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# PROFITABILITY DETERMINANTS OF INDONESIAN ISLAMIC BANKS: FINANCING TO DEPOSIT RATIO AND GOVERNANCE

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**Abstract**: This study examines the impact of the FDR on the profitability of Islamic commercial banks in Indonesia, GCG as an intervening variable. The analysis utilizes financial data from 2015 to 2019, collected from annual reports and financial statements of selected banks. The study employs regression and mediation analyses to test the hypotheses. The results indicate that FDR does not significantly affect profitability, measured by ROA. Furthermore, GCG does not mediate the relationship between FDR and ROA. These findings suggest that other factors may play a more critical role in determining the profitability of Islamic banks. The study underscores the importance of adopting conservative financing strategies and enhancing corporate governance frameworks tailored to Sharia compliance. These insights provide valuable recommendations for bank managers and policymakers to improve financial performance and ensure sustainable growth in the Islamic banking sector.

**Keywords**: FDR; Profitabilty; Islamic Banks; Corporate Governance

***Abstrak**: Penelitian ini menguji dampak FDR terhadap profitabilitas bank umum syariah di Indonesia, dengan mempertimbangkan GCG sebagai variabel intervening. Analisis ini menggunakan data keuangan dari tahun 2015 hingga 2019, yang dikumpulkan dari laporan tahunan dan laporan keuangan bank-bank terpilih. Penelitian ini menggunakan analisis regresi dan mediasi untuk menguji hipotesis. Hasil penelitian menunjukkan bahwa FDR tidak secara signifikan mempengaruhi profitabilitas, yang diukur dengan ROA. Selain itu, GCG tidak memediasi hubungan antara FDR dan ROA. Temuan ini menunjukkan bahwa faktor-faktor lain mungkin memainkan peran yang lebih penting dalam menentukan profitabilitas bank syariah. Studi ini menggarisbawahi pentingnya mengadopsi strategi pembiayaan yang konservatif dan meningkatkan kerangka kerja tata kelola perusahaan yang disesuaikan dengan kepatuhan Syariah. Wawasan ini memberikan rekomendasi yang berharga bagi para manajer bank dan pembuat kebijakan untuk meningkatkan kinerja keuangan dan memastikan pertumbuhan yang berkelanjutan di sektor perbankan syariah.*

***Kata Kunci**: FDR; Profitabilitas; Bank Syariah; Tata Kelola Perusahaan*



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## Introduction

Islamic banking in Indonesia has witnessed significant growth over the past decade, driven by the increasing demand for Sharia-compliant financial products and services.[1] According to data from the Financial Services Authority (OJK), the market share of Islamic banking in Indonesia increased significantly from around 3-4% in 2010 to approximately 6-7% in 2020. The principles of Islamic banking, which prohibit interest (riba) and emphasize risk-sharing, ethical investments, and asset-backed financing, have appealed to a large segment of the Indonesian population.[2] A report from Bank Indonesia notes that the demand for Sharia-compliant financial products has risen due to increased awareness of Sharia principles, including the prohibition of riba, risk-sharing mechanisms, and ethical investment practices.[3] This sector's expansion is not only a reflection of religious adherence but also a response to the global financial crises, which highlighted the need for a more resilient and ethical banking system.[4]

Despite this growth, the profitability of Islamic commercial banks remains a critical issue, as these institutions face unique challenges compared to their conventional counterparts.[5] Key profitability metrics such as Return on Assets (ROA) and Return on Equity (ROE) are crucial in assessing their financial performance.[6] Moreover, Islamic banks in Indonesia face challenges in liquidity management, reflected in their Financing to Deposit Ratio (FDR), which averages between 80-90%, indicating high utilization of deposits for financing but also posing liquidity risks that must be carefully managed.[7] The FDR plays a pivotal role in this context, as it directly impacts liquidity management and profitability.[8] Additionally, effective corporate governance is essential for maintaining the trust of stakeholders and ensuring the sustainable growth of these banks.[9]

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[1] Agus Alimuddin, Fani Monada Essa Putri, Immawan Azhar Ben Atasoge, And Risa Alvia, "Baitul Mal Dan Ghanimah Studi Tentang Ijtihad Umar Bin Khattab Dalam Penguatan Lembaga Keuangan Publik," *Jurnal Akuntansi Dan Perbankan Syariah* 05, no. 01 (2022): 31.

