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THE IMPACT OF CORPORATE GOVERNANCE TO FINANCIAL PERFORMANCE OF TAKAFUL IN INDONESIA

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Abstract: Takaful industry plays an essential role in answering significant issue in the society such as social, economic and environment. The presence of corporate governance become crucial to every Takaful firm in promoting and raising the public trust in one of the Islamic finance ecosystem whom currently to be called as the sleeping giant. Unfortunately, although the regulation has been established by the Financial Services Authority (OJK), certain cases of malpractices and failure of insurance currently rise to the surface. This study contributes to the literature by investigating corporate governance factors that influenced financial performance of Takaful listed in Indonesian Sharia Insurance Association (AASI). Panel Data regression analysis will be used in analyzing the data over the period 2017 – 2021. The data is collected from insurance statistic report published by Financial Services Authority also from annual report and sustainability report of every insurance. Corporate governance variables will be used as independent variables and Return on Asset will be used as a financial performance's dependent variable. This study provides several corporate governance upon takaful performance from the perspective of a developing country. It also provides an empirical examination of current structures of takaful firms and suggestion to the decision makers and the stakeholders to be adopted in boosting firm performance. This study also gives a recommendation to the policymakers in assessing and reviewing corporate governance policies.

Keywords: Takaful, Sharia Insurance, Corporate Governance, Financial Performance, ROA.

INTRODUCTION

Globally, the takaful industry has a relatively small contribution compared to other sharia financial sectors, with only a contribution of 1% of the total assets of the sharia financial sector. The condition of sharia insurance in Indonesia has also shown limited development, both in terms of penetration of contributions (premiums) and recorded assets, which are still very the conventional insurance business. The development of Indonesia's Islamic finance sector is relatively far behind compared to countries with other concentrations of Muslim population, especially in terms of financial sector performance (quantitative development) and awareness. The not yet optimal development of the Indonesian sharia financial sector has also contributed to the very limited development of the sharia insurance industry (Serpina & Primurdia, 2022). According to Shariah regulations, takaful aids in lowering anxiety and dread, compensating loss and injury, and offering protection to the honor, his heirs, and his property or money. Moreover, takaful's noble characteristics allow it to establish itself as the financial sector that advances the goals of Shariah in the global economy (Abdullah, 2012).

Sharia insurance plays an important role in driving global and Indonesian economic development. In line with the increasing demand of the world community for products that support sharia lifestyles, various financial service providers, including insurance, have begun to see sharia ideology as a concept that can increase value for customers. The Sharia Insurance industry has the potential to grow and become one of the strong industries. There is enormous potential of course in order to realize the value of maqashid sharia values through efforts to increase prosperity and protection for 270 million people in a diverse multicultural country with the largest Muslim population in the world through Sharia Life Insurance. The continuous growth of Sharia Insurance is expected to fulfill the essential needs of Halal lifestyle for individuals and businesses along with Indonesia's hope to become a global leader in Sharia Economy. Based on Sharia IKNB Statistics (Ojk, 2021), the number of Life Insurance Companies with Sharia Principles in 2021 is 7 companies, General Insurance Companies with Sharia Principles are 6 companies, Reinsurance Companies with Sharia Principles are 1 company, Life Insurance Companies that have Sharia Units are 23 companies, General Insurance Companies that have Sharia Units are 20 companies and Reinsurance Companies that have Sharia Units are 3 companies.

The Takaful industry is unique in terms of tax policy, quality of regulation and method of contract used (Sallemi et al., 2021) Therefore, an adequate corporate governance structure and intellectual capital must be established to effectively run the Takaful industry so that it is expected to protect stakeholder. Meanwhile, according to (Thompson and Wright, 1995) a good governance system can help Takaful operators improve the efficiency of their operational activities and improve economic performance through improved resource allocation, strategic innovation, and product design systems. The research shows that governance plays an important role in running a company.

According to (Fekadu, 2015), Companies with good governance mechanisms have a higher success rate in achieving company goals (Fekadu, 2015).

