

# **CORPORATE GOVERNANCE AND CAPITAL STRUCTURE ANALYSIS AT ISLAMIC BANK IN INDONESIA**

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## **Abstract**

*This study aims to examine and analyze the impact of corporate governance on the capital structure and financial performance of Islamic banks in Indonesia. Indicators of corporate governance consists of: the board of commissioners, board of directors and the supervisory board of sharia, the board committees, and the sharia compliance.*

*The population in this study are all Islamic banks that go public in Indonesia Stock Exchange. The sampling technique used purposive sampling, with the criteria of Islamic banks which take corporate governance self assessment year 2010-2013, so obtain seven Islamic banks: BNI Syariah, Bank Muamalat Indonesia, Bank Syariah Mandiri, Bank Mega Syariah, Bank Panin Syariah, BCA Syariah and BRI Syariah. With a panel of data obtained 28 observations. Analysis data used a descriptive and regression analysis. The results show a). The highest value of Islamic bank capital structure are 417.6%, the lowest value of capital structure are 6.2%, and the average value of capital structure are 188.15%. b). The board of commissioners has a significant negative effect on capital structure, c). The board of directors does not affect on the capital structure. d). Committees of the board duties did not affect on the capital structure, e). The sharia supervisory board did not affect on the capital structure. f). Shariah compliance functions negative affect on the capital structure. g). Implementation of corporate governance not affect on financial performance, h). Capital structure have positive affect on financial performance.*

**Keyword : corporate governance, self assesment, capital structure, financial performance**

## **A. Introduction**

Islamic bank in Indonesia had develop well. This is demonstrated by the data that until 2014 the total assets of Islamic bank (both Islamic banks, units of sharia, and sharia rural banks) reached Rp 268.3 trillion. Islamic bank is still dominated by Islamic Banks (BUS) and Sharia Business Unit (UUS), with a market share of 4.8%, and capital assets ratio increased from 14.4% at the end of 2014 to 15.7%. This development can be sustainable if Islamic banks are committed in implementing good corporate governance. This is reasonable because Islamic banking as intermediary institutions that raise funds and distribute funds from the community to have asymmetric information. That is information on the prospects and operations of Islamic banks owned by external parties such as customers is smaller than the information held by the bank management syariah. Therefore, it is necessary for corporate governance. With the expected good corporate governance higher customer confidence so as to encourage Islamic banks to rapidly grow in the long term. Each Islamic bank which go public in Indonesia Stock Exchange shall follow good corporate governance self assessment.

Capital owned banks determine the success of Islamic banks. In many cases are common, the agency conflict is almost inevitable associated with the capital structure decisions. The difference between the interests of shareholders with the managerial becomes prevalent

faced. To reduce this conflict is needed for the mechanism of corporate governance in a company (Kurniawan and Rihardjo, 2014).

Several previous studies examine the effect of good corporate governance which use the indicator board of commissioners, board of directors, the audit committee of the capital structure. However, the study measures the commissioners, directors and committee terms of its size or the number of commissioners (Kurniawan and Rihardjo, 2014; Moon and Yuyetta, 2014 Hamzah and Suparjan 2009; Kajanathan, 2012). However, this study examines the implementation of good corporate governance that is used is the self-assessment of good corporate governance.

Several studies on the effect on the capital structure of corporate governance, including: (1) Rajedran (2012), there is significant influence between the board and the board composition Committee of the capital structure, corporate governance practices also significantly influential to the capital structure. Board size and board meetings no significant effect on capital structure. (2) Ahmadpour, Samimi A. J, Golmohammadi (2012), shows the concentration Ownership, Board Size, and Internal Auditor have a positive relationship with the capital structure, but there is a negative relationship between the Institutional Share Ratio and capital structure, as well as the relationship was not significant between Board Independence, CEO duality of the capital structure. (3) Rehman, MA, Rehman, RU, Raof, A. (2010) found a relationship between corporate governance and capital structure of 19 Bank of Pakistan from 2005-2006 were chosen at random, they found that there is a positive relationship between board size and capital structure.