[2] U Priyadi, "Determinants Of Credit Risk Of Indonesian Sharīʿah Rural Banks," *ISRA International Journal Of Islamic Finance* 13, no. 3 (2021): 284.

[3] Ali İhsan Akgün, "The Relationship Between The Accounting Standards And The Global Financial Crisis: Empirical Analysis Of Mergers And Acquisitions In Banking Industry," *China Accounting And Finance Review* 26, no. 3 (2024).

[4] Cut D Hasrina and Azlim Yusri, "The Development Analysis of Sharia Bank in Province of Aceh in Last Decade," 2019.

[5] Wahyu Wastuti, Riris Aishah Prasetyowati, And Ratna Anggraini, "Financing Growth And Bank Risk: Empirical Evidence From Indonesia," 7, no. 1 (2024): 1.

[6] Bun Yamin, "The Effect Of Return On Asset (ROA), Operational Efficiency Ratio (BOPO), Inflation, Credit Interest Rate And Gross Domestic Product (GDP) Towards Murabahah Financing In Sharia Banking In Indonesia (2016-2019)," *Asian Journal Of Economics Business And Accounting*, (2022): 94.

[7] Sutrisno, "Islamic Banking Profitability in Indonesia," *International Journal of Finance & Banking Studies* 12, no. 1 (2023): 1.

[8] Lucky Nugroho, Ahmad Badawi, Erik Nugraha, And Yananto M Putra, "What Determines Islamic Performance Ratio Of Islamic Banking In Indonesia? An Analysis Using Financing To Deposit Ratio As Moderator," *Share Jurnal Ekonomi Dan Keuangan Islam* 10, no. 1 (2021): 104.

[9] Muhammad S Shahid And Usman Shahid, "CEO Overconfidence And Corporate Investment: Moderating Role Of Corporate Governance Practices," *Review Of Applied Management And Social Sciences* 3, No. 1 (2020): 41.

Table 1. ROA Development Of Indonesian Sharia Commercial Banks In 2015-2019

| | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| ROA | 0.48 | 0.62 | 0.62 | 1.27 | 1.72 |

**Source**: www.ojk.go.id 2020

As shown in Table 1, the ROA variable exhibited growth between 2015 and 2019. The ROA began at 0.49% in 2015 and increased to 0.62% in 2016, maintaining this level in 2017. In 2018, ROA significantly rose to 1.27%, and further increased to 1.72% in 2019. From 2016 to 2017, the profits of Islamic banks remained stable, without notable changes. This stability occurred despite a slowdown in growth, attributed to unfavorable economic conditions that had not yet improved.

The primary research problem addressed in this study is the impact of the FDR on the profitability of Islamic commercial banks in Indonesia. Understanding the dynamics between FDR and profitability is crucial for Islamic banks to optimize their financial strategies and ensure sustainable operations.[10] The larger assets enable Islamic banks to offer more significant financing, potentially leading to higher profitability.[11]

Effective corporate governance can mitigate the risks associated with high FDRs by ensuring better management practices, transparency, and accountability.[12] The distribution of financing by Islamic banks has not consistently resulted in increased profitability.[13] The FDR is a critical measure of a bank's liquidity and financing capacity. Research has demonstrated that a balanced FDR is essential for maintaining a bank's liquidity while ensuring sufficient financing activities to generate profits.[14] Studies have shown that a higher FDR can strain a bank's liquidity, potentially leading to financial instability and reduced profitability.[15] Conversely, a lower FDR may indicate underutilization of funds, limiting the bank's income-generating potential.[16] The effectiveness of FDR in influencing profitability may be influenced by factors such as Non-Performing Financing (NPF), Capital Adequacy Ratio (CAR), and Operating Efficiency Ratio (OER).[17]

[10] Saleh Sitompul And Siti K Nasution, "The Effect Of Car, BOPO, NPF, And FDR On Profitability Of Sharia Commercial Banks In Indonesia," *Budapest International Research And Critics Institute (Birci-Journal) Humanities And Social Sciences* 2, no. 3 (2019): 234.