On the other hand, according to (Haqqi, 2014) the Islamic Financial Services Board (IFSB) Malaysia has defined Sharia Governance as a sharia governance system that refers to a set of institutional and organizational arrangements through which institutions offering Islamic financial services ensure that there is effective independent supervision of sharia compliance. It is stated in (Alman, 2012) that the Sharia Supervisory Board (DPS) is one of the internal governance mechanisms which includes monitoring and controlling the implementation and compliance of financial services transaction activities to ensure that these activities are in accordance with sharia.

In 2020, based on market share premiums, the sharia insurance industry will be concentrated in the Gulf Cooperation Council (GCC) countries, especially Saudi Arabia and the UAE with a share reaching 53%, followed by the Middle East and South Asia regions. Meanwhile, the premium contribution from Southeast Asia was recorded at only 18% with the majority coming from Malaysia (Serpina & Primurdia, 2022). Takaful increased by double digits to US$62 billion in 2020, with Turkey, Iran, Saudi Arabia, and Southeast Asia being the main contributors. The government of Algeria approved takaful legislation back in February 2021, and Moroccan consumers are demanding takaful coverage for specific financial products like property finance, indicating that it is also garnering popularity in other countries like North Africa (Dinar Standard & Salam Gateway, 2022). Public interest in sharia insurance protection is increasing every year. This is evidenced by the continued growth of contributions and gross claims since October 2015-2022, even though in 2022 gross claims had fallen by 6.65%, from 16,563 billion Rupiah to 15,461 billion Rupiah (Suparyanto dan Rosad, 2022)

Based on sharia insurance performance data, in general sharia insurance experienced month-to-month (MoM) growth in September-October 2022 of 0.44%. This growth is divided into several categories. In the asset category, it increased by 0.44% to 45,189 billion Rupiah. Furthermore, the gross contribution category increased by 7.37% to 21,546 billion Rupiah. Followed by the category of gross claims which increased by 6.86% to 15,461 billion Rupiah, the investment category by 0.15% to 36,394 billion Rupiah, and the investment return category by 15.44% to 1,107 billion Rupiah (Suparyanto dan Rosad, 2022).

However, according to (Hendra, 2021) there are also several insurance companies that are currently experiencing default problems such as Wanaartha, Bumiputera, Jiwasraya which should be used as lessons for the community, regulators, as well as the management and stakeholders of insurance companies.

The rise of troubled insurance companies and the demands of regulators for insurance businesses to spin off certainly makes the issue of corporate governance on company performance worthy of study. There are several studies that specifically discuss the effect of corporate governance on insurance performance such as those conducted by (Kiptoo et al., 2021) which examines the effect of corporate governance on the performance of insurance companies in Kenya. In addition, there is research (Abebe Zelalem et al., 2022) which discusses the effect of corporate governance on the performance of insurance companies in Ethiopia. In addition, there is also research conducted by (Abdoush et al., 2022) which discusses the effect of corporate governance on the performance of insurance companies during the financial crisis in the UK. These three studies empirically prove that several corporate governance variables affect company performance.

However, research related to corporate governance and its relationship with company performance is mostly conducted in the banking industry and capital markets such as research conducted by (Buallay, 2019) on banks in the Middle East and North Africa (MENA) region. In addition, there is research related to corporate governance and its influence on Islamic banking in countries included in the Organization of Islamic Cooperation (OIC) (Harun et al., 2020)As well as research conducted by (Pillai & Al-Malkawi, 2018) on the effect of corporate governance on financial and non-financial service companies in the Gulf Cooperation Council countries. The four studies also show significant results on corporate governance variables on company performance.

In addition, the dynamics of insurance companies are quite rapid, marked in the last 5 years there are several companies that have just separated themselves into sharia units such as Jasindo Syariah, Askrida Syariah, Capital Life Syariah and Reinsurance Syariah Indonesia. In addition, in the last 5 years, there have been several companies that have changed their names such as Asuransi Jaya Proteksi to PT Chubb General Insurance Indonesia. PT ACE Life Assurance which is now PT Chubb Life Insurance Indonesia (Chubb Life). PT Asuransi BRIngin Jiwa Sejahtera became PT Asuransi BRI Life. Then there is Astra Aviva Life which changed its name to Astra Life Insurance. Then there is Kresna Insurance which changed its name to Maximus Insurance. In addition, there are also strategic actions in the form of acquisitions such as those of PT Asuransi Adira Dinamika by Zurich Insurance Group which then officially changed its name to PT Zurich Asuransi Indonesia Tbk.