Based on the research gap and also not inconsistent among studies with one another, encourage researchers to analyze the impact of corporate governance on the capital structure and financial performance of Islamic banks in Indonesia.

## **B. Literature Review and Hypothesis**

### ***Corporate Governance***

Corporate governance is a necessity for Islamic banks. Corporate governance refers to a series of systems, laws and procedures that guide and direct the behavior of corporations, shareholders and managers, in accordance with institutional policy. Corporate governance also provides the basis for a stable business environment and productive that can protect the interests of internal and external stakeholders (Rehman et al, 2010). According Faozan (2013) Corporate governance is a system to organize, manage and supervise the process of controlling the effort to raise the value of the shares, as well as a form of concern to stakeholders. Application of corporate governance has become an obligation of all bank operating in Indonesia. It is characterized by the presence of Bank Indonesia Regulation (PBI) 8/4/2006 which was amended by Regulation No. 08.14.2006 concerning the implementation of Good Corporate Governance (GCG) for commercial banks and PBI No. 11/33/2009 governing pelaksanaan GCG for Islamic Banks (BUS) and Sharia Business Unit (UUS) in Indonesia. Islamic banks like conventional banks, is obliged to maintain and develop good corporate governance practices in order to protect not only the rights of shareholders, but also the rights of other stakeholders. Normative studies looking at the general principles for good corporate governance is fully in line with the teachings of Islam (Agusianto 2009 in Cahyo 2013). But there is another aspect that is special and unique that ensure compliance with sharia runs permanently, by establishing a Shariah Supervisory Board (DPS) in the structure of Corporate Governance (Musthapa&Salih (2002) in Cahya 2013).

In the context of Islamic financial institutions, CG should include: (1) organizational settings where the action line manager (align) with the interests of stakeholders. (2) The organs of governance (which includes the board of directors, the supervisory board of sharia, management) has a goal to satisfy the interests of stakeholders and facilitate the effective monitoring so that the use of resources can be efficient, (3) comply with the rules and principles of Islamic law (IFSB 2005). The principles of corporate governance, namely: transparency, accountability, fairness, responsibility and fairness.

### ***Capital Structure***

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### **Hyphotesis**

#### **1.Board of Commisioners and Capital Structure**

One indicator of corporate governance is BOC . Commissioners in charge and responsible for supervising , monitoring , control and provide advice to the Board of Directors and ensuring the Commercial Bank in implementing Good Corporate Governance ( GCG ) at all levels and levels of the organization of Islamic banking . The BoC is accountable for all duties and authority to the General Meeting of Shareholders . BOC accountable to the GMS is a manifestation of accountability supervising the management of the company in order to

implement the principles of good corporate governance . If the board of directors is carrying out duties properly, it will be able to reduce the use of debt or capital structure

*H1: Board of Commicioners negative influence to capital structure*

## 2. Board of Directorsand Capital Structure

Policies and Procedures Implementation of Corporate Governance set up in more detail the duties and responsibilities of the Board of Directors, among others: are fully responsible for the implementation of the management of Islamic banks is based on the precautionary principle and the Sharia, shall manage Islamic banks well, implementing good corporate governance well, follow up the findings of the audit, manage risk and compliance, and so on. The board of directors is an independent party that professional and qualified enough to carry out the project effectively and efficiently. Commissioners are expected to perform tasks and tanggungjawabnya well so as to reduce the composition of the capital structure.

*H2: The Board of Directors significant negative effect on capital structure*

## 3. Board of Commissioners and Capital Structure

To assist the implementation of the Board of Commissioners, formed committees with members who have relevant expertise and as required by the applicable regulations. Committees of the above appointed by the commissioner on the Board of Commissioners, with the following explanation: The Audit Committee has generally been performing its duties according to applicable regulations, namely to assist the BOC in performing oversight function, to evaluate the planning and execution of audit and monitor the follow-up of audit results in order to assess the adequacy of internal controls, including the adequacy of financial reporting processes, to evaluate the: execution of duties Internal Audit Unit (SKAI); and makes recommendations on the appointment of KAP (Public Accounting Firm) according to the provisions applicable to the AGM by the Board of Commissioners. If the board committee performing their duties and responsibilities properly, it will lead to the composition of the capital structure.