[11] Agus Widarjono and Sahabudin S Sidiq, "The Sectoral Financing Diversification and the Profitability of Islamic Banking in Indonesia," *Jurnal Ekonomi Dan Bisnis Islam (Journal of Islamic Economics and Business)* 8, no. 2 (2022): 201.

[12] Alex Abugri, "Effect Of Corporate Governance On Financial Distress: Evidence From Listed Firms At Ghana Stock Exchange," *International Journal Of Multidisciplinary Research And Analysis* 05, no. 02 (2022).

[13] Hasan Mukhibad And Muhammad Khafid, "Financial Performance Determinant Of Islamic Banking In Indonesia," *Jurnal Keuangan Dan Perbankan* 22, no. 3 (2018).

[14] Ahmad I Rahmansyah, Nasya S Balqis, Yekti Rahajeng, Muhammad S H Elmas, And Siti Masluha, "The Effect Of Non Perfoming Financing And Financing To Deposit Ratio On Return On Assets," *Assets Jurnal Ilmiah Ilmu Akuntansi Keuangan Dan Pajak* 6, no. 2 (2022): 100.

[15] Septi A Mulyana And Wirman Wirman, "Pengaruh Non Performing Financing (NPF) Dan Financing To Deposit Ratio (FDR) Terhadap Profitabilitas," *Al-Kharaj Jurnal Ekonomi Keuangan & Bisnis Syariah* 5, no. 3.

[16] Sutrisno, "Financing Scheme and Determinant Factors," (2022): 18.

[17] Mokhammad Ridho, "Does Non-Performing Financing And Capital Adequacy Impact Profitability Of Islamic Banks In Indonesia?," (2023): 160.

Islamic banks must balance the ethical and financial aspects of their operations, adhering to risk-sharing mechanisms and avoiding interest-based transactions.[18] The integration of FDR with other financial indicators, such as NPF and CAR, provides a holistic view of a bank's financial health and operational efficiency.[19] This integrated approach helps Islamic banks navigate the complexities of maintaining liquidity and profitability while complying with Sharia principles.[20]

Effective corporate governance is paramount in this scenario.[21] Research has consistently highlighted the positive impact of robust governance practices on financial performance.[22] Strong corporate governance frameworks enhance decision-making processes, reduce capital expenditure, and improve overall financial outcomes.[23] In Islamic banks, governance practices must align with Sharia compliance, adding an additional layer of complexity and ethical considerations.[24] By fostering transparency, accountability, and ethical management, corporate governance can significantly influence the profitability of Islamic commercial banks.[25] Although there has been considerable research on the impact of FDR on profitability, the results have been mixed and inconclusive. An uncertain relationship between FDR and profitability, highlighting the need for further research to better understand how FDR truly affects profitability, especially when considered in a broader context like Good Corporate Governance (GCG).[26]

Previous studies have extensively explored the relationship between the FDR and bank profitability, emphasizing its critical role in liquidity management and financial stability.[27] However, there remains a gap in understanding how corporate governance practices mediate this relationship in the context of Islamic banking. This study adds novelty by analyzing GCG mediation between FDR and ROA, a topic that has not been widely explored in previous studies. GCG plays an essential role in the profitability of Islamic banks,

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[18] Taufikur Rahman And Khusna Fatmawati, "The Influence Of Financial Ratios On Non Performing Financing Of The Sharia Rural Banks Of Special Region Of Yogyakarta (BPRS DIY) Period 2015 – 2018," *Asian Journal Of Islamic Management (AJIM)* 2, no. 1 (2020): 25.

[19] Faaza Fakhrunnas, Riska D Astuti, And M B H Anto, "Determinants Of Non-Performing Financing In Indonesian Islamic Banks: A Regional And Sectoral Analysis," *Banks And Bank Systems* 17, no. 4 (2022).

[20] Ismail Nura, Nurlaila Nurlaila, And Marliyah Marliyah, "Pengaruh CAR, BOPO, FDR Dan NPF Terhadap Tingkat Bagi Hasil Mudharabah Dimediasi ROA Di Bank Umum Syariah Indonesia," *Owner* 7, no. 1 (2023): 908.

