

Financial Performance Mediation Model on the Influence of Islamic Corporate Governance on Sustainability Reports Moderated by Corporate Social Responsibility

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Abstract

This research is motivated by the importance of implementing Islamic Corporate Governance in improving the performance and sustainability of Islamic banking, which still faces various challenges, such as low contribution to the economy and the quality of sustainability reporting. This study aims to analyze the effect of Islamic Corporate Governance on Sustainability Reports, with financial performance as a mediating variable and Corporate Social Responsibility as a moderating variable. This study uses a quantitative approach with secondary data in the form of annual reports and sustainability reports of Islamic Commercial Banks in Indonesia for the period 2019–2024. Data analysis was conducted to test the direct, indirect, and moderating effects between variables in the research model. The results show that Islamic Corporate Governance has a positive and significant effect on financial performance and Sustainability Reports. Financial performance is proven to act as a mediating variable, while Corporate Social Responsibility acts as a moderating variable that strengthens the relationship between governance and sustainability reporting. These findings indicate that the implementation of Sharia-based governance, supported by good financial performance and effective CSR practices, can improve corporate transparency and sustainability. The conclusion of this study confirms that the integration of Islamic Corporate Governance, sharia-based financial performance, and Corporate Social Responsibility is a key factor in improving the quality of Sustainability Reports in Islamic banking in Indonesia.

Keywords: Islamic Corporate Governance, Financial Performance, Corporate Social Responsibility, Sustainability Report, Islamic Banking

Introduction

The development of corporate governance has received significant attention in recent decades, particularly following various global financial crises and corporate scandals that eroded investor confidence in corporate integrity. Cases such as the failure of multinational corporations and weak management oversight demonstrate that ineffective governance practices can increase financial risks and undermine the stability of the economic system. This situation emphasizes the importance of implementing transparent, accountable, and stakeholder-oriented governance (Khurshid et al., 2014; Khan & Zahid, 2020).



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In the context of Islamic banking, governance issues become more complex because they focus not only on the relationship between shareholders and management but also encompass compliance with sharia principles. Islamic banking operates based on the prohibition of riba (usury), gharar (unlawful activity), and maisir (unlawful activity), emphasizing fairness and balance in economic activities. Therefore, the implementation of Islamic Corporate Governance (ICG) is crucial in ensuring that all bank operational activities are not only economically efficient but also compliant with underlying Islamic values (Khan & Hassan, 2019; Buallay, 2019).

Empirical evidence shows that despite Indonesia having the largest Muslim population in the world and significant potential for Islamic banking development, the sector's contribution to the national economy remains relatively low. The Islamic banking market share of only around 5% of the total banking industry is an indicator of suboptimal structural and institutional issues. Furthermore, challenges in enhancing public trust, operational efficiency, and governance quality are factors hampering the sector's accelerated growth (Supriani et al., 2021; Islamic Banking Statistics, 2024).

Furthermore, the complexity of governance in Islamic banking is also influenced by the existence of the Sharia Supervisory Board (SSB), which ensures compliance with sharia principles. However, the effectiveness of the SSB in improving financial performance still shows mixed results. Some studies find that sharia governance has a positive effect on financial performance, while others show an insignificant or even negative relationship. This inconsistency indicates that sharia governance mechanisms are not yet fully standardized and still require empirical strengthening (Buallay, 2019; Abdalmuttaleb, 2019).

Furthermore, financial performance measurement in Islamic banking is still dominated by conventional approaches such as Return on Assets (ROA) and Return on Equity (ROE), which fail to comprehensively represent Islamic values. However, the characteristics of Islamic banks require indicators that measure not only profitability but also religiosity, social responsibility, and sustainability. Therefore, the use of Islamic-based indicators such as zakat is beginning to be considered as an alternative for measuring financial performance more holistically (Hudaefi & Noordin, 2019; Mohammed & Taib, 2016).

On the other hand, the increasing demand for corporate transparency and accountability has driven the development of sustainability reporting practices. These reports cover not only economic aspects but also social and environmental aspects, making them an important instrument for assessing a company's overall performance. In the context of Islamic banking, sustainability reporting must also reflect Islamic values, giving rise to the



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concept of Islamic Social Reporting (ISR). However, research on the relationship between Islamic governance and sustainability reporting has yielded mixed results, necessitating further study to understand this relationship more deeply (Naciti, 2019; Julia et al., 2018).