*H3: Board Committee significant effect on capital structure*

## 4. Sharia Supervisi Board and capital structure

The public will be very confident to conduct transactions with Islamic banks if Islamic banks can actually implement the principles of Islamic banks. Sharia Supervisory Board is independent and duty to supervise the activities of the Bank, as well as ensuring compliance with business activities and operations of the bank to comply with Sharia principles. Duties and responsibilities of the Sharia Supervisory Board (DPS) includes: ensuring and supervising the suitability of Bank operations to the fatwa issued by DSN, assess aspects of sharia to the operational guidelines, and products issued by the Bank, reviewing new products and services that no fatwa to be requested fatwa to the DSN; and review of fulfillment of Sharia Principles on the mechanisms of funding and disbursement of funds and the Bank services. If the sharia supervisory board carry out its duties and responsibilities properly, it will be able to lower the capital structure.

*H4: Sharia Supervisory Board significant negative effect on capital structure*

## 5. Shariah Compliance and Capital Structure

Sharia compliance as a corporate governance mechanism can reduce the agency conflict between management and customers. In the application of sharia compliance function or compliance, the steps undertaken BUS include: appoint the Director of Compliance and has an independent compliance unit to the operating unit according to the needs and size of the Bank; create compliance policies and procedures; provide information about the applicable regulations and the monitoring of the implementation; monitoring the availability of guidelines in each unit as well as an update to the guidelines of the work; conduct a review of compliance with the draft regulations, policies and procedures will be established; submit reports on the implementation of the principal duties the Director of Compliance and special reports to Bank Indonesia and other interested parties; providing quality resources and compliance with the provisions through training and socialization; and prevent the Board of Directors of the Bank that did not adopt or establish policies and decisions that deviate from the rules and regulations in force as well as avoiding the recommendations and decisions contrary to the law.

H5: Shariah Compliance significant negative effect on capital structure

## 6. Capital Structure and Financial Performance

Capital structure is composed of debt and shares specified by the company . The composition greatly affect the company's performance . Agency theory states that the debt can be used as a mechanism to reduce the agency conflict between management and shareholders. The higher the debt , then the monitoring is done very effectively so as to improve company performance . Hipotesinya :

H6 : Capital structure has a significant positive effect on financial performance

## C. Research Method

This type of research is "an explanatory research" or research that is explained, means that this study emphasizes the relationship between variables the study by testing the hypothesis description. The population in this study is a Commercial Bank which go public in Indonesia Stock Exchange. The sampling technique used purposive sampling with several criteria, among others: Islamic banks to go public in Indonesia Stock Exchange for which data is complete and perform a self-assessment GCG 2010-2013. With this technique obtained 28 samples, with 4 years of observation, in order to obtain 112 observations. The data used in this research is secondary data from the annual report and the 2010-2013 GCG self assessment.

The independent variables consist of 1). Duties and responsibilities of the board of directors, 2).Duties and responsibilities of the board of directors, 3).The completion and implementation of the tasks of the board committee, 4).Duties and responsibilities of the supervisory board of sharia, 5).The application of sharia compliance function. The dependent variable is capital structure and financial performance.

### Data Analysis Techniques

This study uses panel data regression analysis. Panel data regression has the characteristics of cross section data and time series. According Widarjono (2013), some of the advantages of

using panel data is the first, panel data which is a combination of two cross section data and time series are able to provide more data so that it will produce a degree of freedom (degrees of freedom) is greater. Second, combining information from a cross section data and time series can cope with problems that arise when there is a problem of enforced variables (omitted-variable).

#### Panel Data Regression Model Estimation

Based on these assumptions arose various possible models / panel data regression techniques. Some of the methods used to mengestmasimeodel regression with panel data is a common approach Effect, Fixed Effects and Random Effects. The use of panel data has several advantages. This has implications for excellence should not be done in the classic assumption test panel data model (Verbeek, 2000; Gujarati, 2003; Wibisono, 2005; Aulia 2004 in Ajija, 2011).