[21] Abul Hassan, M Sadiq Sohail, And Md Mahfuzur Rahaman Munshi, "Sharīʿah Governance And Agency Dynamics Of Islamic Banking Operations In The Kingdom Of Saudi Arabia," *ISRA International Journal Of Islamic Finance* 14, no. 1 (2022): 89.

[22] Monica V Achim, Sorin N Borlea, And Codruţa Mare, "Corporate Governance And Business Performance: Evidence For The Romanian Economy," *Journal Of Business Economics And Management* 17, no. 3 (2015): 458.

[23] Alex Abugri, "Effect of Corporate Governance.

[24] Darwanto And Anis Chariri, "Corporate Governance And Financial Performance In Islamic Banks: The Role Of The Sharia Supervisory Board In Multiple-Layer Management," *Banks And Bank Systems* 14, no. 4 (2019).

[25] Muhammad Ishtiaq And Hina Mushtaq, "Corporate Governance Regulations And Practices Under COVID-19 Crisis: Time To Rethink," *Journal Of Law & Social Studies* 3, no. 2 (2021): 153.

[26] Anafil Windriya, "Macroeconomic Sensitivity And Financial Performance On Islamic Banks Profitability," *Jurnal Ilmiah Ekonomi Islam* 9, no. 2 (2023): 2620.

[27] Ahmad I Rahmansyah, Nasya S Balqis, Yekti Rahajeng, Muhammad S H Elmas, And Siti Masluha, "The Effect Of Non Perfoming Financing.

but they did not investigate how GCG might mediate the relationship between FDR and ROA. [28] Furthermore, this study focuses on the context of Sharia economics in Indonesia, which has unique characteristics and has not been widely discussed in international research. While corporate governance is known to enhance financial performance, its specific impact as an intervening variable between FDR and profitability in Sharia-compliant banks has not been thoroughly investigated.[29]

Additionally, existing research primarily focuses on conventional banking systems, with limited studies addressing the unique operational and ethical frameworks of Islamic banks.[30] The interplay between Sharia principles, corporate governance, and financial performance presents a distinct area that requires deeper exploration.[31] Furthermore, the dynamic nature of corporate governance practices and their adaptation to market conditions, particularly in emerging economies like Indonesia, remains underexplored.[32]

This study addresses research gaps by examining the impact of the FDR on the profitability of Islamic commercial banks in Indonesia, focusing on the mediating role of GCG. The objectives include analyzing how FDR affects profitability, evaluating GCG as an intervening variable, identifying key factors influencing profitability, and offering recommendations to enhance profitability through effective financing and governance practices. The study's findings indicate that FDR does not significantly impact profitability, nor does GCG mediate this relationship, highlighting the need for further research on other influencing factors.

## Methods

This research investigates the impact of the FDR on the profitability of Indonesian Islamic commercial banks, specifically focusing on those registered with Bank Indonesia from 2015 to 2019. The research methodology is structured in several key stages to ensure clarity and reproducibility: Data collection, sampling procedure, data validation, variable measurement, statistical analysis, and hypothesis Testing. The study employs secondary data sourced from the annual financial statements of Islamic commercial banks and the Financial Services Authority (OJK) Annual Reports. The selection of banks and data points is based on purposive sampling, which ensures that only banks with complete data across the variables of interest are included in the study. The summary of the sampling results is presented in Table 2.

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[28] Nabila F Iman And Umiyati Umiyati, "Analisis Determinan Atas Profitabilitas Bank Syariah Di Indonesia," *Jurnal Akuntansi Dan Keuangan Islam* 10, no. 1 (2022): 31.

[29] Muhammad S Shahid And Usman Shahid, "CEO Overconfidence And Corporate.

[30] Shaleh Yudiansyah, Srinita, Suriani, And Eddy Gunawan, "Does Sharia Banking Have The Capability To Increase Micro, Small And Medium Enterprises Financing?," *International Journal Of Finance Economics And Business* 1, no. 4 (2022): 250.

