Shirkah: Journal of Economics and Business
Vol. 10, No. 2 (2025), page 312-330
p-ISSN: 2503-4235 e-ISSN: 2503-4243
Journal homepage: http://shirkah.or.id/new-ojs/index.php/home

Research Paper

Corporate Governance, Risk Management, and Financial Performance: The Mediating Role of Risk Governance in Indonesia's Islamic Banks

Fauziah [a,1], Nur Atiqah [a,2], Pratiwi Kurniati[a,3], Prihantono [a,4], Mohd. Shahrul Kamaruddin[b,5]

[a] Faculty of Islamic Economics and Business, IAIN Pontianak, Indonesia
[b] Faculty of Cognitive Science and Human Development, University Malaysia Sarawak, Malaysia
[1] fauziah_mian@iainptk.ac.id*, [2] nur_atiqah@iainptk.ac.id, [3] pratiwi_kurniati@iainptk.ac.id, [4] prihantono@iainptk.ac.id, [5] kmshahrul@unimas.my

*Corresponding author

ARTICLE INFO

Keywords
Corporate Governance; Financial Performance; Indonesia's Islamic Bank; Risk Management; Risk Governance

Article history
Received: 03 January 2025
Revised: 24 July 2025
Accepted: 25 July 2025
Available online: 29 August 2025

To cite in APA style
Fauziah, Atiqah, N., Kurniati, P., Prihantono, & Kamaruddin, M. S. (2025). Corporate governance, risk management, and financial performance: The mediating role of risk governance in Indonesia's Islamic banks. *Shirkah: Journal of Economics and Business*, *10*(2), 312-330.

ABSTRACT

Islamic banks face increasing pressure to strengthen governance and risk oversight, yet the mediating role of risk governance in financial performance remains underexplored, particularly in Indonesia. This study aims to examine the structural relationships among corporate governance, risk management, risk governance, and the financial performance of Indonesia's Islamic banks. A quantitative research, drawing on secondary data from annual reports of eight Islamic banks between 2016 and 2023 with 64 observations, was employed. Corporate governance was measured using a composite governance index, risk governance through committee structures, risk management via credit, operational, liquidity, and Sharia-compliance controls, while financial performance was proxied by ROA and ROE. Data were analyzed using path analysis with PLS-SEM. The findings reveal that corporate governance significantly strengthens risk governance but does not directly improve financial performance. Conversely, risk management exerts a significant positive influence on financial performance, though it does not shape risk governance. Risk governance itself neither impacts financial performance nor mediates the relationships between governance, risk management, and performance. These results suggest that risk governance in Indonesian Islamic banks remains compliance-oriented rather than performance-enhancing. The study highlights the need for regulatory reforms and strategic integration of risk governance to support sustainable growth.

Introduction

For decades, corporate governance has constituted a core subject of enquiry within the financial literature owing to its profound implications for firm performance (Alodat et al., 2022; Farooq et al., 2022; Galuma, 2021). In the banking sector, corporate governance is indispensable not only to enhance operational efficiency and financial performance but also to safeguard the stability of the broader financial system (Abebe Zelalem et al., 2022; Boachie, 2023; Molla et al., 2023). This is particularly pertinent for Islamic banks that operate under unique guidelines based on Sharia principles (Alam et al., 2022; Alam et al., 2021). An effective corporate governance system in Islamic banking can enhance financial performance by addressing the issues of trust between shareholders, reducing conflicts of interest, and promoting transparency. Sustaining sharia-compliant governance strengthens corporate image and attracts investors who value ethical Islamic-based financial practices. Therefore, Sharia governance plays an important role in bridging sustainable business practices with financial performance by offering stakeholder confidence in both religious compliance and profitability (Jan et al., 2019; Uddin et al., 2024).

Empirical evidence on the impacts of global governance remains inconclusive. In Indonesia, audit committees significantly influence Return on Assets (ROA), while other governance variables such as board size and independent commissioners show inconsistent results (Tamara et al., 2024). In Malaysia, larger Sharia supervisory boards correlate positively with performance (Aslam & Haron, 2020). On the other hand, other studies suggest that larger board sizes may negatively affect the financial performance of Islamic banks in Malaysia (Tazilah et al., 2021). For a larger scope, the findings of a study (Khalil & Boulila Taktak, 2020) reveal that the number of members in the Shariah Board has a significant negative effect on the financial performance of Islamic banks. The findings show that members' financial or accounting backgrounds do not affect banks' financial positions. Wasim and Zafar (2024) argue that effective Sharia governance has a significant and positive correlation with the financial performance of Islamic banks, but their findings are dependent on the regional environment and risk management system.

Risk management plays a crucial role in Islamic banking. Although studies show that risk management enhances short-term performance (Alsalami et al., 2023), its influence on long-term market value remains inconclusive. Researchers emphasize the need for stronger governance and risk disclosure frameworks to mitigate operational and reputational risks (Alhammadi et al., 2020; Elamer et al., 2017; Minaryanti et al., 2024). The absence of standardized Islamic risk management practices across jurisdictions further complicates effective governance implementation (Wasim & Zafar, 2024). Although operational risks in Islamic banks often mirror those in conventional banks (Safiullah & Shamsuddin, 2018), studies in conventional financial institutions have shown that effective risk management structures, such as Chief Risk Officers (CROs) and risk committees, positively impact financial performance (Erin et al., 2020). Islamic banks, especially in emerging markets, face additional challenges due to underdeveloped money markets and the limited availability of sharia-compliant financial instruments (Aldoseri & Worthington, 2016).

Despite increasing attention on corporate governance and risk management, limited empirical research has directly examined how these factors influence financial performance through risk governance as mediators. Using a Structural Equation Model, Jallali and Zoghlami (2022) identified that risk governance fully mediates the relationship between corporate governance and bank performance, highlighting that without strong risk governance mechanisms, the direct influence of governance on performance diminishes considerably. The study emphasized the critical role of risk governance in maximizing the benefits of good corporate governance within banking institutions.

To redress this empirical–theoretical gap, this study introduces risk governance as a mediating variable in the relationship between corporate governance, risk management, and financial performance, specifically in the context of Indonesian Islamic banks. The context of this study is marked by regulatory oversight from the Financial Services Authority (OJK) and the institutionalized role of the Sharia Supervisory Board. Risk governance practices in Indonesia's Islamic banking sector exhibit distinct characteristics compared with conventional systems. These include the formal integration of the Sharia Supervisory Board into risk decision making, adherence to religious-based compliance protocols, and the limited presence of standardized tools for risk mitigation. Furthermore, reliance on ethical values creates a governance culture that is not always adequately represented by conventional metrics. The fragmented development of Sharia-compliant financial instruments requires models that are both flexible and deeply rooted in Islamic ethical frameworks. Thus, this study extends previous frameworks by applying causal path analysis to quantitatively test mediating relationships, providing clearer estimates than prior correlational or generalized SEM models.

