints are minimized (Meckling & Jensen, 1976). This is particularly relevant in Islamic banking, where CSR initiatives often involve long-term investment with a volatile short-term return (Uyar et al., 2023). When banks are financially sound, greater financial capacity means fewer resource constraints, allowing boards to allocate sufficient resources for monitoring and CSR activities without threatening the bank's financial position.

Thus, it is logical to assume that financial stability enhances the impact of corporate governance features, such as board independence, competence, and size, on CSR practices by providing the necessary resources, managerial flexibility, and legitimacy. Moreover, financial stability can enable diverse boards to plan and implement CSR more proactively, which in turn can increase the positive effect of governance on social performance.

Ha3: Financial stability positively moderates the relationship between Islamic Corporate Governance and Social Performance.

The impact of ICG on financial performance is well documented (Khan & Zahid, 2020; Umiyati et al., 2020), but the strength and consistency of the relationship may vary with the institution's underlying financial stability. Financial stability is the ability of an institution to remain in sound financial condition, manage risks, and continue its operations without undue financial pressure (Lassoued, 2018). Even well-designed

governance arrangements can fail in the face of external shocks, liquidity shortages, or risk aversion during financial turbulence. In contrast, ICG's profitability potential can be fully realized in a stable financial environment.

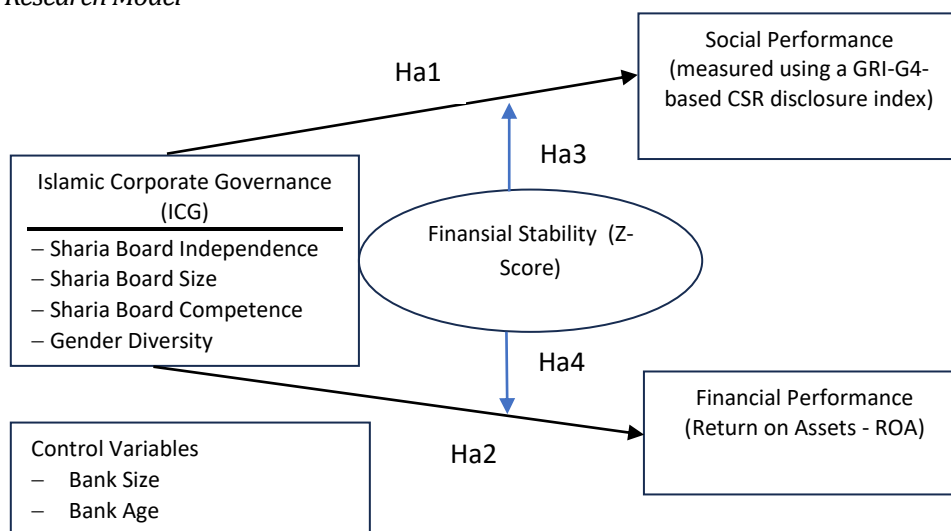
Indeed, the literature on stakeholder theory (Hill & Jones, 1992) suggests that Islamic banks are more likely to pursue strategies that reconcile long-term profitability with stakeholder satisfaction when they are financially resilient. "Financial stability enables the board — particularly one with capable, independent, and diverse members — to pursue value-creating opportunities without undue concern about short-term solvency. According to Lassoued (2018), the financial soundness of Islamic banks can better support the Shariah Supervisory Board (SSB) in its monitoring functions, thereby improving compliance, operational efficiency, and reputational capital.

Furthermore, the benefits of diversity and competence for financial performance are likely to be more pronounced in financially stable banks where boards have the authority to contribute strategically rather than reactively. Stability reduces financial constraints and thus enables better risk management, capital allocation, and oversight, which are key to optimizing returns on assets (ROA) (Grassa et al., 2023). Hence, it is expected that financial stability would strengthen the positive effect of ICG on financial performance by providing an enabling condition for the governance mechanisms to operate effectively (Khan & Zahid, 2020).

Ha4: Financial stability positively moderates the relationship between Islamic Corporate Governance and financial performance.