[31] Rendra A Hidayat, Indah Shofiyah, And Hendra Hendra, "Comparative Analysis Of The Performance Of Sharia Banks And Conventional Banks In Indonesia," *Akrual Jurnal Akuntansi* 13, no. 2 (2022): 251.

[32] Bridget Mcnally And Thomas O'Connor, "The Corporate Governance Lifecycle In Emerging Markets The Case Of The Republic Of Korea," *Corporate Governance* 23, no. 5 (2023): 1046.

Table 2. Sampling Results

| Bank Criteria | Quantity |
|---|---|
| BUS registered with the Otoritas Jasa Keuangan during the period 2015-2019 | 14 |
| Number of samples that meet the criteria | 8 |
| Banks that have complete data based on the variables to be studied | 8 |
| Years of observation | 5 |

**Source**: Author's Calculation 2024

The sample preparation involved a rigorous process of data collection and validation to ensure accuracy and completeness. Data were gathered through the documentation method, which involved reviewing relevant literature, studies, and financial reports available on the official websites of the Islamic commercial banks included in the study. Data were extracted from the annual financial statements available on these websites and cross-referenced with the OJK Financial Services Authority Annual Reports to ensure consistency. The experimental setup involved performing a series of statistical analyses to test the hypotheses. The primary variable of interest, the Financing to Deposit Ratio (FDR), was calculated using the formula:

FDR = (Total Financing/Total Deposits) x 100

Profitability was measured using Return on Assets (ROA), calculated as:

ROA = (Net Profit/Total Assets) x 100

Corporate governance was assessed using a comprehensive set of disclosure items outlined in Table 3. Each bank's corporate governance score was calculated based on these disclosures, with the GCG Index calculated as:

GCG = (Total Score Disclosed)/(Maximum Score) x 100

Table 3. Disclosure of Corporate Governance Items

| Disclosure Items |
|---|
| Sharia Commercial Banks |
| Corporate Governance Self-Assessment |
| Share Ownership >5% Of Paid-Up Capital |
| Board Of Commissioners |
| Board Of Directors |
| Financial Relationships (Board Members, Controlling Shareholders, Commissioners, Direct |
| Family Ties (Board Members, Controlling Shareholders, Commissioners, Directors) |
| Concurrent Roles (Board Of Commissioners) |
| Sharia Supervisory Boards |
| Committee Structure And Expertise |
| Consultants/Advisors Disclosure (Name, Purpose, Scope) |
| Remuneration Policy (Board Of Commissioners, Board Of Directors, Sharia Supervisory) |
| High-To-Low Pay Ratio |
| Board Of Commissioners Meetings (Frequency, Attendance) |
| Sharia Supervisory Board Meetings (Frequency, Attendance) |
| Internal Frauds And Resolutions |
| Legal Issues And Resolutions (Civil, Criminal) |
| Interest-Laden Deals |

| Disclosure Items |
|---|
| Buyback Of Bonds/Shares |
| Social Fund Distribution |
| Non-Halal Revenue Usage |
| Sharia Commercial Banks |
| Corporate Governance Self-Assessment |
| Share Ownership >5% Of Paid-Up Capital |
| Board Of Commissioners |
| Board Of Directors |
| Financial Relationships (Board Members, Controlling Shareholders, Commissioners) |
| Family Ties (Board Members, Controlling Shareholders, Commissioners, Directors) |
| Concurrent Roles (Board Of Commissioners) |
| Sharia Supervisory Boards |
| Committee Structure And Expertise |
| Consultants/Advisors Disclosure (Name, Purpose, Scope) |

**Source**: Sofana et al. 2021

The primary parameters measured in this study include the FDR, ROA, and the GCG index. FDR represents the ratio of total financing provided by the bank to the total deposits received, indicating the bank's liquidity and risk levels.[33] ROA measures the bank's profitability relative to its total assets, providing insight into its financial performance.[34] The GCG index, calculated based on a comprehensive set of governance disclosures, evaluates the quality of corporate governance practices in the banks.[35]

The statistical analysis involved several steps to test the hypotheses. Descriptive statistics and correlation analysis were performed to understand the relationships between FDR, ROA, and GCG. Regression analysis was conducted to test the direct impact of FDR on ROA. Mediation analysis was then performed to determine if GCG acts as an intervening variable between FDR and ROA. The SPSS software enabled a detailed regression analysis process, providing insights into the direct relationship between these variables. Mediation analysis, also conducted using the Sobel test, was then performed to determine if GCG acts as an intervening variable between FDR and ROA.

