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Governance violations and their impact on business growth: A case study of Sharia Rural Bank Saka Dana Mulia Kudus

Sumarno[1], Muchlis Yahya[2], Rahman El Junusi[3], Ali Murtadho[4], Misbah Zulfa Elizabeth[5], & Irwan Abdullah[6]

[1]Program Studi Studi Islam (S3), Universitas Islam Negeri Walisongo Semarang, Kota Semarang, Indonesia
[2]Program Studi Ekonomi Islam (S1), Universitas Islam Negeri Walisongo Semarang, Kota Semarang, Indonesia
[3]Program Studi Manajemen (S1), Universitas Islam Negeri Walisongo Semarang, Kota Semarang, Indonesia
[4]Program Studi Ekonomi Syariah (S2), Universitas Islam Negeri Walisongo Semarang, Kota Semarang, Indonesia
[5]Program Studi Sosiologi (S1), Universitas Islam Negeri Walisongo Semarang, Kota Semarang, Indonesia
[6]Program Studi Magister Antropologi (S2), Universitas Gadjah Mada, Kab. Sleman, Indonesia

ABSTRACT

Introduction

Governance failure in Islamic rural banking remains a critical challenge because weak implementation of prudential principles, ineffective oversight, and inadequate risk management can threaten institutional sustainability and ultimately result in the revocation of an operating license. Although governance has been extensively discussed in Islamic banking, comprehensive evidence explaining how governance violations, liquidity risk, and capital inadequacy jointly contribute to institutional failure remains limited, particularly among Sharia Rural Banks in Indonesia.

Objectives

This study aims to identify the types of governance violations that occurred at Sharia Rural Bank Saka Dana Mulia Kudus, analyze the implementation of good corporate governance and Islamic corporate governance, examine the relationship between governance failure, liquidity risk management, and minimum capital adequacy, and evaluate their impact on sustainable business growth.

Method

This study employed a qualitative approach using a single-case study design focusing on Sharia Rural Bank Saka Dana Mulia Kudus.

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Contact: Sumarno ✉ soemarno555@gmail.com

Secondary data were collected from regulatory documents, banking publication reports, financial statements, official policies, media reports, and academic literature covering the period from 2020 to 2024. Document analysis, thematic coding, and source triangulation were applied to identify governance failures, liquidity risk, capital adequacy issues, and their consequences for banking performance and business continuity.

Results

The findings reveal that governance failure resulted from the ineffective performance of the board of directors and board of commissioners, weak implementation of prudential principles, inadequate liquidity risk management, failure to satisfy minimum capital adequacy requirements, and ineffective Sharia compliance oversight. These weaknesses caused severe deterioration in financial performance, reflected by extremely high non-performing financing, declining profitability, insufficient liquidity reserves, negative capital adequacy, and continuing operating losses. The resulting decline in depositor confidence, reduction in third-party funds, unsuccessful restructuring efforts, and worsening financial health ultimately led to the revocation of the bank's operating license and significantly hindered business growth.

Implications

The findings emphasize the importance of strengthening governance structures, improving liquidity risk management, ensuring sustainable capital adequacy, enhancing the effectiveness of the Sharia Supervisory Board, and implementing more proactive regulatory supervision and early warning mechanisms to safeguard institutional stability and promote sustainable growth in Islamic rural banking.

Originality/Novelty

This study provides a comprehensive analytical framework integrating governance failure, liquidity risk management, minimum capital adequacy, and Islamic corporate governance to explain institutional failure in a Sharia Rural Bank. It offers practical early warning indicators for regulators and banking practitioners while demonstrating that Islamic institutional identity alone does not guarantee effective governance without substantive oversight, prudent management, and integrated risk control.

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INTRODUCTION

Violations in the application of bank governance can occur due to a failure to prioritise the principle of prudence and a lack of professionalism in conducting business and operational activities (Khairunnisak et al., 2023; A. P. Sari, 2023; Sihotang, 2021; Sulistyandari et al., 2024). These impact business continuity, potentially leading to the revocation of a business licence, which can hinder business growth; consequently, the application of governance is crucial for banks, including Sharia Rural Banks (Wahyuni & Hayati, 2022; Yuliyanti & Cahyonowati, 2023).

The Financial Services Authority has regulated the implementation of good governance through regulations and circulars; however, there are still Sharia Rural Banks that have committed violations resulting in the revocation of their operating licences, such as Sharia Rural Banks Saka Dana Mulia Kudus (Otoritas Jasa Keuangan, 2024; Respati & Sukmana, 2024). Sharia Rural Bank Saka Dana Mulia was designated as a bank under supervision for rehabilitation but was unable to resolve its issues, leading the Financial Services Authority to upgrade its status to supervision for resolution. The Financial Services Authority gave the directors, commissioners and shareholders the opportunity to undertake rehabilitation efforts, but these efforts were unsuccessful (Respati & Sukmana, 2024). These steps indicate that attempts to rescue the bank were made, but the efforts undertaken by Sharia Rural Banks were unsuccessful. The financial data and financial ratios of Sharia Rural Banks Saka Dana Mulia Kudus can be viewed in Tables 1-3.

Table 1

Financial Data of Sharia Rural Bank Saka Dana Mulia Kudus

Year	Assets	Financing	Third-Party Funds	Profit for the Year
2020	32,344,490	26,433,832	13,246,970	(297,248)
2021	36,608,196	29,712,629	10,339,490	171,857
2022	37,963,034	28,624,321	11,538,771	(510,796)
2023	28,405,815	24,878,278	8,054,180	(2,707,147)
2024 (March)	24,021,362	22,208,268	5,646,726	(811,470)

Source: Otoritas Jasa Keuangan.