Figure 1

Research Model



Source: Authors' work

Research Methods

Research Design

This study adopts a quantitative research design, using panel data regression, to investigate the effect of Islamic Corporate Governance (ICG) on both social and financial performance among Islamic banking institutions in Indonesia. This approach ensures statistical rigor and enhances the generalizability of findings across time and institutions (Baltagi, 2008; F. Hair Jr et al., 2014; Sun, 2015).

The variables include ICG dimensions—independent board, board size, competence, and gender diversity—based on established literature (Armstrong et al., 2015; Kor, 2003; Lanis & Richardson, 2011), with social performance measured through GRI-G4-based content analysis (Global Reporting Initiative, 2013, 2016) and financial performance proxied by Return on Assets (ROA). Financial stability is included as a moderating variable using percentage asset change and gross profit margin (Lassoued, 2018), alongside control variables such as firm size and age. Panel regression analysis is conducted using Stata version 17 to test the proposed hypotheses.

Data and Sample Selection

The study focuses on Islamic commercial banks (BUS) operating in Indonesia, with data collected from 2019 to 2023. A purposive sampling technique was employed to ensure relevance and data completeness, with the following inclusion criteria: (1) Islamic banks registered with the Financial Services Authority (OJK) and listed on the Indonesia Stock Exchange (IDX) during 2019-2023; (2) issuance of audited financial statements over the same period; and (3) availability of complete and consistent data for the variables under investigation, including Islamic Corporate Governance (ICG), Corporate Social Responsibility Disclosure (CSR), financial performance, and financial stability.

The final sample consists of 14 Islamic banks, yielding a total of 70 firm-year observations. This dataset draws on secondary sources, including annual reports, sustainability reports, and financial disclosures accessed from official bank websites and the IDX. The use of secondary data is aligned with prior research practices in corporate governance and CSR studies (Armstrong et al., 2015; Lanis & Richardson, 2011), ensuring data reliability and comparability across firms and time. This sampling strategy supports the objective of examining institutional governance mechanisms and their impact on both social and financial outcomes within the Islamic banking sector.

Table 1*Definition and Measurement of Variables*

Variable	Measurements
<i>Dependent Variable</i>	
Social Performance	Content analysis by comparing the suitability between the sustainability report and the GRI-G4 guidelines (Global Reporting Initiative, 2013, 2016)
Financial Performance	Return On Assets (ROA) ROA = Profit after tax/total asset
<i>Independent Variables</i>	
Independent Sharia Board	Members of the independent board of commissioners are divided into full boards of commissioners (Armstrong et al., 2015).
Sharia Board Size	The company's Annual Report reports the number of boards of commissioners and board directors (Lanis & Richardson, 2011).
The Board of Commissioners' Competence	The ratio between the number of board of commissioners that has experience working in the company's main industries and the amount of board of commissioners (Kor, 2003).
Gender Diversity on Boards	DWOMEN = dummy variable = 1 if there are female directors in the company, 0 if there are not female directors. PWOMEN = number of female board directors/total number of board directors.
<i>Moderating Variable</i>	
Financial Stability	Δ CHANGE = Percentage Change of assets over two years GPM = Gross Profit Margin
<i>Control Variables</i>	
Company Size	Natural logarithm of Total Assets, $Size = \ln Total Asset$
Company Age	The difference between the observation period date and the company's establishment date, divided by 365 days.

Source: Authors' work

Variable Definitions and Measurements

This study uses both social and financial performance as dependent variables to assess the impact of Islamic Corporate Governance (ICG) practices in Indonesian Islamic banks. Social performance, measured using a GRI-G4-based CSR disclosure index, operationalized through content analysis of sustainability reports and aligned with GRI-G4 guidelines (Global Reporting Initiative, 2013, 2016), following methodologies applied by (Haniffa & Hudaib, 2007). Financial performance is proxied by Return on Assets

(ROA), calculated as the ratio of profit after tax to total assets, consistent with prior financial performance literature (Lanis & Richardson, 2011; Simpson & Kohers, 2002).