Hypothesis Development

Studies examining the nexus between corporate governance, risk governance, and financial performance have emerged as a central topic in strategic management and financial research. These three concepts collectively form an institutional framework that ensures accountability, risk control, and sustainable corporate performance (Rahman et al. 2021). Corporate governance, risk governance, risk management, and financial performance interact within a broader institutional framework that governs strategic oversight, risk control, and the achievement of sustainable organizational outcomes. The relationships among these variables are explained through several key theoretical approaches, including agency theory, stewardship theory, the Enterprise Risk Management framework, resource dependence theory, and contingency theory.

Agency theory, which asserts that governance systems are designed to monitor and mitigate managerial opportunism, offers the most cogent explanation of the relationship between corporate governance and risk governance (Hendrastuti & Harahap, 2023). Within this framework, corporate governance practices such as the presence of independent board members and effective audit committees encourage the formation of more structured and stringent risk management systems. Cheah et al. (2023) emphasize that the effectiveness of audit committees significantly influences the quality of risk management, indicating that corporate governance functions as a primary driver in shaping a robust risk governance system. Halim et al. (2017) further highlight that the existence of a Risk Management Committee, which is part of the corporate governance structure, serves as a crucial intermediary to ensure that governance principles are systematically integrated into risk management practices.

Stewardship theory posits that corporate governance structures that promote trust and managerial autonomy enhance financial performance by encouraging managers to act as stewards of organizational assets rather than as mere agents of shareholders. Kyere and

Ausloos (2021) found that corporate governance mechanisms, such as board independence and institutional ownership, positively affect ROA and Tobin's Q. The theoretical rationale for this is that strong governance reduces agency costs, boosts investor confidence, and enhances operational efficiency. Ismaeel and Soliman (2022) added that, in the context of small and medium-sized enterprises, high-quality corporate governance practices drive strategic decision-making based on informed judgment, which directly impacts profitability.

The Enterprise Risk Management (ERM) framework views risk governance as a central function that ensures that corporate strategic decisions are made with full consideration of risks and uncertainties. A strong risk-governance system proactively detects, assesses, and controls risks, thereby avoiding significant losses and fostering long-term efficiency. A study by Erin et al. (2020) found that the presence of a Chief Risk Officer and an independent risk committee has a positive and significant association with ROA. The theoretical explanation is that an effective risk-oversight structure enhances cash flow predictability, supports operational continuity, and strengthens corporate competitiveness.

Contingency theory posits that the effectiveness of internal systems, such as risk management and governance, depends on their alignment with external conditions. Halim et al., (2017) suggested that corporate governance does not directly influence financial performance unless mediated by risk governance. This assertion is supported by Sibarani and Lusmeida (2021), who find that ERM fully mediates the relationship between corporate governance and financial performance in Indonesian publicly listed firms.

Risk management is widely acknowledged as a critical function in achieving organizational resilience and long-term financial health. Saad et al. (2024) identified risk management as a key determinant of financial performance in Islamic banking, although its effectiveness depends on its integration with broader governance mechanisms. While risk management aims to reduce volatility and enhance decision making, its impact on financial performance can only be optimized when robust risk governance structures are in place to ensure alignment with strategic objectives.

The mediating role of risk governance in the relationship between corporate governance and financial performance is elucidated through Contingency Theory, which posits that an organization's effectiveness depends on the alignment between internal structures and external environments. In this context, effective corporate governance does not necessarily improve financial performance directly; rather, its impact depends on how well the firm manages the risks arising from strategic choices. The influence of corporate governance on financial performance becomes insignificant in the absence of a Risk Management Committee (Halim et al., 2017), suggesting that risk governance is a critical conduit for this influence. Sibarani and Lusmeida (2021) reinforce this view by demonstrating that Enterprise Risk Management mediates the corporate governance and financial performance relationship, implying that corporate governance can only effectively enhance financial performance when complemented by an integrated risk management system.

The interaction between risk management and governance highlights the structural integration between operational and strategic oversight. Saad et al., (2024) further demonstrated that risk governance mediates the relationship between risk management and financial performance. Their findings revealed that consistent risk identification and mitigation practices enhance board-level risk supervision, suggesting that the positive impact of risk management on financial performance is significantly strengthened when risk governance frameworks are effectively operationalized.

This theoretical reasoning indicates that the relationships among the study variables are inherently structural and systemic, rather than linear. Sound governance practices foster effective risk management, which in turn leads to sustainable improvement in financial performance. Thus, the relationships between the variables were articulated through several hypotheses.

H1: Corporate Governance (CG) has a positive effect on Risk Governance (RG).
H2: Corporate Governance (CG) has a positive effect on Financial Performance (FP).
H3: Risk Governance (RG) mediates the relationship between Corporate Governance (CG) and Financial Performance (FP).
H4: Risk Governance has a positive effect on Financial Performance
H5: Risk Management (RM) has a positive effect on Financial Performance (FP).
H6: Risk Management (RM) has a positive effect on Risk Governance (RG).
H7: Risk Governance (RG) mediates the relationship between Risk Management (RM) and Financial Performance (FP).

Conceptual Framework

This study proposes a conceptual framework to explain the relationships between corporate governance, risk management, risk governance, and financial performance in the context of Islamic banks in Indonesia (see Figure 1). Corporate Governance (CG) and Risk Management (RM) are considered independent variables, while Financial Performance (FP) is treated as the dependent variable.