### **D. Result and Discussion**

#### *Descriptive Analysis*

Table 1 (Annex) shows that Bank Mega Syariah is Islamic Banks with a ratio of Debt to Equity Ratio is the highest among other BUS, which showed that most of the assets of Bank Mega Syariah financed by debt. Bank with the lowest DER ratio is Bank PaninSyariah which does not reach 100% since 2010-2013. This may mean that the majority of Bank PaninSyariah financing using their own capital. With an average ratio of DER Islamic Banks starting in 2010-2013 was 149%, 182%, 217% and 204%, meaning that the average debt of Islamic banks is high, ie above 100%.

Implementation of good corporate governance of Islamic banking aims to ensure the achievement of the vision and mission of the bank. In addition, as the foundation for the development of the banking company to be more sustainable. One form of evaluation of the implementation of good corporate governance in Islamic Banks is to conduct the self-assessment that the parameters in accordance with the provisions of Bank Indonesia. There are 11 factors assessed in the self-assessment, but in this study only analyzed five factors that judgment. Table 2 (annex) shows that Islamic Banks in Indonesia has been implementing the principles of good corporate governance in accordance with the criteria or indicators that have been set by Bank Indonesia.

#### **Result of Hypothesis Test**

##### 1. Board of Commissioners and Capital Structure

Results of t test analysis showed a probability p value less than the significance value  $\alpha$  of 5%, so it can be stated that the duties and responsibilities of the board of commissioners, to direct, monitor, and evaluate the policy of Islamic banks significant negative effect on capital structure. It means that when the commissioners to work optimally it will be able to reduce the agency conflict that is off her debt. This discovery research aligned with Hamzah and Suparjan (2009), the commissioners affect the company's capital structure. Performance maximum commissioners indicated by use of debt or equity in the capital structure of Islamic banks, namely the use of debt that is less than the total equity. The use of debt that is too large will increase the risk of banks so as to influence the commissioners it is necessary to continuously improve the quality of the measured performance of the duties and obligations.

## 2. Board of Directors and Capital Structure

The test results demonstrate the value of the probability  $p$   $t$  is greater than the significance value  $\alpha$  so that it can be stated that duties and responsibilities of the board of directors does not have a significant effect on the capital structure. Previous research (Moon and Yuyetta, 2014) found that the size of the board of directors does not affect the capital structure. The study explains that the size of the size of the board of directors will not affect the capital structure because it only describes the number of members but not the performance of the board itself. So in this study can be said that the performance of the directors are not able to influence funding decisions Islamic Banks. Assessment of self assessment has shown that the implementation of the tasks and responsibilities of the board of directors in accordance with the criteria set, but could not affect the capital structure in the banking, this may be due to the self-assessment has not been able to measure the overall performance of the board of directors in which the active role and participation in banking strategic decisions are not fully reflected in the assessment of self-assessment.

## 3. Audit Commitee and Capital Structure

Statistical test results showed  $t$   $p$ -value is greater than the value of  $\alpha$  significant thus stated that the completion and implementation committee assignment did not affect the capital structure. Previous research (Moon and Yuyetta, 2014) did not directly examine the overall performance of the committee but the audit committee in particular, in the study found that the audit committee did not affect the capital structure. Implementation of the task committee can not affect funding decisions might have caused the committees to maximize the performance of its duties to assist the implementation of the tasks of the board of commissioners that role directly to the capital structure can not be measured by self-assessment ratings. However, these results differ from those found by Kurniawan and Rihardjo (2014) that the audit committee affect the capital structure. Audit committees play a role in the company's internal controls to be getting better which limits the control of the manager decides to use debt funding decisions.