The independent variables are attributes of corporate governance, including board independence, size, competence and gender diversity. Board independence is measured by the percentage of independent members on the board of commissioners (Armstrong et al., 2015). Board size and competence are based on Kor (2003), Lanis & Richardson (2011), respectively. Gender diversity is captured as a binary (DWOMEN) and proportional (PWOMEN) indicator of female representation. These characteristics of the board constitute conventional corporate governance and differ from the Sharia Supervisory Board (SSB) which has a separate function of Sharia oversight. Financial stability is used as a moderating variable, measured by Z-score to measure the risk of insolvency, in accordance with the method of Boyd & Runkle (1993). Control variables include bank size (natural logarithm of total assets) and bank age (from the year of establishment), which are standard controls in governance-performance studies (Pathan & Faff, 2013). These operationalizations guarantee the robustness and comparability of the empirical results with the existing literature. The measurement of the variables is presented in [Table 1](#).

Model Specification and Analytical Techniques

Using panel data regression models, this study examines the direct and moderating effects of corporate governance attributes on the social and financial performance of Islamic banks in Indonesia during 2019–2023. We define two main regression models: one to estimate the effect of corporate governance attributes on social performance (proxied by a GRI-G4-based CSR disclosure index), and the other to estimate the effect on financial performance (measured by Return on Assets). To control for possible unobserved heterogeneity, fixed-effects or random-effects models are used, as indicated by the Hausman specification test, following the econometric procedures presented in (Baltagi, 2008). Interaction terms between the corporate governance variables and financial stability (measured by the Z-score) are introduced to test for moderating effects following (Baron & Kenny, 1986). Omitted variable bias is reduced using control variables like bank size and age. All the statistical analyzes are conducted in STATA version 17, which is a popular software for panel data analysis in governance and financial research (Gujarati & Porter, 2009). This ensures the robustness and reproducibility of the empirical results.

The regression models used for hypothesis testing are:

$$\begin{aligned} SP_{it} = & \alpha + \beta_1 BIND_{it} + \beta_2 BSIZE_{it} + \beta_3 BCOMP_{it} + \beta_4 BGD_{it} + \beta_5 FINSTAB_{it} + \beta_6 SIZE_{it} + \\ & \beta_7 AGE_{it} + \beta_8 BIND * FINSTAB_{it} + \beta_9 BSIZE * FINSTAB_{it} + \beta_{10} BCOMP * FINSTAB_{it} + \\ & \beta_{11} BGD * FINSTAB_{it} + \varepsilon \quad (1) \end{aligned}$$

$$FPit = \alpha + \beta_1 BINDit + \beta_2 BSIZEit + \beta_3 BCOMPit + \beta_4 BGDit + \beta_5 FINSTABit + \beta_6 SIZEit + \beta_7 AGEit + \beta_8 BIND*FINSTABit + \beta_9 BSIZE*FINSTABit + \beta_{10} BCOMP*FINSTABit + \beta_{11} BGD*FINSTABit + \varepsilon \quad (2)$$

Results and Discussion

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This section presents the results of static panel data estimations examining the impact of Islamic Corporate Governance (ICG) on social and financial performance, as well as the moderating role of financial stability in these relationships. The models were evaluated using various estimators, including pooled OLS, fixed effects, random effects, and heteroscedasticity-robust random effects models to ensure the robustness and reliability of the findings. The key statistical diagnostics (e.g., Breusch-Pagan Lagrange Multiplier, Hausman test, VIF, Wald test, and Wooldridge test) were applied to determine model adequacy and specification.

The Effect of Islamic Corporate Governance on Social Performance

Table 2 summarizes the regression outcomes assessing the effect of ICG components on corporate social responsibility (CSR) disclosure. The diagnostic statistics suggest that the heteroscedasticity-corrected random effects model is the most appropriate, as the Breusch-Pagan test yielded a p-value of 0.0000 ($p < 0.05$), indicating the presence of random effects, while the Hausman test returned a p-value of 0.7662 ($p > 0.05$), supporting the random effects specification. The VIF value of 5.06 confirms the absence of multicollinearity, while the Wooldridge test ($p = 0.0726$) indicates no serial correlation.