## Result And Discussion

### Descriptive Statistics

The dataset analysis reveals the mean and standard deviation values for the FDR, ROA, and GCG. Table 4 shows that the mean FDR is approximately 85.185 with a standard deviation of 7.597, suggesting moderate variability in financing activities relative to deposits among the banks. The ROA has a mean of approximately 0.814 and a standard deviation of 0.598, indicating that profitability levels are relatively low. GCG shows a mean

[33] Lucky Nugroho, Ahmad Badawi, Erik Nugraha, And Yananto M Putra, "What Determines Islamic.

[34] Cathy Ismantara And Irwanto Handojo, "Factors Affecting Firm Value With Capital Structure As Intervening Variable," *Media Bisnis* 14, no. 1 (2022): 9.

[35] Nida Ulya Sofana, Faris Shalahuddin Zakiy, Muchammad Fauzi, Singgih Muheramtohadi, And Najim Nur Fauziah, "The Effect Of Sharia Share Selection Based On Financial Ratio And Corporate Governance Mechanism On The Quality Of Company Profit," *Journal Of Islamic Accounting And Finance Research* 3, no. 2 (2021): 241.

of approximately 95.754 with a standard deviation of 8.153, reflecting consistent governance practices across the sample.

Table 4. Descriptive statistics

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| FDR | 37 | 71.87 | 98.46 | 85.185 | 7.597 |
| CG | 37 | 57.15 | 100.00 | 95.754 | 8.153 |
| ROA | 37 | 0.05 | 2.63 | 0.814 | 0.598 |
| Valid N (listwise) | 37 | | | | |

**Source**: SPSS, Data Processed By The Authors

## Correlation Matrix

The correlation matrix reveals the relationships between the variables in Table 5. The correlation between FDR and ROA is 0.146, indicating a weak positive relationship. The correlation between FDR and GCG is -0.123, suggesting a weak negative relationship. Finally, the correlation between ROA and GCG is -0.164, also indicating a weak negative relationship. These correlations suggest that higher FDR is slightly associated with increased profitability, though the relationship is minimal. Additionally, higher FDR is weakly linked to lower GCG scores, and better corporate governance is weakly associated with reduced profitability.

Table 5. Correlation Matrix

| | FDR | GCG | ROA |
|---|---|---|---|
| FDR | 1.000 | -0.123 | 0.146 |
| GCG | -0.123 | 1.000 | -0.164 |
| ROA | 0.146 | -0.164 | 1.000 |

**Source**: SPSS, Data Processed By The Authors

## Regression Analysis

The subsequent procedure involves testing the classical assumptions, including heteroscedasticity, multicollinearity, and correlation tests. Specifically, the multicollinearity test is applied only to regression equation 1 during the multiple regression analysis. In this study, the variables of FDR, Corporate Governance, and profitability were analyzed using multiple linear regression analysis with two equations :

(1) $ROA = \alpha + \quad FDR + \quad GCG + e$

(2) $CG = \alpha + \quad FDR + e$

Regression analysis aims to determine the direction and strength of the relationship between dependent and independent variables within an equation. This analysis is validated through classical assumption tests. In the context of time series multiple linear regression analysis, these standard tests include assessments for autocorrelation, multicollinearity, and normality. Once the classical assumptions have been evaluated, regression analysis is performed on equations 1 and 2, with the results provided in Tables 6 and 7.