Table 2

Financial Ratio Data of Sharia Rural Bank Saka Dana Mulia Kudus

Year	ROA	BOPO	NI	CAR	NPL	FDR
2020	(0.99)	110.05	6.36	19.18	8.65	91.23
2021	0.61	96.63	6.67	15.00	10.53	90.02
2022	(1.39)	110.74	8.13	20.47	7.81	82.36
2023	(8.35)	146.34	11.22	(1.46)	44.85	308.89
2024 (March)	(12.83)	334.01	1.95	(8.48)	54.8	93.66

Source: Otoritas Jasa Keuangan.

Table 3

Liquidity Ratio Data of Sharia Rural Bank Saka Dana Mulia Kudus

Year	Liquid Assets / Total Assets	Liquid Assets / Current Liabilities
2020	14.11%	15.75%
2021	15.63%	17.33%
2022	21.18%	23.13%
2023	13.95%	14.17%
2024 (March)	10.37%	10.20%

Source: Otoritas Jasa Keuangan.

Trends in financial ratios and liquidity ratios indicate a significant decline in performance from 2022 to 2024. The drastic increase in the NPF ratio to 54.8% indicates a deterioration in the quality of financing, whilst the BOPO ratio, which has risen sharply to 334%, indicates extremely high operational inefficiency; meanwhile, the decline in liquid assets as a percentage of total assets to 10.37% and liquid assets as a percentage of current liabilities to 10.20% indicates that the bank's liquidity is insufficient to cover short-term debt (Ramadhanti et al., 2019; Yulfiswandi & Halim, 2024).

Studies examining breaches of corporate governance that lead to the revocation of a business licence are very limited. The majority of research conducted still focuses on fraud within the broader context of corporate governance. Such breaches result in the revocation of a business licence and disrupt sustainable business growth, as the condition of a bank poses a threat to the banking system (Kurniati et al., 2022). The forms of violations occurring in Sharia Rural Banks include credit-related violations, such as fictitious loans; capital inadequacy, with a declining capital adequacy ratio due to an increase in non-performing loans that cannot be recovered; and violations in bank governance, such as inadequate internal oversight and ineffective supervision (Rohman et al., 2024). Researchers have not yet identified studies examining the types of violations in the implementation of governance at Sharia Rural Banks and their impact on sustainable business growth, which constitutes the primary justification for this study.

Research on banking institution failures generally focuses on financial performance, credit risk, or cases of fraud within corporate governance. Previous studies have highlighted the relationship between good corporate governance and the financial performance of Islamic banks or the stability of the banking system (Khan & Zahid, 2020; Utami & Damayanti, 2024). However, research specifically analysing governance violations leading to the revocation of a Sharia bank's operating licence, particularly for Sharia Rural Banks, remains very limited. Most studies merely describe aspects of fraud or weaknesses in internal controls without comprehensively examining how governance failures, weaknesses in liquidity risk management, and systemic capital inadequacy can lead to regulatory resolution of the bank. Therefore, this study aims to fill this gap by analysing the case of Sharia Rural Banks Saka Dana Mulia Kudus as an empirical example of governance failure that led to the revocation of the bank's operating licence and its implications for business growth in Central Java.

Table 4

Business Growth Data of Sharia Rural Banks in Central Java

No	Description	2020	2021	2022	2023	2024
Rp Millions						
1	Assets	256,122	434,392	738,627	638,095	327,965
2	Financing	144,504	316,554	630,018	479,593	357,834
3	Third-party funds	319,512	314,701	631,915	459,889	361,294
No	**Description**	**2020**	**2021**	**2022**	**2023**	**2024**
Percentage						
1	Assets	14.51%	21.49%	30.08%	19.98%	8.56%
2	Financing	10.89%	21.51%	35.24%	19.83%	12.35%
3	Third-party funds	27.77%	21.41%	35.41%	19.03%	12.56%

Source: Otoritas Jasa Keuangan.

The data in Table 4 indicates that the business performance of Sharia Rural Banks in Central Java has shown year-on-year growth; however, business growth in 2024 has declined compared to the previous year, both in nominal terms and as a percentage, across assets and business lines—including financing and third-party funds. The poor level of financial health is attributed to breaches in the implementation of corporate governance, comprising the ineffective execution of duties and responsibilities by the board of directors and commissioners, difficulties in managing liquidity risk, and challenges in fulfil the minimum capital adequacy requirement. In light of the above, the implementation of governance*, risk management* and *compliance* is an absolute necessity in banking operations to drive business growth, thereby increasing the market share of Islamic banking, particularly Sharia Rural Banks in Central Java

The urgency of this research lies in detailing governance violations by Sharia Rural Banks in conducting business operations, thereby providing lessons for Sharia Rural Banks in fulfilling their intermediary functions to enhance business growth and ensure that Islamic banking benefits the economic activities of the wider community in the micro, small and medium enterprise (MSME) sector in accordance with Sharia principles. The solutions proposed in this study regarding the conduct of banking operations must prioritise the principle of prudence and the application of good governance, risk management mitigation, and comprehensive compliance implementation across all operational units, in accordance with the principles of good governance and Sharia principles for all personnel within the Islamic banking sector, from operational staff to shareholders (Mufidah, 2025; Rahmatika et al., 2024).