## 4. Sharia Supervisi Board andCapital Structure

T test results showed statistical  $p$ -value is greater than the value of  $\alpha$  of 0.05 can be stated that the duties and responsibilities of the sharia supervisory board did not affect the capital structure. This shows that the supervisory function by the supervisory board of sharia in fact not able to influence managerial decisions in terms of funding. Duties and responsibilities of the sharia supervisory board may be maximized on banking operations, which the DPS supervision focused on compliance with the principles of sharia by banks such as ensuring all transactions and banking products already meet Islamic principles.

## 5. Sharia Compliance and Capital Structure

T test results showed statistical  $p$ -value less than 0.05  $\alpha$  value is stated that the application of shariah compliance function significant negative effect on capital structure. Implementation of bank compliance function as an indicator of the implementation of GCG proven appraiser influence funding decisions Islamic banks. This means that such compliance can influence the managerial to determine the percentage use of smaller debts. Excessive use

of debt can indeed increase the risk of banks and reduce profit due to interest expense that must be paid. Compliance can control the bank's decision not to use the debt to obtain funding from external parties.

#### 6. Capital Structure and Financial Performance

Statistical tests showed that the capital structure has a significant positive effect on the performance of the market. It supports the agency theory which states that the debt can be used as a mechanism to reduce the agency conflict between management and shareholders, so as to improve company performance. The higher the debt, then the monitoring is done very effectively so as to improve financial performance.

#### Coefficient of Determination

The coefficient of determination shown by the value of R<sup>2</sup> increasingly approaching one indicates the ability of the independent variables in explaining the dependent variables is very large. R<sup>2</sup> equation results in this study was 0.6, or 60%, which means that the independent variables in this study could explain the capital structure of 60%, while the rest is explained by variables outside the research. While the test results of determination of 0, 2 means that for financial performance is explained by the variable corporate governance and capital structure, while the remainder is 0, 8 is explained by other variables outside the model.

#### **E. Conclusion, Limitations and Suggestions**

The results show a). Value of capital structure at Islamic bank in Indonesia are very high, with an average value of 188.15%. It means that Islamic banks in Indonesia generally use a debt greater than stock. b). Only the board of commissioners that can be used as a corporate governance mechanism in reducing agency conflict, while the board of directors, the audit committee of the board, the supervisory board of sharia, shariah complaint can not be used as a corporate mechanism in Islamic banks in Indonesia. c). Duties and responsibilities of the board of directors does not affect on the capital structure. d). Committees of the board duties did not affect the capital structure, e). Duties and responsibilities of the sharia supervisory board did not affect the capital structure. f). The implementation of shariah compliance functions affect the capital structure. The test results of determination of 48.55%, which means that corporate governance variables in this study could explain the capital structure of 48.55%, and amounted to 51.45% is explained by other variables outside the research. While the test results of determination of 0, 2 means that for financial performance is explained by the variable corporate governance and capital structure, while the remainder is 0, 8 is explained by other variables outside the model.

Limitations and Suggestions in this research that factors used to assess good corporate governance in this study only 5 factors of 11 factors assessed in the self assessment Islamic banking so that further research is expected to use the eleventh factor for the results obtained more accurate and thorough.

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## Appendix

Table 1  
DER Islamic Bank in Indonesia

Islamic Bank	DER			
	2010	2011	2012	2013
BNI SYARIAH	78%	121%	184%	294%
BANK MUAMALAT INDONESIA	176%	207%	330%	230%
BANK SYARIAH MANDIRI	248%	229%	219%	227%
BANK MEGA SYARIAH	366%	418%	341%	247%
BANK PANIN SYARIAH	14%	6%	43%	77%
BCA SYARIAH	37%	61%	84%	88%
BRI SYARIAH	125%	231%	321%	265%
RATA-RATA	<b>149%</b>	<b>182%</b>	<b>217%</b>	<b>204%</b>

Source: *annual report of Indonesia Islamic Bank*

Table 2  
Self Assesment GCG at Islamic Bank

Component	2010	2011	2012	2013
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Board of Commisioneris	0.2	0.2	0.1	0.2
Board of Directors	0.3	0.3	0.2	0.2
Commitee Audit	0.2	0.2	0.2	0.2
Sharia Supervisi Board	0.2	0.2	0.1	0.1
Shariah Compliance	0.1	0.1	0.1	0.1