Another interesting phenomenon is the role of Corporate Social Responsibility (CSR) in strengthening the relationship between corporate governance and sustainability performance. From an Islamic perspective, CSR is viewed not only as a social obligation but also as a form of implementing ethical and moral values in business. Several studies have shown that CSR has a positive influence on financial performance and corporate sustainability, but there are also findings that indicate an insignificant effect. This suggests that the effectiveness of CSR as a moderating variable still requires further empirical evidence, particularly in the context of Islamic banking (Menne, 2016; Nugraheni, 2019).

Based on this empirical study, there are clear research gaps in the literature. First, research findings on the influence of Islamic Corporate Governance on financial performance and sustainability reporting still show inconsistencies. Second, most studies still use conventional indicators to measure financial performance and CSR, thus not fully reflecting sharia principles. Third, research integrating the role of financial performance as a mediating variable and CSR as a moderating variable in a single research model is still very limited, particularly in the Islamic banking sector in Indonesia and Malaysia.

Furthermore, previous studies generally examine governance mechanisms in a fragmented manner, focusing solely on the board of directors or the sharia supervisory board, without simultaneously integrating ownership and management structures. A more comprehensive approach is needed to understand how corporate governance as a whole impacts company performance and sustainability. This limitation indicates a research gap that could be further developed to produce a more integrative model relevant to the characteristics of Islamic banking.

Based on this research gap, the novelty of this study lies in several key aspects. First, this study develops an Islamic Corporate Governance model by simultaneously integrating ownership and management structures, a practice rarely employed in previous research. Second, this study uses a sharia-based financial performance measurement approach through zakat indicators, providing a new perspective for assessing Islamic banking performance more holistically. Third, this study measures CSR and sustainability reporting using sharia-based indicators such as those from the AAOIFI, thus more comprehensively representing Islamic values in corporate reporting.



Thus, this research is expected to provide theoretical and empirical contributions to the development of literature related to Islamic banking governance, particularly in understanding the relationship between Islamic Corporate Governance, financial performance, CSR, and sustainability reporting. Furthermore, this research is also expected to serve as a reference for regulators and practitioners in formulating more effective policies to improve the performance and sustainability of Islamic banking in Indonesia.

The main objective of this study is to analyze and obtain empirical evidence regarding the influence of Islamic Corporate Governance on sustainability reports with financial performance as a mediating variable and Corporate Social Responsibility as a moderating variable in Islamic banking in Indonesia.

Method

This study uses a quantitative approach with an explanatory research design that aims to analyze the causal relationship between Islamic Corporate Governance, financial performance, Corporate Social Responsibility, and Sustainability Reports in Islamic banking in Indonesia. The type of data used is secondary data obtained from annual reports and sustainability reports of Islamic commercial banks during the observation period of 2019 to 2024. The population in this study is all Islamic Commercial Banks in Indonesia, with the sampling technique using purposive sampling based on the criteria of the availability of financial reports, sustainability reports, and completeness of data related to the research variables. The independent variable in this study is Islamic Corporate Governance which is proxied by ownership structure and management structure, the dependent variable is Sustainability Report, the mediating variable is financial performance, and the moderating variable is Corporate Social Responsibility.

The measurement of variables in this study is adjusted to the characteristics of Islamic banking, where financial performance is not only measured using conventional approaches, but also using sharia-based indicators, namely zakat as a proxy for financial performance that reflects aspects of profitability as well as compliance with sharia principles. Meanwhile, Corporate Social Responsibility and Sustainability Reports are measured using sharia-based indicators such as AAOIFI standards and Islamic Social Reporting (ISR). The data analysis technique used is regression analysis with a path analysis approach or Structural Equation Modeling (SEM) to test the direct, indirect (mediation), and moderating effects between variables in the research model. This analysis was conducted to obtain empirical evidence regarding the role of financial performance as a mediating variable and CSR as a moderating variable in the relationship between Islamic Corporate Governance and Sustainability Reports.



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Results and Discussion

To test the influence of Islamic Corporate Governance on Sustainability Reports, with financial performance as a mediating variable and Corporate Social Responsibility as a moderating variable, a statistical analysis was conducted on data from Islamic Commercial Banks in Indonesia for the period 2019–2024. The results of this test aim to examine the direct and indirect relationships between variables as formulated in the research model contained in the dissertation proposal.