This study examines breaches of good governance at Sharia-compliant rural banks that have led to the revocation of their operating licences, thereby hindering the regional growth of these banks. The primary objective is to fully promote the implementation of good governance and to urge banks to apply it in their business activities and sound banking operations based on the principle of prudence, through improved management quality, risk reduction and enhanced compliance with the regulations and provisions of the the Financial Services Authority. This research was conducted using a qualitative single-case study approach and relied on secondary data from various sources, including policy documents, journal articles and others, to obtain a more comprehensive picture. Methodologically, this study draws upon agency theory, liquidity risk theory and minimum capital adequacy requirements to examine breaches in the application of corporate governance.

The relevance of this research is very high, particularly in supporting the Financial Services Authority (Otoritas Jasa Keuangan, 2022b) in encouraging financial services industry players to implement good governance to ensure sound governance and improve risk management (Mafinanik & Karman, 2025; Rizkyawan et al., 2025; Zakiya et al., 2025). The Financial Services Authority continues to strengthen organisational governance through the enhancement of internal audit functions, risk management, quality control, and the enforcement of integrity to support the OJK's tasks of regulating and supervising the financial services sector (Otoritas Jasa Keuangan, 2025b).

The implications of this study include the implementation of good governance as established by the Financial Services Authority for Sharia Rural Banks and the supervision and control carried out earnestly by the Financial Services Authority regarding the implementation of applicable regulations and circulars, so that early detection of governance violations committed by Sharia Rural Banks can be carried out and measures taken to prevent the revocation of their business licences. As for the academic world, the aim is to complement previous research, particularly regarding the types of violations occurring in the implementation of governance at Sharia Rural Banks, and it is hoped that this will provide a scientific contribution to governance implementation, thereby enriching the body of knowledge in the field of Islamic banking. Thus, this research is not only intended to identify the types of violations committed in the implementation of governance but also to understand the implementation of good governance as a whole.

LITERATURE REVIEW

The Concept of Good Corporate Governance

The theoretical foundations of *governance* are based on *agency theory*. *Agency theory* was developed by Jensen & Meckling (2009) and is a key theory in the field of finance. It explains the contractual relationship between the company's owners (principals) and the managers (agents) entrusted with managing the firm (Al-Fandawi & Khiari, 2023; Madden & Stevens, 2024). In the banking context, agency conflicts may arise when bank management makes decisions that are not aligned with the interests of shareholders, depositors, or regulators (Quoc Trung, 2021; Sewanyina et al., 2025). Weaknesses in the oversight mechanisms of the board of commissioners or supervisory committee can increase the likelihood of opportunistic behaviour by management, such as excessive risk-taking, imprudent financing management, or failure to manage liquidity (Khan & Zahid, 2020; Ko et al., 2019).

Ahmed & Chapra (2002) explain that *Islamic Corporate Governance* is a system of governance for Islamic financial institutions that aims to ensure that the activities of these institutions are not only economically efficient and stable, but also in accordance with Sharia principles and Islamic moral values. According to Iqbal & Mirakhor (2004), *Islamic Corporate Governance* essentially adopts a stakeholder-based governance model, which emphasises the protection of the rights and interests of all parties involved in corporate activities, grounded in Sharia principles such as justice, respect for property rights, fulfilment of contracts, and moral and social responsibility, with the aim of maintaining a balance of interests, preventing conflicts, and creating a fair and sustainable economic order.

In Sharia financial institutions, agency conflicts also involve an additional dimension, namely compliance with Sharia principles. Therefore, governance mechanisms involve not only the board of directors and commissioners but also the Sharia Supervisory Board (SSB), which is tasked with ensuring that the bank's operational activities comply with Sharia principles as regulated by AAOIFI and IFSB standards (Abdulrahman et al., 2024; Minaryanti et al., 2024; Rahmatika et al., 2024; Wijayanti & Setiawan, 2022). Failure to perform this supervisory function can result in weak internal controls and increased risk of financial institution failure (Ashik-Uz-Zaman et al., 2025; Kim, 2022). Thus, agency theory provides an analytical framework to explain how weaknesses in governance oversight can lead to increased liquidity risk, deteriorating asset quality, and declining capital adequacy, ultimately resulting in bank failure.

The implementation of good governance for Sharia-compliant rural banks encompasses the performance of the duties and responsibilities of the board of directors and commissioners; the performance of the duties and responsibilities of the Sharia supervisory board; the composition and performance of the duties or functions of committees; the implementation of Sharia Principles in the operations of the Sharia Rural Banks; control and supervision aspects, namely the implementation of internal and external audit functions; the implementation of compliance functions, including the compliance function and the assignment of board members overseeing the compliance function, the internal audit function, and the external audit function; risk management aspects, maximum lending limits and the bank's business plan, as well as financial and non-financial transparency (Otoritas Jasa Keuangan, 2018).

Liquidity Risk Theory refers to a conceptual framework that explains liquidity risk as a bank's inability to meet maturing short-term obligations using cash flows or high-quality liquid assets without disrupting normal operations. Liquidity risk has an impact on the operational failure of companies, particularly banks in this case, namely Sharia Rural Banks (Diamond & Rajan, 2001). Liquidity risk disclosure is one category of financial risk disclosure, including the failure to manage liquidity risk (S. P. Sari & Sholikhah, 2019). Massive withdrawals of funds from banks and a lack of liquidity are cited as causes of bank failure, given that banks' capital is very limited (Correia et al., 2026). Furthermore, capital injections do not consistently reduce a bank's liquidity risk (Haq et al., 2026).