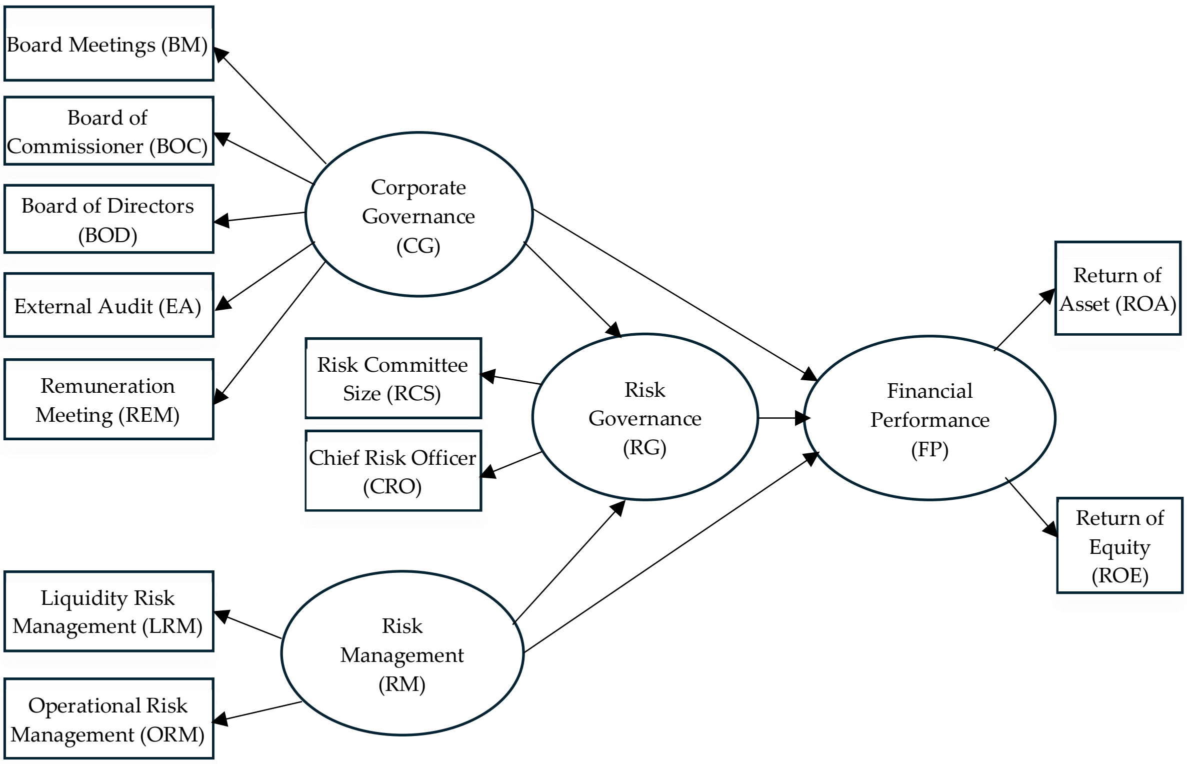

Figure 1. Conceptual Framework

Risk Governance (RG) functions as the mediating variable that channels the influence of CG and RM on FP.

Corporate governance is hypothesized to have a direct positive effect on both risk governance and financial performance, reflecting the role of strong governance structures in enhancing oversight and operational efficiency. Similarly, risk management practices are expected to positively influence risk governance by ensuring that risk strategies are properly implemented within banks' governance mechanisms and directly improve financial performance through better risk mitigation. Risk governance is posited to have a direct impact on financial performance, acting as a mechanism that aligns governance and risk practices with strategic objectives. Furthermore, it is hypothesized to mediate the relationships among corporate governance, risk management, and financial performance, thereby providing a comprehensive understanding of how these factors interact.

Method

Research Design

This study employed a quantitative causal research design to examine the correlations between corporate governance factors, risk governance, and the financial performance of Islamic banks. This design was adopted to establish the flow of direct and indirect correlations between variables through the mediating variable risk governance. This research model assumes that corporate governance has a direct impact on banks' financial performance and an indirect impact through risk governance. In this study, corporate governance was the independent variable, risk governance was the mediating variable, and bank financial performance was the dependent variable.

Path analysis was used to test the hypotheses to estimate the mediation effect. Partial least squares structural equation modelling (PLS-SEM) was selected for this study because of its predictive orientation and flexibility in handling complex structural models, particularly those involving latent variables with both reflective and formative indicators. Additionally, PLS-SEM accommodates non-normal data distributions and relatively moderate sample sizes, which are characteristics of the data in this study. Supported by Hair et al. (2019), PLS-SEM is superior in exploratory and predictive contexts and is well suited for early theory development and the validation of new models that examine mediation effects among variables.

Sample and Data

The study population represents all Sharia banks in the Southeast Asian region. The sample was determined through the purposive sampling method, with the provision of Sharia banks that published annual financial statements in the 2018-2022 research period (see Table 1). The selected sample includes Sharia banks in the Asian Bank Global's ten largest Sharia banks.

The study included seven sharia institutions from Indonesia, seven from Malaysia, and one each from Thailand, Brunei Darussalam, and the Philippines, representing a fairly balanced regional composition across national and cross-border scales. This distribution indicates that Indonesia and Malaysia dominate the sample population, while contributions from Thailand, Brunei, and the Philippines are representative. Consequently, research needs to consider differences in regulatory systems, macroeconomic conditions, political risk, and policy quality across countries as important variables.

Table 1. Islamic Banks Observed in the Study

No.	Islamic Banks
1	PT Bank Muamalat Indonesia Tbk
2	PT Bank BCA Syariah
3	PT Bank Jawa Barat Banten Syariah
4	PT Bank Bukopin Syariah
5	PT Bank Mega Syariah
6	PT Bank Panin Syariah
7	PT Bank Victoria Syariah
8	PT BTPN Syariah Tbk
Total Sample	8 Islamic Banks in Indonesia x 8 years = 64 observations

Data Collection

Secondary data were obtained from the annual bank reports and other relevant data provided to the public. The variables were operationalized using conventional measures such as Corporate Governance (CG) measured using the Corporate Governance Index (CGI), a composite index constructed based on a checklist of five indicators: board of directors' size, board of commissioners' size, frequency of board meetings, remuneration committee meetings, and external audit meetings. Risk Governance (RG) was measured using the Risk Governance Index (RGI), developed through a checklist-based scoring system that includes the number of risk committee members and other governance structures supporting risk oversight. Financial Performance (FP) is proxied by Return on Assets (ROA) and Return on Equity (ROE). Risk Management (RM) is proxied by four indicators: credit risk management, operational risk management, liquidity risk management, and non-Sharia compliance risk management.

Variable Measurement

This study employs several latent variables, each measured through a set of observed indicators, to assess their respective constructs (see Table 2). The first latent variable is Financial Performance (FP), which is operationalized using three accounting-based indicators. First, Return on Assets (ROA) is calculated as net income divided by total assets and reflects the firm's economic profitability. The second, Return on Equity (ROE), represents financial profitability and is measured by dividing net income by shareholder equity. The third indicator, the Net Banking Margin (NBM), serves as a measure of income-generating efficiency within the financial sector.

The second latent construct is Corporate Governance (CG), which is evaluated through a variety of organizational governance indicators. The Board of Directors (BOD) is measured by the number of directors serving during the year, while the Board of Commissioners (BOC) is assessed by the size of the supervisory board within the same period. Board Meetings (BM) are represented by the total number of meetings held jointly by both boards, and Remuneration Meetings (REM) refers to the number of meetings focused on compensation matters. Additionally, an External Audit (EA) is included as an indicator to capture the frequency of external audit meetings conducted during the year.