Literature review

Theoretical Review

a. **Takaful**

Takaful is a system that combines the mutual form (which is founded on the principle of mutual aid (ta'awun) and voluntary contribution (tabarru), where the group voluntarily shares the risk) with equity financing and profits that are capitalized like any other regular stock business. The distinguishing feature of Takaful firms is that policyholders instead of shareholders partake in the excess profits from Takaful and investment assets. In order to serve the interests of the policyholders, the designated investment funds, which represent the retained reserves, accumulated surplus, and provisions, are run and controlled by shareholders. The corporation pays out a portion of its income to its shareholders as compensation for their investments. (Hemrit, 2020)

b. Difference Between Takaful and Conventional Insurance

According to Malik & Ullah (2019) things that distinguish the takaful and the conventional insurance come from the contract, risk mitigation mechanism, ownership, investment, underwriting profit, sharia supervision by the sharia supervisory board, and the prohibition (gharar, maysir, and riba). Conventional insurance is a contract of compensation (aqd mua'wza), but takaful is a contract based on tabarru. Takaful is a risk-sharing method, whereas insurance is a risk-transfer mechanism. Each member makes a contribution to the Takaful Fund in proportion to the risk they bring to the Takaful. The takaful operator maintains the takaful fund as an agent or administrator under the wakalah model yet the takaful fund is held by the contributors. Meanwhile, the conventional insurance company owns the takaful fund and any premiums paid into the takaful add to the firm's income. Underwriting profit occurs when the premiums collected come to more than the cost of paying claims. In conventional insurance, this profit belongs to the insurance company. However, in the wakalah model of takaful, this profit is called the surplus and belongs to the participants. And the last, the agreement must be compliant with Shari'ah requirements, free from intrigue (riba), betting (maysir), misrepresentation, pressure, and a high degree of vulnerability (gharar).

c. Corporate Governance

Good Corporate Governance for Insurance Companies are structures and processes that are used and implemented by Insurance Company to achieve the business targets and optimize the value of Insurance Companies for all stakeholders, especially policyholders, insured, participants, and/or parties entitled to benefit , in an accountable manner and based on laws and ethical values. (Otoritas Jasa Keuangan, 2016)

According to Hamdani (2019) good corporate governance consists of three syllables which mean good, company and regulation. Companies with good governance ensure the implementation of the principles of transparency, accountability responsibility, professionalism and prioritize justice. Corporate governance is the procedure and control mechanism for managing an organization. Corporate governance includes the distribution of rights and obligations to the parties in the partnership (company), such as B. Management (commissions and directors), administrators, shareholders and other stakeholders; and providing procedures for decision making (OECD, 2017). Corporate governance aims to help companies build the trust, transparency and accountability needed to encourage long-term investment, financial stability and honesty/integrity in their operations to support sustainable growth and societal inclusiveness

d. Sharia Governance

The definition of sharia governance according to (Islamic Financial Services Board, 2009) is an institutional and organizational rule that aims to ensure that each Islamic financial institution can ensure that sharia compliance can run independently through the process of issuing relevant sharia fatwas, disseminating fatwa information and internal review of sharia compliance. Meanwhile, according to Rama (2015), the use of the term sharia governance historically has a similar function with the term hisbah in classical Muslim society which aims to encourage the implementation of sharia in the muamalat system of Muslim society where institutionally there is an important role of the Sharia Supervisory Board which is considered a form of the modern concept of muhtasib (enforcing the right and forbidding the wrong) in modern Muslim society. Meanwhile, according to Hamdani (2019) comprehensively GCG sharia contains three aspects: governance structure, governance process, and governance outcome. The board of directors, commissioners, committees, work units and the sharia supervisory board are included in the governance structure. The governance process ensures the effective implementation of Islamic GCG principals supported by adequate structure and infrastructure to produce governance outcomes in accordance with stakeholder expectations.