The core concept of Liquidity Risk Theory is that banks must be able to meet their short-term obligations on time without incurring significant losses. This theory states that banks will remain liquid if they extend short-term, self-liquidating loans (e.g. financing). This is achieved through the management of a balanced asset and liability structure, particularly by maintaining a proportion of liquid assets such as cash, current accounts, and easily realisable securities. In modern developments, this theory also encompasses a more comprehensive approach to liquidity risk management, including the management of *funding liquidity* and *market liquidity*, as well as its relationship with financial system stability (Badaru & Ibrahim, 2026).

Liquidity risk theory describes the risk that arises when a bank is unable to meet its short-term obligations without incurring significant losses. This risk stems from a mismatch between cash inflows and outflows (*maturity mismatch*), limited access to funding sources, and illiquid market conditions (Eltweri et al., 2024; Ismail & Ahmed, 2023). Within a modern theoretical framework, liquidity risk is distinguished into *funding liquidity risk* (the inability to obtain funds to meet obligations) and *market liquidity risk* (the inability to sell assets without a substantial discount). This concept developed significantly following the 2008 global financial crisis, which demonstrated that failures in liquidity management can trigger systemic crises (Haq et al., 2026; Krüger et al., 2025; Liu & Xie, 2024).

Consequently, the Basel Committee on Banking Supervision introduced Basel III standards such as the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) to strengthen banks' liquidity resilience (Financial Stability Institute, 2013). Theoretically, Liquidity Risk Theory emphasises the importance of *asset*-liability management (*ALM*), diversification of funding sources, and the maintenance of liquidity buffers to safeguard stability and depositor confidence (Financial Stability Institute, 2019). Thus, the core of Liquidity Risk Theory is to maintain depositor confidence and bank stability through the ability to meet fund withdrawals, whilst optimising profitability without compromising adequate liquidity levels; failure to do so results in liquidity risk, which may lead to the revocation of the bank's operating licence.

The Capital Adequacy Ratio (CAR) is a key indicator in assessing a bank's capital adequacy to absorb financing risks and maintain operational stability in accordance with Sharia principles (Marakka & Oktaviana, 2023). Conceptually, the CAR measures the ratio of a bank's capital to risk-weighted assets, thereby reflecting the bank's resilience against potential losses (Jokipii & Milne, 2011). In the context of Sharia Rural Banks, the function of the CAR becomes increasingly important due to the dominant financing structure based on profit-sharing and sale-purchase contracts, which carry inherent risks such as *non-performing financing* (Umami & Rani, 2021). Therefore, the CAR acts as *a capital buffer* that enables banks to absorb unexpected losses, maintain solvency, and protect public funds (Financial Stability Institute, 2019).

The Capital Adequacy Ratio (CAR) is a key indicator in assessing a bank's capital resilience against the risk of losses arising from financial intermediation activities. This concept has evolved alongside the increasing complexity of global banking risks and has been formalised through an international regulatory framework by the Basel Committee on Banking Supervision in the Basel I, Basel II, and Basel III standards (P. A. Nguyen et al., 2021). Conceptually, the CAR measures the ratio of a bank's capital (Tier 1 and Tier 2 capital) to *its risk-weighted assets* (*RWA*). Banking capital theory emphasises that capital serves as *a buffer* to absorb unexpected losses, maintain solvency, and protect depositors and the stability of the financial system (Jokipii & Milne, 2011).

Furthermore, from an Islamic banking perspective, the CAR concept relates not only to financial stability, but also to the principles of *prudential banking* and compliance with Financial Services Authority regulations. Sharia Rural Banks are required to maintain a minimum CAR level (generally ≥8%) to ensure business continuity and customer confidence (Otoritas Jasa Keuangan, 2022a) . A high CAR reflects the bank's ability to manage risks and support healthy financing expansion, whilst a low CAR may indicate vulnerability to losses and the potential for bank failure. This is evidenced by a study on Sharia Rural Banks which shows that bank failures are often caused by an inability to meet CAR requirements due to operational losses and financing risks (Correia et al., 2026). Thus, theoretically, the CAR in Sharia Rural Banks serves as the primary instrument in maintaining a balance between financing growth, risk management, and the stability of the Islamic financial system. The higher the CAR, the greater the bank's capacity to withstand credit, market, and operational risks; conversely, a lower CAR—or one falling below the Financial Services Authority's requirements—can be a contributing factor to the revocation of a bank's operating licence.

Violations in the Implementation of Good Corporate Governance

Violations in the implementation of corporate governance at Sharia Rural Banks have a negative impact on the continuity of the bank's business operations. Studies show that violations committed by the board of directors can harm the general public and stakeholders in particular. Such violations can lead to the revocation of the bank's operating licence. Ineffective implementation of good corporate governance practices and internal controls can result in fraud and losses for both owners and the government (Wahyuni & Hayati, 2022). Given the current intense business competition, companies must adopt competitive strategies to avoid bankruptcy through the implementation of good governance (Yuliyanti & Cahyonowati, 2023). Violations in the implementation of governance will impact the sustainability of the bank's operations and hinder both sectoral and national business growth.

Violations in the implementation of corporate governance, as evidenced by the revocation of the business licence of the Sharia Rural Bank, occurred due to several factors, namely the ineffective performance of the duties and responsibilities of the directors and commissioners, difficulties in managing liquidity risk, and difficulties in fulfil the minimum capital requirement. Poor governance leads to companies being vulnerable to various problems and lacking resilience (Zahrawani & Sholikhah, 2021). Most corporate collapses are linked to company managers committing fraud for personal gain (Yuliyanti & Cahyonowati, 2023). Weak liquidity risk controls can exacerbate a company's financial condition (Fauziah et al., 2025). Banks declared unsound due to insufficient capital result in declining financial performance and may even face liquidation (Umami & Rani, 2021). Violations in the implementation of good governance will result in deteriorating financial performance and hinder the sustainable growth of the bank's business.