The third latent variable, Risk Management (RM), encompasses four components that reflect distinct areas of risk oversight. Credit Risk Management (CRM) is measured through the ratio of loan loss reserves to gross loans, indicating the institution's provision for potential credit default. Operational Risk Management (ORM) is represented by the capital adequacy ratio, calculated as the total capital plus 50% unrestricted investment accounts, reflecting the institution's capacity to absorb operational losses. Liquidity Risk Management (LRM) is assessed using the short-term liquidity ratio, defined as liquid assets divided by total assets, which indicates the organization's ability to meet short-term obligations. Non-Sharia Compliance Risk Management (SCRM) is measured by the number of members on the Sharia Supervisory Board, serving as a proxy for religious compliance governance. Finally, the latent variable Risk Governance is represented by the Risk Committee Size (RCS), which refers to the number of individuals serving on the risk committee.

Table 2. Variable Measurement

Latent Variables	**Observed Variables**	**Measures**
Financial Performance (FP)	Accounting economic profitability (ROA)	Net Income/ Total Assets
	Accounting financial profitability (ROE)	Net Income/ Shareholder equity net banking margin (NBM)
Corporate governance (CG)	Board of Director (BOD)	Size the Board of Directors during the current year
	Board of Commissioner (BOC)	Size the Board of Commissioner during the current year
	Board meetings (BM)	The total number of board of directors and board of commissioner meetings
	Remuneration meeting (REM)	The total number of board directors and board commissioner meetings during the current the year
	External Audit (EA)	The number of external audit meetings during the current year
Risk Management (RM)	Credit Risk Management (CRM)	Loan loss reserve/ Gross Loans
	Operational risk management (ORM)	(Capital adequacy ratio) Total capital (capital and current account) + 50% (unrestricted investment account)
	Liquidity risk management (LRM)	Short term liquidity ratio = liquid assets/ total assets
	Non-Sharia compliance risk management (SCRM)	Number of Sharia board of advisory members
Risk Governance	Risk Committee size (RCS)	Size of the risk committee

Data Analysis

The accuracy of the measurement model was evaluated through validity and reliability tests. Internal consistency reliability was assessed using Cronbach's Alpha and Composite Reliability (CR). In line with established guidelines, a threshold value of 0.70 or higher was adopted as the acceptable criterion for both measures. Convergent validity was assessed through Average Variance Extracted (AVE) with a minimum threshold of 0.5. Discriminant validity was evaluated using the Fornell-Larcker criterion and a cross-loading analysis.

Mediation Analysis

This study evaluates whether risk governance mediates the relationship between corporate governance and financial performance, as well as between risk management and financial performance. Mediation analysis enables a deeper understanding of how internal governance structures and risk practices contribute to organizational outcomes, both directly and indirectly, through the quality and effectiveness of risk governance processes. Partial Least Squares Structural Equation Modeling (PLS-SEM) manages complex models involving latent constructs with both reflective and formative indicators. PLS-SEM also offers flexibility in exploring the relationships in predictive and theory-building models (Hair et al., 2019). The mediating role of risk governance was examined using a bootstrapping procedure with 5,000 subsamples using SmartPLS 4. The significance of the indirect effects was determined through bias-corrected confidence intervals, with mediation established when the interval excluded zero. This approach provides insights into whether improvements in risk governance serve as an essential channel through which corporate and risk management practices can lead to enhanced financial outcomes, underscoring the strategic importance of risk governance in Islamic financial institutions.

Estimating Model

Path analysis was employed to examine the mediating relationships using SmartPLS 4 software. The estimation model in this study describes the correlations between several key variables within the framework of Islamic banking in Indonesia. In this model, Corporate Governance (CG) and Risk Management (RM) serve as independent variables that are expected to influence both Risk Governance (RG) and Financial Performance (FP). Risk Governance (RG) functions as a mediating variable, positioned to explain the indirect relationship between corporate governance, risk management, and financial performance. Finally, Financial Performance (FP) is identified as the dependent variable, representing the outcome affected by the interplay of governance and risk-related practices.

Figure 2 shows the estimated model of the correlations between the variables. Corporate governance is expected to have a direct correlation with risk governance, whereas its influence on financial performance is assumed to occur indirectly through the mediation of risk governance. Similarly, risk management is proposed to have a direct effect on risk governance, and its ultimate impact on financial performance is mediated by risk governance. In this framework, risk governance plays a central role as an intermediary variable, bridging the relationship between corporate governance and risk management and the financial performance of Islamic banks. This structure highlights the importance of effective risk governance mechanisms in optimizing the governance framework and risk management practices to achieve better financial outcomes for Islamic banking institutions.

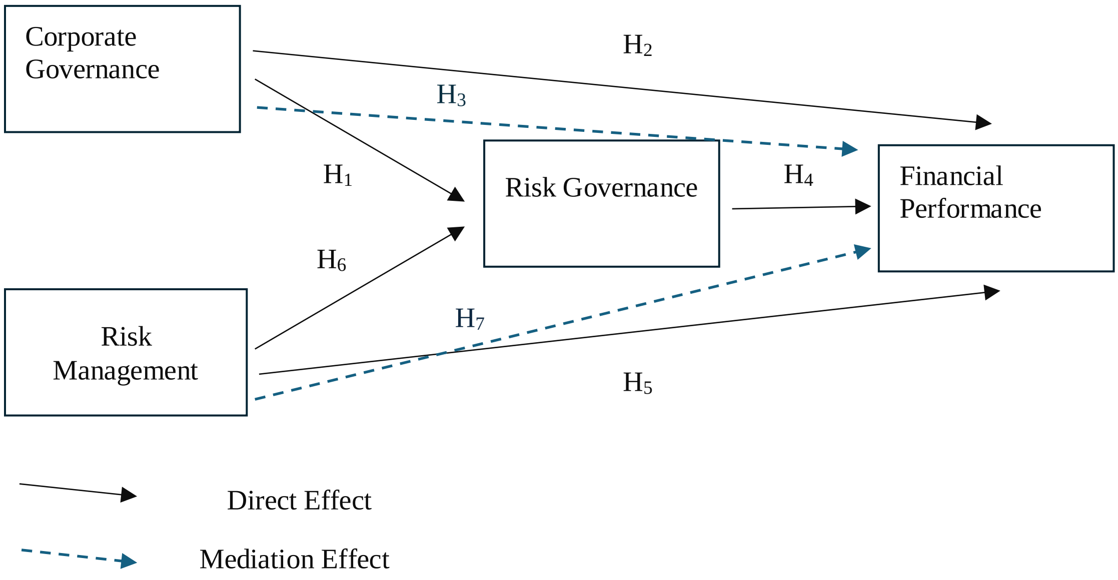

Figure 2. The Research Model

Results

Table 3 demonstrates the results of validity and reliability. Reliability was assessed using Cronbach's Alpha (α) and Composite Reliability (rho_c), with a threshold of ≥0.70 indicating good internal consistency. Convergent validity was evaluated using the Average Variance Extracted (AVE), which should ideally exceed 0.50 to ensure that the construct adequately explains the variance of its indicators. Furthermore, discriminant validity was tested using the Fornell Larcker Criterion, which requires that the square root of the AVE on the diagonal is higher than the correlations between constructs in the corresponding rows and columns.