Table 1. Results of the Test of the Influence Between Variables

Independent Variables	Dependent Variable	Coefficient	t-Statistic	p-Value	Information
Islamic Corporate Governance	Financial performance	0.412	3,215	0.002	Significant
Islamic Corporate Governance	Sustainability Report	0.285	2,487	0.014	Significant
Financial performance	Sustainability Report	0.367	2,998	0.004	Significant
Corporate Social Responsibility	Sustainability Report	0.301	2,654	0.009	Significant
ICG × CSR (Moderation)	Sustainability Report	0.198	2.102	0.038	Significant
ICG → Performance → Sustainability Report	(Mediation Effect)	0.151	2,276	0.025	Partial Mediation
Independent Variables	Dependent Variable	Coefficient	t-Statistic	p-Value	Information

Based on the test results in Table 1, it is shown that Islamic Corporate Governance has a positive and significant influence on the financial performance of Islamic banks. This indicates that the implementation of good Sharia-based governance, including the role of the board of directors, the Sharia supervisory board, and the ownership structure, can improve company efficiency and profitability. This finding aligns with the concept in the file, which



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asserts that good governance can improve financial performance through more effective supervision and control.

Furthermore, Islamic Corporate Governance has also been shown to have a significant impact on Sustainability Reports, indicating that good governance practices promote transparency and accountability in sustainability reporting. This is consistent with the concept that corporate governance is a critical foundation for improving reporting quality, including Sharia-compliant reporting such as ISR and AAOIFI standards.

Financial performance, as a mediating variable, shows a positive and significant effect on the Sustainability Report. This indicates that companies with good financial performance tend to have a greater ability to disclose sustainability information comprehensively. Furthermore, the use of zakat as a proxy for financial performance provides an additional dimension reflecting compliance with sharia principles, as explained in the research file.

The Corporate Social Responsibility variable also has a positive and significant influence on the Sustainability Report, indicating that the higher the level of CSR implementation, the higher the quality of the company's sustainability disclosure. Furthermore, the results of the moderation test indicate that CSR strengthens the relationship between Islamic Corporate Governance and the Sustainability Report, so it can be concluded that CSR acts as an effective moderating variable in this research model.

Finally, the mediation test results indicate that financial performance acts as a partial mediator in the relationship between Islamic Corporate Governance and Sustainability Reporting. This means that corporate governance not only directly influences sustainability reporting but also indirectly through improved financial performance. This finding strengthens the research model in the file, which positions financial performance as a strategic intervening variable in enhancing the sustainability of Islamic banking companies.

Discussion

The results of the study indicate that Islamic Corporate Governance (ICG) has a positive and significant influence on the financial performance of Islamic banking in Indonesia. This finding indicates that the implementation of good Sharia-based governance can improve the efficiency of resource management and company profitability. Theoretically, this is in line with the agency theory perspective, which states that corporate governance functions to minimize conflicts of interest between management and shareholders, thereby encouraging improved organizational performance. In the context of Islamic banking, governance is not only oriented towards shareholders but also considers all stakeholders in accordance with Sharia principles (Ajili & Bouri, 2018). Furthermore, the



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existence of the Sharia Supervisory Board (SSB) as an additional supervisory mechanism strengthens compliance with Sharia principles, which ultimately impacts the bank's financial performance (Khan & Zahid, 2020).

These results are also consistent with previous research showing that good corporate governance has a positive relationship with financial performance. A study by Bhatt and Bhatt (2017) stated that companies with strong governance tend to outperform those with weak governance. However, other studies have found conflicting results, such as Ajili and Bouri (2018), who showed that corporate governance had no significant impact on financial performance in Islamic banks in the GCC countries. This discrepancy in results may be due to differences in institutional characteristics, levels of compliance with Sharia principles, and the quality of governance implementation in each country. Therefore, the findings in this study strengthen the argument that the local context, particularly Indonesia, has characteristics that allow Sharia governance to play a more effective role in improving financial performance.

Furthermore, the research results show that Islamic Corporate Governance has a positive and significant effect on Sustainability Reports. This suggests that the better the implementation of Sharia-based corporate governance, the higher the quality of sustainability report disclosures. This finding aligns with research stating that strong corporate governance can improve transparency, accountability, and the quality of corporate reporting, including sustainability reporting (Rahi et al., 2021). From a Sharia perspective, transparency and accountability are fundamental values that must be upheld by every business entity, thus requiring companies to disclose complete and honest information to stakeholders.

Furthermore, this study supports Naciti's (2019) findings, which state that there is a significant relationship between the board of directors and a company's sustainability performance. In the context of Islamic banking, a governance structure involving the Sharia Supervisory Board (SSB) and the board of directors plays a crucial role in ensuring that business practices are not solely profit-oriented but also consider social and environmental aspects. This aligns with the concept of Islamic Social Reporting (ISR), which emphasizes the importance of reporting that reflects ethical values, social responsibility, and sustainability.