Business Growth

Stable and sustainable business growth for Sharia Rural Banks is the primary objective of all stakeholders, as well as associations and the government. Strong business growth can provide benefits such as increased shareholder returns, improved living standards for employees, and support for micro, small, and medium-sized enterprises that utilise the role of Sharia Rural Banks (Lestari et al., 2025). Sustainable business growth and optimal overall financial performance are crucial aspects in maintaining and enhancing competitiveness and the long-term sustainability of the company through strategies focused on optimising financial performance and the bank's sustainability (Utami & Damayanti, 2024). For company management, corporate growth is a matter of significant importance regarding the development of the business undertaken. Business growth is characterised by an increase in total assets, the volume of Islamic banking financing, and third-party funds, which consistently rise year on year (Putri & Rachmawati, 2022). Recent scholarship has broadened the analysis of factors influencing the business growth and sustainability of Islamic banks, including the contribution of ESG commitment, digitalisation, and customer trust to long-term performance (Ben Hamadou et al., 2026; Fatawijaya et al., 2025; Hamsyi et al., 2025; Q. T. T. Nguyen et al., 2023).

The sustainable business growth of Sharia Rural Banks has not been smooth sailing, as several Sharia Rural Banks have had their operating licences revoked by the authorities; this poses a challenge for stakeholders in growing and developing the Sharia Rural Banks business. Challenges to the stability of sustainable business growth include breaches in the implementation of good governance and competition amongst the banks themselves (Trinh et al., 2025). The challenge for the growth of Sharia Rural Banks is to create a strong Sharia financial sector, particularly a Sharia banking system that is professionally managed, in a sound condition, and trusted by all stakeholders (Dawes, 2026; Egala et al., 2021; Rabbanie et al., 2023). Consequently, the sustainable business growth of Sharia Rural Banks cannot proceed smoothly due to the many challenges that must be faced, including breaches in the implementation of good governance, which could result in the revocation of the Sharia Rural Banks operating licence.

Research Gaps and Justification

Although the Financial Services Authority has issued regulations on good corporate governance and the implementation of risk management, accompanied by technical guidelines for implementation in the form of circulars to serve as a guide for the operational and business activities of Sharia Rural Banks, however, in practice, some Sharia Rural Banks do not comply with the regulations and circulars, which constitutes a weakness in the implementation of good corporate governance, leading the Financial Services Authority to revoke their business licences.

There are 28 (twenty-eight) Sharia Rural Banks in Central Java operating their business activities in accordance with the principles of prudence and Sharia, and implementing good corporate governance and risk management; although only 1 (one) of all Sharia Rural Banks had its operating licence revoked. However, granular empirical investigations that dissect the structural anatomy of severe governance violations that directly cause bank liquidation within the Islamic microfinance sector (BPRS) remain exceptionally rare. Most historical studies examine internal control flaws abstractly without establishing the exact causal chains showing how governance failures systematically deplete capital reserves and trigger liquidity crises. Consequently, conducting an exhaustive case study on BPRS Saka Dana Mulia Kudus provides a compelling academic justification to fill this void, supplying a vital real-world evaluation model for the literature.

Contribution of This Study

This study serves as a warning to Sharia Rural Banks regarding the implementation of good corporate governance and risk management, which must be carried out seriously and with integrity to avoid the revocation of business licences, whilst also supporting the Financial Services Authority in encouraging financial services industry players to adopt good governance to ensure sound management and improve risk management with the aim of fostering business growth in both the short and long term, thereby increasing public interest in using Sharia-compliant Rural Banks in line with the vision and mission of popularising Sharia banking and integrating Sharia principles into economic activities. Academically, this study makes a significant contribution to the field of Islamic economics, particularly Islamic banking, by providing a clear description of the types of violations committed in the implementation of good governance. Theoretically, this research enriches detailed analysis of governance aspects and serves as a reminder that the implementation of good governance is mandatory for Islamic banks (Al Adawiyah et al., 2025; Sup et al., 2023, 2024).

METHOD

Research Design

This study employs a qualitative approach using a single-case study design, focusing on Sharia Rural Banks Saka Dana Mulia Kudus as the subject of the research. The qualitative method was chosen as it allows for an in-depth exploration of breaches in the implementation of good governance. Case study analysis is an analytical approach used to provide an overview and analyse a specific case in a systematic and detailed manner. Through this case study analysis, this research uncovers the types of violations in the implementation of bank governance at Sharia Rural Banks Saka Dana Mulia Kudus, leading to the revocation of its operating licence (Infobanknews.com, 2024; Widianti, 2024).

Data Sources

The study utilised secondary data sourced from several primary sources, namely regulatory documents comprising the OJK's press release regarding the revocation of Sharia Rural Banks Saka Dana Mulia's operating licence and OJK regulations and circulars pertaining to the governance and capitalisation of Sharia Rural Banks, as well as the bank's public reports available on the OJK website for the period 2020–2024, mass media and economic news, namely news articles from national and regional media discussing the condition of Sharia Rural Bank Saka Dana Mulia; and digital public discourse, namely tracking trends in public discussion via search engines using the keyword "Sharia Rural Banks Saka Dana Mulia" (Infobanknews.com, 2024; Respati & Sukmana, 2024; Widianti, 2024).