The results show that several ICG dimensions significantly enhance social performance. Specifically, board independence (LnBIND), board size (LnBSIZE), and board competence (LnBCOMP) are all positively associated with CSR performance at the 10%, 5%, and 10% significance levels, respectively. A 1% increase in the proportion of independent directors is associated with a 0.0450% increase in CSR activities. Similarly, a 1% increase in board size corresponds to a 0.0766% increase in social performance, and a 1% increase in board competence yields a 0.0214% increase in social performance. These findings partially support the acceptance of Ha1, indicating that certain board characteristics enhance firms' CSR disclosure practices. The insignificant effect of board gender diversity (LnBGD) suggests that female representation on boards does not significantly influence CSR in this context.

Table 2*Static Panel Data Analysis Results for Model 1*

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Variables	Pooled OLS	Random Effect	Fixed Effect	Corrected Heteros (REM)
Constant	-1.7870 (1.7406)	-1.8818 (2.5418)	15.7257 (17.3605)	-1.8818 (2.9752)
LnBIND	0.4827 (0.3005)	0.0450** (0.2178)	0.1499 (0.1981)	0.0450* (0.1526)
LnBSIZE	0.9038** (0.4037)	0.0766* (0.2993)	0.0139* (0.2811)	0.0766** (0.3191)
LnBCOMP	-0.1693 (0.1790)	0.0214* (0.1436)	0.0897 (0.1394)	0.0214* (0.1615)
LnBGD	0.2473* (0.1380)	-0.0156 (0.0938)	-0.0095 (0.0881)	-0.0156 (0.0550)
FINSTAB	0.0343 (0.0775)	-0.0138 (0.0436)	-0.0532 (0.0591)	-0.0138 (0.0295)
LnSIZE	0.2417 (0.4237)	-0.2524 (0.7703)	-6.7725 (5.6335)	-0.2524 (0.8893)
LnAGE	0.0633 (0.1167)	0.3966** (0.1823)	1.5719*** (0.4423)	0.3966* (0.3001)
BIND*FINSTAB	-0.2852 (2.1022)	1.5780* (1.3306)	2.6570 (1.5989)	1.5780* (1.8279)
BSIZE*FINSTAB	0.1455 (0.4343)	0.0611 (0.2423)	0.0142 (0.2152)	0.0611 (0.1605)
BCOMP*FINSTAB	0.2584 (1.1305)	0.2017* (0.6970)	0.1831 (0.7294)	0.2017* (0.6469)
BGD*FINSTAB	-0.3251 (3.0277)	-1.9043 (1.6849)	-2.6892 (2.1672)	-1.9043 (1.5801)
R ²	0.2158	0.3140	0.2099	0.3140
F	0.0455	0.0414	0.0344	0.0414
BP-LM test	43.11 [0.0000]		-	43.11 [0.0000]
Hausman Test	-	7.40 [0.7662]		7.40 [0.7662]
Multicollinearity (VIF test)	5.06			5.06
Heteroscedasticity (M. Wald test)	27871.93 [0.0000]			27871.93 [0.0000]
Serial Correlation (Wooldridge test)	3.815 [0.0726]			3.815 [0.0726]
Observation	70	70	70	70

Note: Values in parentheses are standard errors, whereas values in brackets are p-values, then ***, **, and * indicate significance at 1%, 5%, and 10% significance levels, respectively.

Source: Authors' work

These results are in line with previous studies such as (Sun, 2015), which asserts that robust corporate governance frameworks are instrumental in enhancing CSR initiatives. The findings also provide empirical support for stakeholder theory (Hill & Jones, 1992), wherein effective governance aligns corporate actions with the expectations of diverse stakeholder groups, including communities. Zhang et al. (2020) similarly emphasize the role of board structure in improving CSR disclosures in emerging markets.

Further analysis reveals that financial stability moderates the effects of board independence and board competence on social performance, both of which are significant at the 10% level. However, no moderating effect was found for board size or gender diversity. Accordingly, Ha3 was partially supported, suggesting that financially stable firms are better positioned to leverage their boards' skills and independence to enhance social performance. These findings are consistent with (Adel et al., 2019), who found that financially sound institutions exhibit stronger CSR responsiveness, particularly when guided by effective governance mechanisms.