e. Empirical Review

The impact of corporate governance and how it was employed in the earlier research are justified by the study's further empirical review. (Kiptoo et al., 2021) investigated the relationship between corporate governance and financial performance of 51 Insurance Firms in Kenya. The findings showed corporate governance significantly affects the performance of insurance firms. Another research conducted by (Nainggolan et al., 2022) in investigating the impact of Sharia governance on the risk-taking and performance of 12 fully-fledged Indonesian Islamic banks and 15 Malaysian Islamic banks from 2006 to 2016. The result showed that both the Sharia Supervisory Boards (SSB) and the Board of Commissioners (BoC) play a crucial role in Indonesian and Malaysian Islamic banks' risk-taking and performance.

MATERIALS AND METHODS

The data were obtained from the insurance statistic reports provided by OJK and financial report published by the firm through their website. The target population for the study was the 53 takaful general and life companies registered as a member of AASI. The data required for analysis were obtained in the range of 2017 - 2021, is based on data limitations caused by the completeness of data on the industry on each company's official website, the majority of which were published in 2017. This is motivated by the implementation of the Financial Services Authority Regulation Number 51 /POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies. Article 12 paragraphs 1 and 2 states that Financial Services Institutions, Issuers and Public Companies must publish a Sustainability Report through the Financial Services Institution, Issuer and Public Company website no later than April 30 of the following year. The Sustainability Report published to the public contains the economic, financial, social and environmental performance of the FSI, Issuer and Public Company in conducting sustainable business. However, in practice in the field, it was only in 2020 that insurance companies simultaneously published their corporate sustainability reports.

Research model and measurement of variables

This study uses the regression analysis method to see the relationship and influence of corporate governance variables on company performance. This study uses a research model previously carried out by (Kiptoo et al., 2021) by replacing the board diversity variable with the sharia corporate governance variable, namely the sharia supervisory board. The research model is as follows:

$$ROA_{it} = \beta_0 + \beta_1 BD_{it} + \beta_2 BI_{it} + \beta_3 BC_{it} + \beta_4 SSB_{it} + \beta_5 SSB_{it} + \beta_6 LEV_{it} + \beta_7 AGE_{it} + \beta_8 SIZE_{it}$$

Notes :

- ROA_{it} = Proportion of net profit after tax to total assets of company i in year t
- $\beta_1 BD_{it}$ = Number of board of directors
- $\beta_2 BI_{it}$ = Number of board of independents
- $\beta_3 BC_{it}$ = Number of directors and commissioners
- $\beta_4 SSB_{it}$ = Number of sharia supervisory board
- $\beta_6 LEV_{it}$ = the proportion between net income to debt to capital
- $\beta_7 AGE_{it}$ = natural logarithm of company age since establishment
- $\beta_8 SIZE_{it}$ = natural logarithm of total assets

RESULTS AND DISCUSSION

Descriptive Statistic

Descriptive statistics explain information about the dependent, independent, and control variables in terms of mean (average), median (median), maximum, minimum, and standard deviation for each variable. Of the 8 variables available, 4 of them are independent variables including Board of Director, Board of Independent, Board Composition, Sharia Supervisory Board. For the dependent variable, there is 1, namely ROA and 3 control variables, namely leverage, size and age.

Based on descriptive statistical data, the independent variable Board of Director has an average of 0.4899731 and a standard deviation of 0.0770656. The independent variable Board of Independent has an average of 0.2681182 and a standard deviation of 0.0676991. The average of the independent variable Board Composition is 8.0.56604 and the standard deviation is 2.15687. The independent variable Sharia Supervisory Board has an average of

1.969811 and a standard deviation of 0.4757709. The dependent variable ROA has an average of 0.0554257 and a standard deviation of 0.093839. The leverage variable has an average of 0.3701293 and a standard deviation of 0.6393335. The size variable has an average of 5.110138 and a standard deviation of 0.4531174. The age variable has an average of 1.290855 and a standard deviation of .4626422. The company size variable (SIZE) has an average of 1.348815 and a standard deviation of 0.3969088.