Data Analysis Techniques

Data was analysed using document analysis and thematic coding to identify patterns of governance violations. The analysis process was carried out in several stages, including data reduction by identifying key information regarding governance violations, financial conditions, and subsequent regulatory actions; data coding by grouping findings into three main categories: governance weaknesses, liquidity risk, minimum capital adequacy requirements; and finally, source triangulation, where findings were validated by comparing data from regulatory reports, the bank's financial statements, and media reports to enhance the research's credibility. This approach enables a more systematic analysis of the relationship between governance failures and the deterioration of the bank's financial indicators.

Ethical Considerations

Since this study is conducted exclusively using open-access, legally mandated corporate disclosure documents and public state regulatory records, it strictly adheres to academic freedom standards and is completely free from proprietary data conflicts. All financial figures are treated with absolute analytical objectivity, entirely avoiding factual manipulation.

Validity and Reliability

Data collection techniques were carried out through documentation and a literature review related to the research topic, ensuring validity through a process of triangulation between the data sources used. Selection criteria included the recency of the data, the institutional credibility of the data publisher, and relevance to the research topic.

To ensure the reliability of the mapping of breaches of good corporate governance, this study employs a triangulation strategy: comparing data from various academic literature, policy documents in the form of regulations and circulars issued by the Financial Services Authority (OJK) as the body responsible for supervising financial institutions, and publicly available banking reports. A flowchart of the research process is provided in Figure 1 to enhance methodological clarity and transparency.

Figure 1

Research Process Flowchart

Source: Authors' analysis.

RESULTS

Ineffectiveness in the Performance of Duties by the Board of Directors and Board of Commissioners

The research findings indicate that the performance of the duties and responsibilities of the board of directors and the board of commissioners is ineffective. The board of directors has failed to apply the principles of prudence and good governance, whilst the board of commissioners has not performed its supervisory, advisory, and evaluative functions optimally. Despite being given the opportunity by the Financial Services Authority to undertake a restructuring, bank management has been unable to improve performance, particularly in the management of liquidity risk.

The latest financial data indicates that several indicators reflect an unhealthy category. These indicators include the Net Non-Performing Finance Ratio, the Operating Expense to Operating Income Ratio, the Return on Assets ratio, and the Net Interest Margin ratio. The Net Non-Performing Finance Ratio of 54.80% indicates that, after deducting provisions, more than half of the financing extended to customers is of low quality. This may have occurred because, in extending financing, the board of directors failed to apply the principle of prudence. An NPF ratio above 5% falls into the 'unhealthy' assessment category. The BOPO ratio of 334.01% indicates inefficiency in the management of operating costs and an inability to maximise operating income. A BOPO ratio exceeding 100% falls into the 'unhealthy' assessment category. The ROA ratio of minus 12.83% is below the healthy threshold of ≥2%, and the NIM ratio of 1.95% is below the healthy threshold of ≥10%.

This situation has led to a decline in the bank's financial health, as evidenced by these unhealthy financial indicators. All these indicators fall below the bank's health standards, indicating a failure on the part of the board of directors and commissioners to implement good corporate governance and to fulfil their duties and responsibilities for the bank's business growth.

Difficulties in Managing Liquidity Risk

The research findings indicate that the bank faces serious difficulties in managing liquidity risk. Almost all liquidity indicators are at high-risk levels. The latest financial data shows that the FDR ratio stands at 93.66% (OJK 2024) which is higher than 90%; this means that if low-quality financing occurs, the bank will be unable to meet its obligations and cash flow needs in a crisis. Furthermore, the bank's core capital stands at minus Rp 712,803, comprising paid-up capital of Rp 2,650,000 and undistributed reserves of minus Rp 3,362,803 OJK 2024. Meanwhile, the Authority requires that Sharia Rural Banks with core capital of less than Rp3,000,000,000.00 (three billion rupiah) must meet a minimum core capital requirement of Rp3,000,000,000.00 (three billion rupiah) by 31 December 2020 at the latest OJK 2015. Liquid assets amounting to 10.37% < 15% of total assets mean that the Bank has only a small liquidity reserve relative to total assets, as the majority of assets are tied up in financing and are of low quality, as reflected by a high NPF of 54.80%. Liquid assets amounting to 10.20% < 20% of current liabilities mean that of all short-term liabilities, only <20% can be paid immediately using liquid assets, resulting in a high reliance on roll-over funding; meanwhile, third-party funds have experienced a sharp decline of Rp 2.41 billion (approximately 29.89%), and the profit for the first three months of the current year recorded a loss of Rp 811.47 million.

With the bank's core capital being insufficient or even negative, the bank faces a very serious liquidity risk as it cannot meet its short-term liabilities due to a lack of liquidity, and operating profit has recorded losses over the past three years. This situation has left the bank unable to meet its short-term obligations and cash flow requirements, particularly during a crisis. Furthermore, cash flows that do not cover one another, coupled with high levels of non-performing loans, have exacerbated the bank's liquidity position.

Difficulties in Fulfil Minimum Capital Requirements

The research findings indicate that the bank is unable to meet its minimum capital adequacy requirements. The financial data shows that the bank's capital adequacy ratio stands at minus 8.48%. Meanwhile, the Financial Services Authority requires that Sharia Rural Banks must provide minimum capital calculated using a minimum KPMM ratio of 12% (twelve per cent) of ATMR since 1 January 2020 (OJK 2017) With the bank's capital being smaller, it will be easily depleted and may even turn negative when the bank suffers significant losses. This means the bank is no longer able to meet its obligations to all depositors and creditors; consequently, the bank can be classified as a failed bank (failure bank). With core capital and KPMM in negative territory and no ability on the part of the capital owners to inject further capital—as all financial indicators meet the criteria for being unhealthy—the bank struggles to meet the minimum capital requirements set by the Financial Services Authority, thereby disrupting the bank's business operations and growth. Furthermore, the bank's core capital is also in a negative state, indicating that the bank lacks the capacity to absorb the risk of losses. Limited access to capital sources and a lack of shareholder support further exacerbate this situation.