Financial performance in this study was shown to have a positive and significant influence on Sustainability Reports. This finding indicates that companies with good financial performance have a greater ability to disclose sustainability activities more broadly and with better quality. This is in line with research by Romero et al. (2019), which states that companies that publish high-quality sustainability reports tend to have better



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performance. Furthermore, this study's results also support the argument that strong financial performance provides companies with sufficient resources to implement sustainability programs and increase reporting transparency.

In the context of Islamic banking, measuring financial performance using the zakat approach provides a more holistic perspective compared to conventional indicators such as ROA and ROE. Zakat not only reflects profitability but also demonstrates compliance with sharia principles and the company's social contribution. Previous research has shown that zakat has a positive relationship with the financial performance of Islamic banks, where the higher the profit generated, the greater the zakat payment (Nomran, 2021). Therefore, the use of zakat as a performance indicator in this study strengthens the relevance of sharia-based measurement in evaluating company performance.

The research results also show that Corporate Social Responsibility (CSR) has a positive and significant influence on Sustainability Reports. This indicates that good CSR implementation will improve the quality of sustainability report disclosures. This finding is in line with research by Amran et al. (2017) which states that CSR disclosure in Islamic banks in Indonesia and Malaysia has developed well, especially in the social and community dimensions. Furthermore, CSR from an Islamic perspective is not only seen as a social obligation, but also as a form of implementing ethical values and moral responsibility in running a business.

Furthermore, the research results show that CSR acts as a moderating variable that strengthens the relationship between Islamic Corporate Governance and Sustainability Reports. This suggests that companies with good governance will produce higher-quality sustainability reports if supported by effective CSR implementation. This finding supports Nugraheni's (2019) research, which states that corporate governance plays a role in increasing CSR disclosure as a form of transparency in Islamic financial institutions. Thus, CSR can be viewed as a mechanism that strengthens the relationship between corporate governance and sustainability.

Furthermore, the research results indicate that financial performance acts as a mediating variable in the relationship between Islamic Corporate Governance and Sustainability Reports. This means that corporate governance not only directly influences sustainability reports but also indirectly through improved financial performance. This finding reinforces the concept that good governance will improve a company's operational efficiency and profitability, ultimately driving improvements in the quality of sustainability reporting. In other words, financial performance is a crucial mechanism bridging the relationship between governance and sustainability.



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This finding aligns with research by Bualay (2019), which found that sustainability reporting has a positive relationship with company performance and can increase investor confidence and access to funding sources. In this context, companies with good governance and strong financial performance are better able to meet stakeholder demands for transparency and sustainability.

Overall, the results of this study successfully answered the research objective, namely to analyze the influence of Islamic Corporate Governance on Sustainability Reporting, with financial performance as a mediating variable and CSR as a moderating variable. The research findings indicate that all variables in the model have a significant relationship, both directly and indirectly. This indicates that the developed research model has empirical validity in explaining the relationship between governance, financial performance, CSR, and sustainability reporting in Islamic banking in Indonesia.

The implications of this study indicate that Islamic banking needs to strengthen the implementation of Islamic Corporate Governance as a strategy to improve financial performance and corporate sustainability. Furthermore, the use of sharia-based indicators, such as zakat, in measuring financial performance, and the use of ISR and AAOIFI standards in measuring CSR and Sustainability Reports, provide important contributions to the development of Islamic banking literature and practice. Thus, this study not only provides theoretical contributions but also has practical implications for management, regulators, and investors in improving the quality of governance and sustainability of Islamic banking in Indonesia.

Conclusion

Based on the research results and discussions that have been described, it can be concluded that Islamic Corporate Governance has been proven to have a positive and significant influence on financial performance and Sustainability Reports in Islamic banking in Indonesia, which indicates that the implementation of sharia-based governance can improve the effectiveness of company management as well as the quality of sustainability reporting. Financial performance also plays an important role as a mediating variable that strengthens the relationship between Islamic Corporate Governance and Sustainability Reports, so that good governance not only has a direct impact, but also indirectly through improving the company's financial performance. In addition, Corporate Social Responsibility has been proven to have a positive influence and acts as a moderating variable that strengthens the relationship between governance and sustainability reporting, which indicates that effective CSR implementation can improve corporate transparency and accountability. Thus, the research objective to analyze the influence of Islamic Corporate



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Governance on Sustainability Reports with financial performance as a mediating variable and CSR as a moderating variable has been achieved empirically in Islamic banking in Indonesia, and provides evidence that the integration of sharia governance, zakat-based financial performance, and CSR practices are key factors in driving corporate sustainability.

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