Table 3. Validity and Reliability

Construct	**Reliability and Convergent Validity**			**Fornell-Lacker Criterion**			
	A	rho_c	AVE	Corporate Governance (X1)	Financial Performance (Y)	Risk Governance (M)	Risk Management (X2)
Corporate Governance	0,910	0,934	0,740	0,860			
Financial Performance	0,886	0,946	0,898	0,313	0,948		
Risk Governance	0,742	0,886	0,795	0,189	0,235	0,891	
Risk Management	0,974	0,987	0,973	0,078	0,153	0,223	0,987

Table 4 presents the R^2 values, which indicate the proportion of variance in each endogenous variable explained by the predictors. The R^2 value for Financial Performance is 0.183, indicating that Corporate Governance, Risk Governance, and Risk Management collectively account for 18.3% of the variance in financial performance. Within management and behavioural finance research, especially in emerging market contexts such as Indonesia, this value, though relatively modest, is deemed acceptable due to the inherent complexity and multidimensional nature of factors influencing financial performance. This suggests that other operational, macroeconomic, and firm-specific factors outside the current model likely accounted for the remaining 81.7% of the variation. The Adjusted R^2 of 0.142 indicates a slight reduction in explanatory power when accounting for model complexity but remains within a reasonable threshold for exploratory models in financial services research. Risk Governance has an R^2 value of 0.405, indicating that 40.5% of its variance is explained by Corporate Governance and Risk Management. This is a relatively strong value in corporate governance studies, reflecting that the predictors effectively capture key factors influencing risk governance practices in Islamic banks in Indonesia.

Table 4. R Square

	Variable	R-square	R-square adjusted
1	Financial Performance	0.183	0.142
2	Risk Governance	0.405	0.385

Table 5 presents the hypotheses testing results. Corporate Governance has a strong and significant positive influence on Risk Governance ($\beta = 0.600$, $p = 0.000$), thus supporting Hypothesis 1. However, its direct effect on Financial Performance ($\beta = 0.022$, $p = 0.886$) was insignificant, leading to the rejection of Hypothesis 2. Risk Management demonstrates a significant, moderate to strong direct effect on Financial Performance ($\beta = 0.430$, $p = 0.009$), confirming Hypothesis 4. However, its effect on Risk Governance remained insignificant ($\beta = 0.092$, $p = 0.502$), leading to the rejection of Hypothesis 3. This study also confirms that the direct effect of Risk Governance on Financial Performance is insignificant ($\beta = -0.035$, $p = 0.761$), and it does not mediate the relationship between Corporate Governance or Risk Management and Financial Performance. These findings partially reject hypotheses 5, 6, and 7.

These results imply that, while strengthening corporate governance structures can improve risk governance frameworks, it is insufficient to directly enhance financial performance. Therefore, banks should focus on improving risk management systems that integrate operational risk controls, credit risk assessments, and market risk responses to drive profitability. Additionally, the weak and insignificant role of Risk Governance suggests that within the Indonesian Islamic banking sector, governance structures might still be largely procedural and compliance-oriented rather than value-generating. The OJK and related policymakers should consider issuing standardized, enforceable risk governance frameworks complemented by mandatory training for board members and risk committees to improve both strategic risk oversight and financial outcomes.

In emerging markets such as Indonesia, the practical role of risk governance may become evident only during periods of financial turbulence or crisis or over a long-term horizon as governance maturity improves. This calls for a long-term policy roadmap to embed Islamic ethical finance principles, emphasizing fairness, transparency, and risk-sharing, within risk governance practices to create both resilience and financial value.

Table 5. Direct and Indirect Effects

No.	Variables	Original sample (O)	Sample mean (M)	Standard deviation (STDEV)	T statistics (|O/STDEV|)	P values
1.	Corporate Governance -> Risk Governance	0.600	0.598	0.099	6.038	**0.000**
2.	Risk Management -> Risk Governance	0.092	0.094	0.138	0.671	0.502
3.	Corporate Governance -> Financial Performance	0.022	0.023	0.153	0.143	0.886
4.	Risk Management -> Financial Performance	0.430	0.453	0.165	2.606	**0.009**
5.	Risk Governance -> Financial Performance	-0.035	-0.031	0.115	0.304	0.761
6.	Corporate Governance -> Risk Governance -> Financial Performance	-0.021	-0.018	0.073	0.290	0.772
7.	Risk Management -> Risk Governance -> Financial Performance	-0.003	-0.007	0.020	0.165	0.869

As depicted in Table 6, the path analysis results show several notable relationships. Corporate Governance has a large effect on Risk Governance (f^2 = 0.542), confirming that strong governance practices considerably enhance risk oversight mechanisms within Islamic banks. This underlines the practical necessity for banks to reinforce governance frameworks by focusing on board effectiveness, internal control systems, and compliance structures.

Conversely, the effect of Corporate Governance on Financial Performance is negligible (f^2 = 0.000), implying that without complementary factors, such as operational efficiency or strategic agility, governance practices alone do not directly improve financial performance. Risk Management's direct effect on Risk Governance is small (f^2 = 0.013), suggesting that while risk management activities exist, their integration into the governance framework is not yet optimal, an important practical insight for regulators like OJK to mandate a stronger alignment between operational risk practices and board-level oversight.

The effect of Risk Governance on Financial Performance is also minimal (f^2 = 0.001), indicating that current risk governance structures may focus more on procedural compliance than on strategic value creation, a pattern often observed in developing economies where risk governance is still maturing. However, risk Management has a moderate effect on Financial Performance (f^2 = 0.200), highlighting its pivotal role in maintaining profitability and operational resilience. Practically, this suggests that Islamic banks should prioritize risk management infrastructure and culture-building as a direct lever to improve financial outcomes.