The Impact of Governance Violations on Business Growth

Research findings indicate that breaches in the implementation of corporate governance have a direct impact on the disruption of the bank's operational activities; a decline in customer confidence, evidenced by a reduction in the bank's third-party funds; a deterioration in financial performance, evidenced by a decline in all aspects of the bank's health assessment; and the failure of bank rehabilitation efforts, evidenced by the revocation of the bank's operating licence. Consequently, the Financial Services Authority upgraded the bank's status to a bank under resolution, and ultimately the bank's operating licence was revoked upon the recommendation of the Deposit Insurance Agency (LPS). All of this has had an impact on the business growth of Sharia Rural Banks in Central Java, as indicated by the data presented earlier (Kurniati et al., 2022; Putri & Rachmawati, 2022; Trinh et al., 2025)

Effectiveness of the Sharia Compliance Function

The research findings indicate that the Sharia compliance function has not been operating effectively. Although a Sharia Supervisory Board (DPS) exists structurally, the Sharia oversight mechanisms have not been able to prevent governance violations. This is reflected in weak internal controls and management oversight, indicating that the Islamic corporate governance system has not been functioning optimally.

DISCUSSION

Ineffective Performance of the Duties and Responsibilities of the Board of Directors and Commissioners

Violations in the application of corporate governance by the board of directors and the board of commissioners in carrying out their duties and responsibilities ineffectively are the cause of the bank's poor financial health (Maulana et al., 2024) and its inability to improve its performance, leading the Financial Services Authority to revoke the bank's operating licence. This occurred because the board of directors and the board of commissioners failed to adhere to the principle of prudence; the board of directors did not implement good corporate governance, and the board of commissioners failed to provide guidance, conduct monitoring, and evaluate the implementation of corporate governance in business operations. The Financial Services Authority has given the directors and commissioners the opportunity to restructure the bank, but this opportunity has not been utilised effectively. The directors and commissioners lack the capacity and commitment required for the bank's restructuring efforts, particularly in the management of liquidity risk.

The bank's financial health was deemed unsatisfactory, leading the OJK to place Sharia Rural Banks Saka Dana Mulia under bank supervision for rehabilitation. The directors and commissioners were unable to improve performance whilst under bank supervision; consequently, the bank's status was upgraded to 'bank under resolution' due to deteriorating capital and liquidity, despite management and shareholders having been given the opportunity to undertake rehabilitation efforts regarding capital injection (Maulana et al., 2024). The Deposit Insurance Agency (LPS) decided not to bail out Sharia Rural Bank Saka Dana Mulia and requested the OJK to revoke its operating licence.

The findings of this study confirm that bank failures are caused not only by financial factors, but also by weak governance. From the perspective of Agency Theory developed by Michael C. Jensen and William H. Meckling, conflicts of interest between management and shareholders can lead to suboptimal decision-making if not balanced by effective oversight mechanisms (Jensen & Meckling, 2009; Khan & Zahid, 2020). In this case, the weak functioning of the board of directors and the board of commissioners reflects the failure of internal control mechanisms.

Difficulties in Managing Liquidity Risk

Failure to manage liquidity risk effectively has a significant negative impact on customer confidence and business operations. Liquidity risk is a key aspect of good governance. Adequate liquidity enables banks to meet financial obligations, maintain customer confidence and conduct operational activities in a stable manner. Liquidity risk issues at Sharia Rural Banks are more complex than those at conventional Rural Banks because they cannot rely on interest-bearing loans, thus facing limitations in enhancing liquidity (Hismendi et al., 2026). Sharia Rural Banks are expected to take proactive steps to manage this liquidity risk effectively so that the stability of operational activities can be maintained and sustainable business growth enhanced (Yulfiswandi & Halim, 2024). The implementation of liquidity risk management must be carried out effectively, as liquidity risk is a major contributor to bank failures during the global financial crisis (Panjaitan & Lisdiono, 2024). Consequently, failure in liquidity risk management can disrupt bank operations and hinder business growth.

Violations in the implementation of risk management were experienced by banks, resulting in the revocation of their business licences because almost all components of liquidity risk occurred at an inadequate risk level. Bank management was unable to mitigate the high-risk liquidity issues, resulting in the risks materialising. Sharia Rural Banks were unable to meet their obligations and cash flow requirements during a crisis; their cash flows could not cover one another, and the bank failed to implement sound governance regarding liquidity risk management, leading to disruptions in operations and the bank's business continuity. Liquidity risk and capital adequacy risk influence profitability; if profitability is good, viability will be good; conversely, if profitability is poor, the banking system will be poor (Minaryanti et al., 2024).

From a risk management perspective, these findings align with the concept of Liquidity Risk Theory, which emphasises that the inability to meet short-term obligations is one of the primary causes of bank failure. A high FDR ratio and low liquid assets indicate that the bank lacks an adequate liquidity buffer, making it vulnerable to crises (Badaru & Ibrahim, 2026; Hismendi et al., 2026).