The following table summarizes the descriptive statistics of each variable used in the research model

Table 1. Descriptive Statistics

Variable	Indicator	Obs	Mean	Std. Dev	Min	Max
Dependent	ROA	265	0.0554257	0.093839	-0.3760781	0.3665233
Independent	Board of Director	265	0.4899731	0.0770656	0.3333333	0.6666667
Independent	Board of Independent	265	0.2681182	0.0676991	0	0.5
Independent	Board Composition	265	8.0.56604	2.15687	2	1.5
Independent	Sharia Supervisory Board	265	1.969811	0.4757709	1	3
Control	leverage	265	0.3701293	0.6393335	-1.379756	7.870184
Control	size	265	5.110138	0.4531174	4.461348	6.543198
Control	age	265	1.348815	0.3969088	0	2.037426

Correlation and diagnostic test result

Three approaches are used to select the estimation model used in panel data research, namely Pooled Least Square, Fixed Effects Model and Random Effects Model. The selection of the evaluation model is determined by statistical tests based on the results of the Chow test, Hausman test and Lagrange Multiplier (LM) test. Using the Chow test, the prob result is 0.0000 which is smaller than the significance value of 5% or the "Prob> F" value is less than 0.05 (alpha) so that H0 is rejected, meaning that the best model is fixed effect. Based on the Hausman test, the Prob>Chi2 result is 0.0130 which is smaller than the significance value of 5% or the "Prob>Chi2" value is less than 0.05 (alpha) so that the regression used is the random effect model. Based on the Lagrange Multiplier test, the Prob>Chi2 result is 0.00 which is smaller than the significance value of 5% or the "Prob>Chi2" value is less than 0.05 (alpha) so that the regression used is the random effect model.

Table 2. Chow Test

Prob (F-Statistic)	Result
0,0000	Fixed Effect

Table 3. Hausman Test

	Result
0,0000	Fixed Effect

Table 4. Lagrange Multiplier (LM)

Prob (F-Statistic)	Result
0,00	Random Effect

The findings in Table 2,3 and 4 also demonstrate a distinction between fixed effect and random effect model values. In order to estimate the relationship between corporate governance and performance, the random-effect model was applied.
According to Gujarati and Porter (2009), the random effect panel model estimation method uses the generalized least square (GLS) method, while the common effect panel model and the fixed effect panel model use ordinary least square (OLS). One of the advantages of the GLS method is that it does not need to fulfill classical assumptions. So, if the regression model uses random effect, there is no need to test classical assumptions. Conversely, if a common effect or fixed effect regression model is used, it is necessary to test the classical assumptions. According to Gujarati and Porter [12], it is very unlikely that multicollinearity will occur in panel data so researchers only need to test for autocorrelation and heteroscedasticity.

Regression Result

The following are the results of data processing using three models, namely common effect, fixed effect and random effect models. As between the following three models, the one chosen is to use the random effect model

Table 5. Fixed effect model regression results

	Variable	Coef	Std. Error	Z	P>|t|	Result
X1	**Board of Director**	0.0990003	0.0749158	1.32	0.186	Not Significant
X2	**Board of Independen**	-0.145639	0.072458	-2.01	0.044	**Negative significant**
X3	**Board Composition**	0.0007974	0.0032911	0.24	0.809	Not Significant
X4	**Sharia Supervisory Board**	0.0274196	0.0106755	2.57	0.01	**Positive significant**
C1	**Leverage**	-0.0609234	0.0070825	-8.6	0.00	**Negative significant**

	Variable	Coef	Std. Error	Z	P>|t|	Result
C2	**Size**	0.1046156	0.0175019	5.98	0.00	**Positive significant**
C3	**Age**	299669	0.0199123	1.5	0.132	Not Significant

The table above shows that Independent Board and Sharia supervisory board, as well as leverage and company size have a significant effect on company performance as measured by ROA. The findings show that each increase in Board Independent has a negative and significant effect on financial performance through a decrease in ROA of 0.145. This suggests that insurance companies with a greater ratio of board independence do not perform better. Therefore, insurance companies should reduce the ratio of board independent ratios to achieve better performance. These results are also similar to research (Ararat et al., 2012) regarding board independence in Turkish companies. The first finding shows that there is no significant relationship between board independence and equity issues. Moreover, independent directors in Turkey are less efficient in restraining related party transactions. In addition, they also found that there is a negative relationship and no relationship between independent directors and firm performance. These