Table 6. Effect Size

No.	Variable	Risk Governance	Financial Performance
1.	Corporate Governance	0.542	0.000
2.	Risk Governance		0.001
3.	Risk Management	0.013	0.200

Discussion

The results of this study confirm that corporate governance positively influences risk governance, consistent with agency theory which emphasizes the role of oversight mechanisms in mitigating managerial opportunism (Kyere & Ausloos, 2021; Halim et al., 2017). Independent commissioners, audit committees, and risk management committees appear to strengthen risk control systems at a strategic level by promoting accountability and transparency. Governance mechanisms such as board independence and audit committee effectiveness are critical to developing robust risk governance systems that ensure risks are systematically identified and mitigated (Benichou, 2024; Guluma, 2021; Thapa et al., 2025). Moreover, effective audit committees enhance the quality of risk management by ensuring better monitoring and internal control processes (Cheah et al., 2023). Despite this, the findings show that corporate governance does not directly influence financial performance, indicating that Sharia banks in Indonesia largely implement governance structures as formal compliance measures rather than strategic tools for value creation. This supports Contingency Theory, which suggests that governance mechanisms only generate value when aligned with contextual institutional and environmental conditions (Halim et al., 2017; Sibarani & Lusmeida, 2021). Therefore, governance alone is insufficient for improving performance unless embedded within broader risk and operational frameworks.

The study also finds that risk management exerts a significant positive impact on financial performance, reflecting its role in reducing losses, minimizing inefficiencies, and stabilizing profitability. By implementing comprehensive risk management strategies, Islamic banks can mitigate credit, liquidity, and market risks, thereby reducing costs and ensuring resilience (Stulz, 2022; Syadali et al., 2023; Umar et al., 2024). Beyond loss reduction, effective risk management enhances the decision-making process, equipping managers with structured frameworks to evaluate financial trade-offs and pursue opportunities with controlled exposure (Galli, 2021). Strong risk management also improves stakeholder trust by signaling institutional preparedness against financial shocks (Saeudy et al., 2022), while maintaining continuity during periods of instability (Sobanova, 2024). Furthermore, calculated opportunity-seeking under risk management frameworks allows Islamic banks to leverage innovation and market expansion without compromising stability (Mishchenko et al., 2021). These findings are consistent with Saad et al. (2024), who found a significant link between risk management and performance in Islamic banking. However, the study reveals that risk management does not significantly shape risk governance, indicating a gap between operational-level practices and their formal integration into governance oversight structures.

A critical finding of this study is the absence of significant direct or mediating effects of risk governance on financial performance. This outcome implies that risk governance in

Indonesian Islamic banks has not yet evolved into a mechanism that creates financial value. Instead, it is largely administrative, focusing on procedural compliance rather than strategic oversight. Unlike prior evidence from Saad et al. (2024), who reported partial mediating effects of risk governance in other contexts, the present findings reflect the underdeveloped nature of risk governance institutions in Indonesia, compounded by the lack of consistent standards across the industry. This suggests that while risk committees and governance structures exist, they are often symbolic rather than functional, limiting their ability to align governance and operational practices with performance outcomes. The absence of mediation also indicates that without stronger institutional integration, risk governance cannot serve as a channel through which corporate governance or risk management translates into financial results. This reinforces the idea that the Indonesian Islamic banking sector must progress beyond compliance-driven approaches toward performance-enhancing governance frameworks (Nomran et al., 2018; Rahmawati et al., 2024; Rehman et al., 2021).

The weak role of risk governance has important implications for regulators and policymakers. The findings highlight the necessity for the Financial Services Authority (OJK) to enforce stronger governance standards that extend beyond formal requirements and actively embed governance principles into strategic planning. Board structures and audit mechanisms must be designed not merely to meet compliance checklists but to strategically support risk governance effectiveness. Given that risk management directly contributes to financial performance, policy frameworks should mandate the integration of operational risk controls, including credit, liquidity, and Sharia noncompliance risks, into governance oversight and corporate strategy (Syadali et al., 2023). Furthermore, reforms must elevate risk governance to a more proactive role by institutionalizing competency-based appointments to risk committees, ensuring that members possess the technical expertise and independence needed for effective oversight. Structured training programs for board members and risk committees could also enhance their capacity to link risk oversight with financial outcomes, transforming governance from a compliance-oriented practice into a driver of institutional resilience and performance (Xi, 2024).

Building on these implications, the study recommends proactive regulatory interventions by OJK to strengthen risk governance within Islamic banks. Such interventions could include issuing enforceable, practice-oriented governance guidelines that clarify roles, responsibilities, and accountability structures. Additionally, capacity-building initiatives for Sharia supervisory boards and risk committees are essential to equip members with the skills required for strategic risk oversight (Karkošková, 2023). By embedding Islamic ethical principles of fairness, transparency, and risk-sharing into governance systems, regulators can ensure that risk governance contributes both to resilience and value creation. Moreover, given the finding that risk governance currently plays a negligible role in mediating relationships among governance, risk management, and performance, a policy roadmap is needed to integrate these dimensions more effectively. This includes long-term efforts to standardize governance practices across Islamic banks, align them with international best practices, and adapt them to Indonesia's regulatory and cultural context. Ultimately, the study underscores the urgency of transforming risk governance from a procedural safeguard into a strategic enabler of sustainable financial performance in the evolving Islamic banking landscape.

Conclusion

This study investigates the structural relationships among corporate governance, risk management, risk governance, and financial performance in Indonesia's Islamic banks. The findings reveal that corporate governance, reflected in board composition and audit structures, significantly strengthens risk governance but does not directly influence financial performance. This indicates that governance mechanisms remain largely procedural and are yet to be strategically mobilized as drivers of financial value. In contrast, risk management, measured through credit risk reserves, capital adequacy, liquidity ratios, and non-compliance controls, directly enhances financial performance, underscoring its vital role in ensuring resilience and profitability. However, its limited influence on risk governance highlights a disconnect between operational risk practices and strategic oversight structures. Moreover, risk governance neither directly affects financial performance nor mediates the relationship between corporate governance, risk management, and financial outcomes, suggesting that current governance frameworks are insufficiently institutionalized to serve as value-creating mechanisms. These findings emphasize the importance of moving beyond compliance-driven practices toward embedding risk oversight strategically within governance systems to foster sustainable growth in Islamic banks.

Despite providing important insights, this research has several limitations. First, it relies on secondary data drawn from annual reports, which may not fully capture the qualitative dimensions of governance dynamics, such as leadership culture, board expertise, or decision-making processes. Second, the study is limited to Indonesian Islamic banks, which restricts the generalizability of findings to other jurisdictions with different regulatory and institutional environments. Third, the cross-sectional design provides only a snapshot of governance-performance relationships and may not adequately reflect long-term trends. Future research should therefore incorporate longitudinal data to explore how these relationships evolve over time, especially during periods of regulatory reform or financial turbulence. Comparative studies across countries could also highlight the role of varying institutional frameworks in shaping governance effectiveness. Furthermore, integrating qualitative analyses would provide deeper insights into how Sharia compliance dynamics, managerial competencies, and organizational culture interact with governance and risk structures to influence financial outcomes.