Table 6. Regression Test Results Equation 1

| $ROA = \alpha + \beta_{1b}\ FDR + \beta_{2b}\ GCG + e$ | | | |
|---|---|---|---|
| Variable | Coeff | t - Stat | Prob. |
| const | 0.997398 | 0.572591 | 0.570689 |
| FDR | 0.010047 | 0.7554 | 0.455211 |
| GCG | -0.010853 | -0.875636 | 0.387373 |
| Adjusted R-squared | -0,013401 | | |
| F – statistic | 0.761968 | | |
| R- squared | 0.042899 | | |

**Source**: SPSS, Data Processed By The Authors

The regression analysis results of equation 1 (Table 6) indicate that the significance value of FDR's impact on ROA is 0.570689. Since 0.570689 > 0.05, the null hypothesis (Ho) is rejected, implying that FDR does not significantly affect ROA. This finding corroborates hypothesis 1, resulting in its rejection. The R Square value reveals that FDR contributes 4% to ROA. From an Agency Theory perspective, this weak positive relationship suggests that the principals (bank owners) and agents (bank managers) might be prioritizing conservative financial decisions, thereby limiting the potential impact of FDR on profitability.[36]

The results of this study differ from previous research that has typically highlighted the significant impact of the FDR on profitability. Rivandi and Gusmariza in 2021 and Mulyana and Wirman in 2022 suggested a negative impact of a higher FDR on profitability due to increased liquidity risks.[37] However, our findings indicate a weak positive relationship, albeit statistically insignificant, which may reflect the unique characteristics of the Indonesian Islamic banking sector.[38]

[36] Mohd Haniff Zainuldin, Tze Kiat Lui, And Kwang Jing Yii, "Principal-Agent Relationship Issues In Islamic Banks: A View Of Islamic Ethical System," *International Journal Of Islamic And Middle Eastern Finance And Management* 11, no. 2 (2018): 297.

[37] Muhammad Rivandi and Tania Gusmariza, "Pengaruh Financing to Deposit Ratio, Capital Adequacy Ratio Dan Non Performing Financing Terhadap Profitabilitas Pada Bank Umum Syariah," *Owner* 5, no. 2 (2021): 473; Septi A Mulyana And Wirman Wirman, "Pengaruh Non Performing Financing.

[38] Taufikur Rahman And Khusna Fatmawati, "The Influence Of Financial Ratios.

Table 7. Regression Test Results Equation 2

| GCG = α + $\beta_{1b}$ FDR + e | | | |
|---|---|---|---|
| Variable | Coeff | t - Stat | Prob. |
| const | 107.041005 | 6.954016 | 0.000000 |
| FDR | -0.132495 | -0.736081 | 0.466586 |
| Adjusted R-squared | -0.012891 | | |
| F – statistic | 0.541815 | | |
| R- squared | 0.015244 | | |

**Source**: SPSS, Data Processed By The Authors

The regression analysis results of equation 2 (Table 7) indicate that the significance value of FDR's influence on GCG is 0.000. Since 0.000 < 0.05, FDR significantly affects GCG. However, in regression equation 1 (Table 6), the significance value of FDR on GCG is 0.570689. Given that 0.570689 > 0.05, this suggests that GCG does not mediate the effect of FDR on ROA. The coefficient of determination is 0.015, indicating that the combined influence of FDR and GCG on the ROA variable is 1%. According to Signaling Theory, while FDR might serve as a signal of the bank's financing capacity, its negative relationship with GCG suggests that higher FDR might be perceived as a risk by stakeholders, potentially leading to lower governance scores.

The mediation hypothesis was tested using the Sobel test, which assessed the strength of FDR's indirect effect on ROA through GCG. The results of this mediation test are as follows:

Table 8. Intervening Variable Effect Test Results

| Variable | Indirect effect | Sobel Test Statistic | p-value |
|---|---|---|---|
| GCG | -0.001433 | -0.738630 | 0.460227 |

**Source**: SPSS, Data Processed By The Authors

These findings suggest that the indirect effect of FDR on ROA via GCG is not significant, with a p-value exceeding 0.05. Consequently, the mediation coefficient is deemed insignificant, indicating no mediation effect. Hypothesis testing confirms that FDR has a direct impact on ROA but does not indirectly influence ROA through GCG. This demonstrates that GCG cannot elucidate the indirect relationship between FDR and ROA, leading to the rejection of hypothesis 2. These results challenge the conventional view that strong governance practices universally enhance financial performance by mitigating agency conflicts.