Source : Annual Report of Islamic Bank

Table 3  
REGRESSION 1  
GCG → CS  
Random Effect Model

Dependent Variable: CS				
Method: Panel EGLS (Cross-section random effects)				
Date: 09/08/15 Time: 08:23				
Sample: 2010 2013				
Periods included: 4				
Cross-sections included: 7				
Total panel (balanced) observations: 28				
Swamy and Arora estimator of component variances				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.076135	0.085644	12.56529	0.0000
X1	-1.726820	0.522947	-3.302095	0.0032
X2	-0.179768	0.239594	-0.750302	0.4610
X3	-0.424487	0.349912	-1.213126	0.2379
X4	0.462235	0.392883	1.176519	0.2520
X5	-1.984296	0.755467	-2.626582	0.0154
Effects Specification			S.D.	Rho
Cross-section random			0.081808	0.6030
Idiosyncratic random			0.066380	0.3970
Weighted Statistics				
R-squared	0.627263	Mean dependent var	0.218140	
Adjusted R-squared	0.542550	S.D. dependent var	0.111312	
S.E. of regression	0.075286	Sum squared resid	0.124695	
F-statistic	7.404567	Durbin-Watson stat	1.188760	
Prob(F-statistic)	0.000332			

Unweighted Statistics			
R-squared	0.610039	Mean dependent var	0.580250
Sum squared resid	0.441511	Durbin-Watson stat	0.648163

Table 4  
REGRESSION 2  
GCG → ROA  
Random Effect Model

Dependent Variable: ROA				
Method: Panel EGLS (Cross-section random effects)				
Date: 09/09/15 Time: 00:56				
Sample: 2010 2013				
Periods included: 4				
Cross-sections included: 7				
Total panel (balanced) observations: 28				
Swamy and Arora estimator of component variances				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3.097982	0.903768	3.427850	0.0024
X1	-4.691728	5.708861	-0.821833	0.4200
X2	-2.863530	3.073850	-0.931578	0.3617
X3	-0.594922	3.901236	-0.152496	0.8802
X4	1.789857	4.502236	0.397548	0.6948
X5	-4.913570	9.558851	-0.514034	0.6124
Effects Specification			S.D.	Rho
Cross-section random			0.308267	0.1004
Idiosyncratic random			0.922566	0.8996
Weighted Statistics				
R-squared	0.199244	Mean dependent var	1.153015	
Adjusted R-squared	0.017253	S.D. dependent var	1.061965	
S.E. of regression	1.052764	Sum squared resid	24.38284	
F-statistic	1.094805	Durbin-Watson stat	2.041462	
Prob(F-statistic)	0.391118			
Unweighted Statistics				
R-squared	0.169769	Mean dependent var	1.386786	
Sum squared resid	27.54825	Durbin-Watson stat	1.897730	

Table 5  
REGRESSION 3  
CS → ROA  
Random effect Model

Dependent Variable: ROA				
Method: Panel EGLS (Cross-section random effects)				
Date: 09/09/15 Time: 01:03				
Sample: 2010 2013				
Periods included: 4				
Cross-sections included: 7				
Total panel (balanced) observations: 28				
Swamy and Arora estimator of component variances				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.259331	0.627064	0.413564	0.6826
CS	1.943050	1.020708	1.903630	0.0681
Effects Specification				
			S.D.	Rho
Cross-section random			0.107074	0.0099
Idiosyncratic random			1.068742	0.9901
Weighted Statistics				
R-squared	0.126040	Mean dependent var		1.359757
Adjusted R-squared	0.092426	S.D. dependent var		1.102856
S.E. of regression	1.050654	Sum squared resid		28.70072
F-statistic	3.749655	Durbin-Watson stat		1.927162
Prob(F-statistic)	0.063759			
Unweighted Statistics				
R-squared	0.128093	Mean dependent var		1.386786
Sum squared resid	28.93110	Durbin-Watson stat		1.914876