The Effect of Islamic Corporate Governance on Financial Performance

Table 3 presents the results of the second model, examining the effect of ICG on financial performance, with financial stability as a potential moderator. The Breusch-Pagan LM test ($p = 0.0000$) shows the superiority of random effects to pooled OLS, and the Hausman test ($p = 0.7128$) shows the superiority of random effects to fixed effects. The VIF statistic is 5.11, which does not suggest serious multicollinearity. Heteroscedasticity is detected by the M. Wald test ($p = 0.0000$) and the Wooldridge test ($p = 0.1164$) shows no evidence of serial correlation. The results are then interpreted using the heteroscedasticity-corrected random effects model.

The findings reveal that board independence (LnBIND), board competence (LnBCOMP), and board gender diversity (LnBGD) have a significant positive impact on financial performance, whereas board size (LnBSIZE) is not significant. This thus partially supports Ha2. In the corrected REM, board independence ($\beta = 0.0010$, $p < 0.10$), board competence ($\beta = 0.0012$, $p < 0.01$), and gender diversity ($\beta = 0.0007$, $p < 0.05$) are associated positively with financial performance. These findings suggest that independent and competent boards can lead to better monitoring and decision-making and that gender diversity can provide broader perspectives that help to promote more effective governance. The insignificance of board size indicates that a larger board does not necessarily lead to better financial performance, as more members do not necessarily mean better monitoring. These findings are generally consistent with those of Khan and Zahid (2020) and Umiyati et al. (2020), who documented the significance of governance quality and board characteristics for the financial performance of Islamic banks.

Table 3*Static Panel Data Analysis Results for Model 2*

Variables	Pooled OLS	Random Effect	Fixed Effect	Corrected Heteros (REM)
Constant	0.0058** (0.0025)	0.0043* (0.0025)	0.0030 (0.0033)	0.0043* (0.0023)
LnBIND	0.0013 (0.0011)	0.0010 (0.0007)	-0.0009 (0.0007)	0.0010* (0.0005)
LnBSIZE	-0.0017 (0.0015)	-0.0013 (0.0010)	-0.0016 (0.0010)	-0.0013 (0.0014)
LnBCOMP	0.0004 (0.0006)	0.0012** (0.0005)	0.0015*** (0.0004)	0.0012*** (0.0007)
LnBGD	0.0016*** (0.0005)	0.0007** (0.0003)	0.0004 (0.0003)	0.0007** (0.0005)
FINSTAB	0.0005 (0.0003)	-0.0001 (0.0001)	-0.0002 (0.0001)	-0.0001 (0.0001)
LnSIZE	3.1583*** (0.0311)	3.2810*** (0.0186)	3.2999*** (0.0171)	3.2810*** (0.0435)
LnAGE	0.0014*** (0.0004)	0.0007 (0.0007)	-0.0018* (0.0010)	0.0007 (0.0005)
BIND*FINSTAB	0.0039 (0.0083)	0.0091* (0.0047)	0.0126*** (0.0043)	0.0091* (0.0065)
BSIZE*FINSTAB	0.0001 (0.0017)	0.0009 (0.0009)	-0.0011 (0.0008)	0.0009* (0.0005)
BCOMP*FINSTAB	-0.0054 (0.0046)	0.0026 (0.0025)	0.0042* (0.0023)	0.0026 (0.0018)
BGD*FINSTAB	0.0091 (0.0116)	0.0170*** (0.0060)	-0.0232*** (0.0056)	0.0170** (0.0070)
R ²	0.9960	0.9953	0.9900	0.9953
F	0.0000	0.0000	0.0000	0.0000
BP-LM test	33.06 [0.0000]		-	33.06 [0.0000]
Hausman Test	-	8.01 [0.7128]		8.01 [0.7128]
Multicollinearity (VIF test)	5.11			5.11
Heteroscedasticity (M. Wald test)	431.70 [0.0000]			431.70 [0.0000]
Serial Correlation (Wooldridge test)	2.829 [0.1164]			2.829 [0.1164]
Observation	70	70	70	70

Note: Values in parentheses are standard errors, whereas values in brackets are p-values, then ***, **, and * indicate significance at 1%, 5%, and 10% significance levels, respectively.