The negative correlation between FDR and GCG observed in this study contrasts with findings by Shahid and Shahid in 2020, who reported that effective corporate governance enhances financial performance by mitigating risks.[39] This discrepancy might be due to the distinct governance frameworks and Sharia compliance requirements in

[39] Muhammad S Shahid And Usman Shahid, "CEO Overconfidence And Corporate.

Islamic banking, which can influence the efficacy of traditional governance practices.[40] Furthermore, the weak and statistically insignificant impact of FDR on ROA challenges conventional theories that emphasize the direct positive relationship between financing activities and profitability. This suggests that other factors, potentially unique to the operational environment and regulatory landscape of Islamic banks in Indonesia, may play a more critical role. [41]

The study also found no significant mediating effect of GCG on the relationship between FDR and ROA. This contrasts with the findings of Sofana et al., in 2021, who highlighted the role of strong corporate governance in enhancing financial performance by reducing agency conflicts and ensuring better management practices.[42] The negative correlation between FDR and GCG, although weak, suggests that higher financing ratios may be associated with lower governance scores, reflecting potential governance challenges in managing higher levels of financing. These findings have significant implications for Islamic commercial banks in Indonesia. The weak and statistically insignificant relationship between FDR and profitability indicates that Islamic banks may need to adopt more nuanced strategies in managing their financing to deposit ratios to avoid liquidity issues without compromising profitability. This highlights the importance of conservative financing strategies that align with the risk-averse nature of Sharia-compliant banking. [43]

The lack of a significant mediating effect of corporate governance on the relationship between FDR and profitability underscores the need for Islamic banks to strengthen their governance frameworks. Given the ethical and operational requirements specific to Islamic banking, tailored governance practices that incorporate Sharia principles and promote transparency and accountability are essential.[44] Enhancing governance mechanisms could mitigate risks and improve overall financial performance.

For policymakers and bank managers, understanding the nuanced interplay between financing ratios, governance, and profitability is crucial. This knowledge can inform the development of effective strategies to enhance financial performance while adhering to Sharia principles. Additionally, the findings contribute to the broader discourse on Islamic banking, offering evidence-based recommendations for optimizing financing strategies and strengthening corporate governance frameworks.[45] Incorporating insights from agency theory and signaling theory can further refine governance practices. importance of aligning the interests of principals and agents, ensuring transparency, accountability, and ethical conduct in financial activities.[46] Signaling theory emphasizes the role of governance and financial disclosures in enhancing investor confidence and market

[40] Darwanto And Anis Chariri, "Corporate Governance And Financial.

[41] Shaleh Yudiansyah, Srinita, Suriani, And Eddy Gunawan, "Does Sharia Banking.

[42] Nida Ulya Sofana, Faris Shalahuddin Zakiy, Muchammad Fauzi, Singgih Muheramtohadi, And Najim Nur Fauziah, "The Effect of Sharia Share.

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perceptions.[47] By integrating these theoretical perspectives, Islamic banks can develop robust governance structures that support sustainable profitability and stakeholder trust.

## Conclusion

This study examined the impact of the FDR on the profitability of Indonesian Islamic commercial banks, considering GCG as a possible mediator. The findings show that FDR does not significantly affect profitability (measured by ROA) and that GCG does not mediate this relationship, challenging previous research. The study's limitations include a narrow focus on 2015-2019 data, a limited sample of Indonesian banks, reliance on secondary data, and the exclusion of other influential factors like macroeconomic conditions. The results suggest that other factors may be more important in determining profitability in Islamic banks. A weak negative correlation between FDR and GCG raises concerns about the effectiveness of current governance practices. The study calls for broader future research, incorporating more variables and alternative theoretical perspectives, to better understand profitability in Islamic banking. It also recommends more conservative financing strategies and improved governance frameworks to align with Sharia principles, enhance transparency, and maintain profitability. These findings contribute valuable insights to the ongoing discourse on Islamic banking.

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## Author Contributions Statement

TW contributed as the originator of the idea and the primary author of this manuscript. FU structured the manuscript, established fundamental theories, analyzed data, and discussed research findings. NS contributed as a collaborator by sharing ideas, engaging in discussions, and assisting in locating references. Additionally, SN and FU served as reviewers, enhancing and refining the manuscript.

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