This result is supported by research conducted by (El-Halaby & Hussainey, 2016) which found that corporate governance mechanisms related to SSB have a higher explanatory power on the variation of Islamic disclosure compared to governance mechanisms related to the board of directors. They stated that the main reason for this result is because the research results are due to the fact that independent directors of Turkish listed companies are not truly independent. The independent directors have personal, financial, and social relationships with the dominant shareholders and this affects their independent judgment, thus jeopardizing their function as independent directors. The hypothesis that there is a positive relationship between board independent and the financial performance of takaful firm is thus rejected.

In addition, the results of this study indicate that any increase in the number of sharia supervisory boards has a positive and significant effect on financial performance through an increase in ROA of 0.027. This shows that insurance companies with a larger number of sharia supervisory boards have better performance. Therefore, insurance companies can consider increasing the number of sharia supervisory boards with relevant backgrounds to achieve better performance.

SSB has a major role in ensuring and reporting the accounting and auditing organization for Islamic financial institution standards where the board of directors has no direct role.

The hypothesis that there is a positive relationship between sharia supervisory board and the financial performance of takaful firm is thus accepted.

Furthermore, the results of this study show that any increase in leverage ratio has a negative and significant effect on financial performance through a decrease in ROA by 0.06. Then it is also found that every 1% increase in size has a positive and significant effect on financial performance through an increase in ROA of 0.104. While the other three variables have no significant effect on company performance.

To ensure the validity of our conclusions, we also ran additional analyses using various models. Table 6 results demonstrate that the outcomes produced by the various models are comparable to those of the fixed effects model that we selected.

Table 6. additional regression analysis results

Variable	Common Effect Model	Fixed Effect Model	Random Effect Model
Board of Director	0,00346	0,163153	0,0990003
(t-statistic) (z-statistic)	0,958	0,072	0,186
Board of Independent	-0,15564	-0,16158	-0,145639
(t-statistic) (z-statistic)	0,053	0,043	0,044
Board Composition	0,00325	-0,00047	0,0007974
(t-statistic) (z-statistic)	0,225	0.914	0,809
Sharia Supervisory Board	0,010006	0,038663	0,0274196
(t-statistic) (z-statistic)	0,312	0,002	0,01
Leverage	-0,06851	-0,05951	-0,0609234
(t-statistic) (z-statistic)	0	0	0
Size	0,093304	0,130589	0,1046156
(t-statistic) (z-statistic)	0	0	0
Age	0,01903	0,047906	299669
(t-statistic) (z-statistic)	0,125	0,269	0,132
C	-0,42754	0,763506	-.5669394
(t-statistic) (z-statistic)	0	0	-5.42

CONCLUSIONS

This study examined the correlation between 53 Indonesian takaful companies' financial performance and corporate governance. Board of Director, Board of Independent, Board Composition, and Sharia Supervisory Board were the corporate governance variables, and ROA was used to measure financial performance together with three control variables, including leverage, size, and age. In order to ascertain the correlation between the variables, regression analysis was performed. The research results demonstrated that board independence has a negative and significant impact on financial performance. This implies that the performance of insurance companies does not improve with increasing board independence ratios. In order to improve performance, insurance companies should lower the ratio of board independent ratios. To improve performance, businesses should consequently lower the proportion of non-executive directors.

The findings also demonstrated the significant and beneficial effect of a sharia supervisory board on financial performance. This demonstrates that insurance businesses with more sharia supervisory boards perform better. In order to improve performance, insurance companies might consider thinking about increasing the number of sharia supervisory boards with relevant backgrounds.

This study contributes to the research by providing another point of view on the impact of corporate governance on performance from the perspective of a sharia financial institution. This research also offers recommendations that policymakers can use in evaluating and reviewing corporate governance regulations, as well as an empirical analysis of the impact of the various governance arrangements employed by takaful firm. Additionally, the study makes suggestions for managers and other stakeholders regarding the board structure that can be used to improve the performance of a company.

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