Source: Authors' work

Regarding the moderating role of financial stability, the interaction terms indicate that it significantly and positively moderates the effects of board independence, board size, and gender diversity on financial performance. The interaction between board independence and financial stability is positive and significant ($\beta = 0.0091$, $p < 0.10$) as are the interactions between board size and financial stability ($\beta = 0.0009$, $p < 0.10$) and between gender diversity and financial stability ($\beta = 0.0170$, $p < 0.05$). Regarding the moderating role of financial stability, the interaction terms indicate that it significantly and positively moderates the effects of board independence, board size and gender diversity on financial performance. The interaction between board independence and financial stability is positive and significant ($\beta = 0.0091$, $p < 0.10$), as are the interactions between board size and financial stability ($\beta = 0.0009$, $p < 0.10$) and between gender diversity and financial stability ($\beta = 0.0170$, $p < 0.05$).

The positive moderating effects imply that financial stability is an enabling condition for governance mechanisms to function more effectively. Financially strong banks are better able to allocate funds, manage risk, and pursue longer-term strategies without undue pressure from short-term financial constraints (Putri et al., 2024). Thus, independent, appropriately sized, and gender-diverse boards may be better equipped to provide effective oversight and contribute to financial decision-making (Mohd Zain & Abdullah, 2025). This finding is consistent with (Lassoued, 2018), who emphasizes the importance of sound governance and effective Shariah oversight in supporting the stability and performance of Islamic banks. However, the insignificant moderation of board competence suggests that the benefits of competence may operate more directly through governance and decision-making capabilities rather than depending on the bank's level of financial stability.

Conclusion

This study investigates the influence of Islamic Corporate Governance (ICG) mechanisms on both social and financial performance in Indonesian Islamic banking institutions, and explores the moderating role of financial stability. Using a dataset comprising 70 observations from 14 Islamic banks over the 2019–2023 period, the findings reveal that specific governance attributes—namely, board independence, board size, and board competence—positively and statistically significantly impact social performance. These results align with stakeholder theory, which posits that strong governance structures enable organizations to meet the ethical and social expectations of a broad range of stakeholders, thereby enhancing the quality and credibility of CSR practices.

In terms of financial performance, the study finds that board independence, board competence, and gender diversity among board members significantly improve financial

outcomes. This suggests that diverse and competent boards are instrumental in enhancing operational efficiency and profitability within the Islamic banking sector. Importantly, the moderating role of financial stability is significant, strengthening the positive impact of governance on both social and financial performance. Financially stable institutions appear better positioned to leverage their governance capabilities to create sustainable value, thereby reinforcing both ethical commitments and financial objectives in accordance with Maqasid al-Shariah.

These findings offer meaningful implications for policymakers, regulators, and practitioners in Islamic finance. Strengthening financial stability not only contributes to systemic resilience but also enhances the effectiveness of governance mechanisms in achieving holistic performance goals. The results underscore the strategic value of cultivating board diversity, competence, and independence within Islamic banks, especially when financial soundness is in place.

For future research, extending the empirical model to Islamic banking institutions in other countries would allow for broader generalizability and cross-country comparisons. Additionally, incorporating other governance variables—such as the presence and role of audit committees, board tenure, and age diversity—could further enrich the understanding of governance dynamics in Islamic financial institutions.

Authors' Declaration

The authors made substantial contributions to the conception and design of the study. They were responsible for data analysis, interpretation, and discussion of the results. All authors read and approved the final manuscript.

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During the preparation of this article, the authors used ChatGPT and QuillBot to improve readability, correct grammatical errors, and refine language usage. All outputs generated by these tools were reviewed, evaluated, and manually edited by the authors. The authors take

full responsibility for the content, accuracy, interpretation, and academic integrity of the published article.

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