Authors' Declaration

The authors made substantial contributions to the conception and design of this study. The authors take responsibility for the data analysis, interpretation, and discussion of the results. The authors have read and approved the final manuscript.

ORCID

Fauziah https://orcid.org/0000-0002-4741-8098
Nur Atiqah https://orcid.org/0009-0008-1885-1037
Pratiwi Kurniati https://orcid.org/0009-0003-9401-5683
Prihantono https://orcid.org/0009-0003-3424-031X
Mohd. Shahrul Kamaruddin https://orcid.org/0000-0002-2832-5849

References

Abebe Zelalem, B., Ali Abebe, A., & Wodajo Bezabih, S. (2022). Corporate governance and financial performance in the emerging economy: The case of Ethiopian insurance companies. *Cogent Economics & Finance*, *10*(1), 2117117. https://doi.org/10.1080/23322039.2022.2117117

Alam, M. K., Rahman, M. M., Islam, F. T., Adedeji, B. S., Mannan, M. A., & Sahabuddin, M. (2021). The practices of Shariah governance systems of Islamic banks in Bangladesh. *Pacific Accounting Review*, *33*(4), 505-524. https://doi.org/10.1108/PAR-10-2020-0195

Alam, M. K., Rahman, M. M., Runy, M. K., Adedeji, B. S., & Hassan, M. F. (2022). The influences of Shariah governance mechanisms on Islamic banks performance and Shariah compliance quality. *Asian Journal of Accounting Research*, *7*(1), 2-16. http://dx.doi.org/10.1108/AJAR-11-2020-0112

Aldoseri, M., & Worthington, A. C. (2016). Risk management in Islamic banking: An emerging market imperative. In S. Boubaker, B. Buchanan, & D. K. Nguyen (Eds.), *Risk Management in Emerging Markets* (pp. 229–252). Emerald Group Publishing Limited. https://doi.org/10.1108/978-1-78635-452-520161020

Alhammadi, S., Archer, S., & Asutay, M. (2020). Risk management and corporate governance failures in Islamic banks: a case study. *Journal of Islamic Accounting and Business Research*, *11*(10), 1921–1939. https://doi.org/10.1108/JIABR-03-2020-0064

Alodat, A. Y., Salleh, Z., Hashim, H. A., & Sulong, F. (2022). Corporate governance and firm performance: Empirical evidence from Jordan. *Journal of Financial Reporting and Accounting*, *20*(5), 866-896. http://dx.doi.org/10.1108/JFRA-12-2020-0361

Alsalami, T., Soo-Wah, L., Nor, S. M., & Alsheikh, A. H. (2023). The impact of enterprise risk management on financial performance: Evidence from the GCC Islamic banks. *Asian Economic and Financial Review*, *13*(11), 818–831. https://doi.org/10.55493/5002.v13i11.4867

Aslam, E., & Haron, R. (2020). Does corporate governance affect the performance of Islamic banks? New insight into Islamic countries. *Corporate Governance: The International Journal of Business in Society*, *20*(6), 1073–1090. https://doi.org/10.1108/CG-11-2019-0350

Benichou, M. (2024). Audit committee and board of directors: A synergy for effective corporate governance. *International Journal of Professional Business Review: Int. J. Prof. Bus. Rev.*, *9*(12), 4. https://doi.org/10.26668/businessreview/2024.v9i12.5238

Boachie, C. (2023). Corporate governance and financial performance of banks in Ghana: the moderating role of ownership structure. *International Journal of Emerging Markets*, *18*(3), 607-632. https://doi.org/10.1108/IJOEM-09-2020-1146

Cheah, C. K., Wong, K. Y., Tan, K. L., Ong, H. S., Kong, Y. M., & Erusan, D. (2023). *Islamic Bank Audit Committee and Risk-Taking Behavior. A Conceptual Framework* (Vol. 1). Atlantis Press SARL. https://doi.org/10.2991/978-2-494069-99-2_12

Elamer, A. A., Ntim, C. G., & Abdou, H. A. (2017). Islamic governance, national governance, and bank risk management and disclosure in MENA Countries. *Business & Society*, *59*(5), 914–955. https://doi.org/10.1177/0007650317746108

Erin, O., Bamigboye, O., & Arumona, J. (2020). Risk governance and financial performance: An empirical analysis. *Business: Theory and Practice*, *21*(2), 758–768. https://doi.org/10.3846/btp.2020.10850

Farooq, M., Noor, A., & Ali, S. (2022). Corporate governance and firm performance: empirical evidence from Pakistan. *Corporate Governance: The International Journal of Business in Society*, *22*(1), 42-66. https://doi.org/10.1108/CG-07-2020-0286

Galli, B. J. (2021). Economic Decision-Making and Risk Management: A Relation From the Banking Perspective. *International Journal of System Dynamics Applications (IJSDA)*, *10*(4), 1-25. https://doi.org/10.4018/IJSDA.20211001.oa2

Guluma, T. F. (2021). The impact of corporate governance measures on firm performance: the influences of managerial overconfidence. *Future Business Journal*, *7*(1), 50. https://doi.org/10.1186/s43093-021-00093-6

Hair, J. F., Risher, J. J., Sarstedt, M., & Ringle, C. M. (2019). When to use and how to report the results of PLS-SEM. *European business review, 31*(1), 2-24. https://doi.org/10.1108/EBR-11-2018-0203

Halim, E. H., Mustika, G., Sari, R. N., Anugerah, R., & Mohd-Sanusi, Z. (2017). Corporate governance practices and financial performance: The mediating effect of risk management committee at manufacturing firms. *Journal of International Studies*, *10*(4), 272–289. https://doi.org/10.14254/2071-8330.2017/10-4/21

Hendrastuti, R., & Harahap, R. F. (2023). Agency theory: Review of the theory and current research. *Jurnal Akuntansi Aktual*, *10*(1), 85. https://doi.org/10.17977/um004v10i12023p085

Ismaeel, F. N., & Soliman, M. M. (2022). The effect of corporate governance on the financial performance of SME listed companies in Egypt. *Corporate Ownership and Control*, *20*(1), 95–102. https://doi.org/10.22495/cocv20i1art9

Jallali, S., & Zoghlami, F. (2022). Does risk governance mediate the impact of governance and risk management on banks' performance? Evidence from a selected sample of Islamic banks. *Journal of Financial Regulation and Compliance*, *30*(4), 439–464. https://doi.org/10.1108/JFRC-04-2021-0037

Jan, A., Marimuthu, M., Hassan, R., & Mehreen. (2019). Sustainable business practices and firm's financial performance in islamic banking: Under the moderating role of islamic corporate governance. *Sustainability (Switzerland)*, *11*(23), 1–25. https://doi.org/10.3390/su11236606

Karkošková, S. (2023). Data governance model to enhance data quality in financial institutions. *Information Systems Management*, *40*(1), 90-110. http://dx.doi.org/10.1080/10580530.2022.2042628

Khalil, A., & Boulila Taktak, N. (2020). The impact of the Shariah Board's characteristics on the financial soundness of Islamic banks. *Journal of Islamic Accounting and Business Research*, *11*(10), 1807–1825. https://doi.org/10.1108/JIABR-08-2018-0127

Kyere, M., & Ausloos, M. (2021). Corporate governance and firms financial performance in the United Kingdom. *International Journal of Finance and Economics*, *26*(2), 1871–1885. https://doi.org/10.1002/ijfe.1883

Minaryanti, A. A., Fitrijanti, T., Sukmadilaga, C., & Mihajat, M. I. S. (2024). The role of Sharia governance in minimizing credit risk in Islamic banking: a systematic literature review. *Journal of Islamic Accounting and Business Research*, *ahead-of-p*(ahead-of-print). https://doi.org/10.1108/JIABR-11-2022-0301

Mishchenko, S., Naumenkova, S., Mishchenko, V., & Dorofeiev, D. (2021). Innovation risk management in financial institutions. *Investment Management and Financial Innovations*, *18*(1), 191-203. http://dx.doi.org/10.21511/imfi.18(1).2021.16

Molla, M. I., Islam, M. S., & Rahaman, M. K. B. (2023). Corporate governance structure and bank performance: Evidence from an emerging economy. *Journal of Economic and Administrative Sciences*, *39*(3), 730-746. http://dx.doi.org/10.1108/JEAS-05-2021-0083

Nomran, N. M., Haron, R., & Hassan, R. (2018). Shari'ah supervisory board characteristics effects on Islamic banks' performance: Evidence from Malaysia. *International Journal of Bank Marketing*, *36*(2), 290–304. https://doi.org/10.1108/IJBM-12-2016-0197

Rahmawati, A. I. E., Prawestri, A. D., Rosadi, S., & Wardani, M. K. (2024). Enhancing Islamic bank performance: The role of Sharia supervisory board attributes and intellectual capital. *JAS (Jurnal Akuntansi Syariah)*, *8*(2), 203–226. https://doi.org/10.46367/jas.v8i2.1943

Rehman, H., Ramzan, M., Haq, M. Z. U., Hwang, J., & Kim, K. B. (2021). Risk management in corporate governance framework. *Sustainability*, *13*(9), 5015. https://doi.org/10.3390/su13095015

Saad, M. M., Ismail, R. F., Zam, Z. M., & Hasnan, S. (2024). Investigating the impact of effective risk management on the performance of Malaysian publicly listed companies. *Edelweiss Applied Science and Technology*, *8*(1), 13–23. https://doi.org/10.55214/25768484.v8i1.412

Safiullah, M., & Shamsuddin, A. (2018). Risk in Islamic banking and corporate governance. *Pacific-Basin Finance Journal*, *47*, 129–149. https://doi.org/https://doi.org/10.1016/j.pacfin.2017.12.008

Saeudy, M., Atkins, J., & Barone, E. A. (2022). Interpreting banks' sustainability initiatives as reputational risk management and mechanisms for coping, re-embedding and rebuilding societal trust. *Qualitative Research in Financial Markets*, *14*(1), 169-188. https://doi.org/10.1108/QRFM-02-2021-0024

Sibarani, L., & Lusmeida, H. (2021). Impact of good corporate governance towards corporate value with enterprise risk management as moderating variable (Empirical study of financial companies listed in IDX for the period 2017-2019). *Ultima Management : Jurnal Ilmu Manajemen*, *13*(1), 74–98. https://doi.org/10.31937/manajemen.v13i1.1957

Sobanova, J., & Kudinska, M. (2024). Managing operational risk in banks during times of instability. *Serbian Journal of Management*, *19*(1), 167-185. https://doi.org/10.5937/sjm19-43757

Stulz, R. M. (2022). Risk-taking and risk management by banks. *Journal of Applied Corporate Finance*, *34*(1), 95-105. https://doi.org/10.1111/jacf.12491

Syadali, M. R. A., Segaf, S., & Parmujianto, P. (2023). Risk management strategy for the problem of borrowing money for Islamic commercial banks. *Enrichment: Journal of Management*, *13*(2), 1227-1236. https://doi.org/10.35335/enrichment.v13i2.1392

Tamara, T. T., Haninun, H., & Aminah, A. (2024). The effect of good corporate governance implementation on financial performance. *Cashflow Current Advanced Research on Sharia Finance and Economic Worldwide*, *3*(2), 365–376. https://doi.org/10.55047/cashflow.v3i2.1084

Tazilah, M. D. A. K., Muhammad, M., Awee, A., & Keang, A. A. L. A. (2021). Corporate-governance-characteristics-and-financial-performance-evidence-from-islamic-banks-in-malaysiaManagement-and-Accounting-Review. *Management and Accounting Review Journal*, *20*(1), 39–60.

Thapa, R. B., Kumar, A., Gupta, S. K., & Bhandari, R. C. (2025). The role of audit committees in strengthening governance and risk management in banks: Evidence from

Nepal. *International Journal of Environmental Sciences*, *11*(7s), 960-971. http://dx.doi.org/10.64252/5zm2j538

Uddin, M. N., Hosen, M., Azad, M. A. K., Günerhan, H., Hoque, N., Uddin, M., & Mamun, A. (2024). Guidelines for developing the shari'ah-compliant products and shari'ah governance for sustainable banks in Bangladesh. *Business Strategy & Development*, *7*(1), e309. http://dx.doi.org/10.1002/bsd2.309

Umar, U. H., Abduh, M., & Besar, M. H. A. (2023). Shari'a supervisory board and Islamic banks' insolvency risk. *Journal of Islamic Monetary Economics and Finance*, *9*(3), 419–442. https://doi.org/10.21098/jimf.v9i3.1635

Wasim, M. H., & Zafar, M. B. (2024). Shariah governance and Islamic banks: a systematic literature review. *Journal of Islamic Accounting and Business Research*, *ahead-of-p*(ahead-of-print). https://doi.org/10.1108/JIABR-11-2023-0386

Xi, W. (2024). Regulatory changes and compliance challenges. In *Strategic Financial Management: A Managerial Approach* (pp. 119-134). Emerald Publishing Limited. https://doi.org/10.1108/978-1-83608-106-720241008