Difficulties in Fulfil Minimum Capital Requirements

A breach of governance standards, namely the bank's difficulty in fulfil the minimum capital adequacy requirements set by the Financial Services Authority, thereby rendering it unable to absorb the potential risks it faces. Difficulties in fulfil minimum capital adequacy requirements arise due to liquidity problems with a very high level of risk, as strong capitalisation can foster a healthy and productive banking industry with the ability to absorb risks in the form of minimum core capital for banks (Otoritas Jasa Keuangan, 2025a). Meanwhile, banks with low capital face certain limitations as their management continually seeks ways to increase capital to protect the bank from various risks. The minimum capital requirement aims to serve as the necessary safety net to absorb unforeseen losses and ensure the bank's survival (Otoritas Jasa Keuangan, 2025a).

Sharia Rural Banks are required to maintain a minimum capital requirement calculated using a minimum KPMM ratio of 12% (twelve per cent) of Risk-Weighted Assets (Otoritas Jasa Keuangan, 2017).The obligation to provide minimum capital must be a priority for bank management, as any difficulties in fulfil this requirement will disrupt the bank's business activities, thereby impacting business growth. If a Sharia Rural Banks struggles to provide the minimum capital, this will affect customer confidence, leading to disruptions in the bank's business continuity. The obligation to provide minimum capital must be fulfilled by the bank to ensure that business and operations run smoothly and do not disrupt the bank's operations. The Financial Services Authority assesses that the bank has inadequate capital quality and adequacy relative to risk conditions, accompanied by very weak capital management compared to the characteristics, scale, and complexity of the Sharia Rural Bank's operations, including having an inadequate capital ratio, therefore requiring a capital increase to anticipate all risks faced; capital instruments of poor quality, non-permanent in nature, and unable to absorb losses; Sharia Rural Banks having poor capital management; and Sharia Rural Banks lacking access to capital sources and lacking shareholder support.

Furthermore, from the perspective of the Capital Adequacy Ratio developed by the Basel Committee on Banking Supervision, capital adequacy is a fundamental factor in maintaining bank stability. A negative CAR indicates that the bank lacks the capacity to absorb risk, thereby accelerating the onset of failure. (Financial stability institute, 2013; Marakka & Oktaviana, 2023). More broadly, declining capital strength and weak risk governance can erode market confidence and customer trust, a pattern observed across the wider financial sector during periods of crisis and elevated economic policy uncertainty (Mol-Gómez-Vázquez et al., 2025; Park & Hur, 2025; Wang et al., 2026; Zhao et al., 2025).

Effectiveness of the Sharia Compliance Function

As a Sharia-based financial institution, Sharia-based Rural Banks should have additional oversight mechanisms through the Sharia Supervisory Board (DPS). The DPS plays a crucial role in ensuring that the bank's operational activities not only comply with Sharia principles but are also conducted ethically and professionally. However, the case of Sharia Rural Banks Saka Dana Mulia demonstrates that a Sharia identity does not automatically guarantee robust governance practices. Weaknesses in management oversight and internal controls indicate that Sharia governance mechanisms have not yet functioned optimally as a system of moral or institutional oversight. These findings suggest that the implementation of Islamic corporate governance needs to be strengthened through enhancing the competence of the Sharia Supervisory Board, integrating Sharia compliance functions with risk management, and more intensive regulatory oversight.

These findings also show that the identity as a Sharia financial institution does not automatically guarantee the quality of governance. The role of the Sharia Supervisory Board (DPS), which should serve as an additional mechanism for moral oversight and compliance, has not been effective. This indicates that the implementation of Islamic corporate governance remains largely a formality and has not been substantively integrated into the risk management and internal control systems.

CONCLUSION

This study demonstrates that governance failure in Sharia Rural Banks is a multidimensional phenomenon arising from the interaction of ineffective leadership, inadequate risk management, and insufficient capital resilience rather than from isolated financial weaknesses. The case of Sharia Rural Bank Saka Dana Mulia Kudus illustrates how the failure of the board of directors to uphold prudential banking principles and the inability of the board of commissioners to exercise effective oversight gradually weakened the institution's financial condition. These governance deficiencies were reflected in deteriorating financing quality, declining profitability, shrinking liquidity reserves, and persistent operational losses, ultimately undermining depositor confidence and threatening the bank's operational sustainability. The findings confirm that governance quality is a fundamental determinant of institutional resilience and sustainable business growth in Islamic banking.

The study further reveals that governance weaknesses became increasingly severe when accompanied by ineffective liquidity risk management, inadequate capital adequacy, and limited effectiveness of the Sharia compliance function. These interconnected weaknesses prevented the bank from fulfilling regulatory requirements, restoring financial stability, and successfully implementing rehabilitation measures despite supervisory intervention. Consequently, governance failure evolved into institutional failure, culminating in the revocation of the bank's operating license. These findings emphasize that effective Islamic banking governance requires not only regulatory compliance but also integrated implementation of prudent management, proactive risk mitigation, competent leadership, and meaningful Sharia supervision. Strengthening these governance components is essential for preserving financial stability, maintaining public confidence, and supporting sustainable business expansion within the Islamic banking sector.

This research contributes to the literature by providing a comprehensive explanation of how governance violations, liquidity risk, capital inadequacy, and ineffective Sharia oversight jointly contribute to the collapse of an Islamic rural bank. Unlike previous studies that primarily examined financial performance or isolated governance issues, this study integrates multiple governance dimensions into a unified analytical framework explaining institutional failure. The findings provide practical insights for regulators, shareholders, and bank management by highlighting the importance of early warning systems, stronger supervisory mechanisms, enhanced board competence, and sustainable capital planning. More broadly, the study reinforces the proposition that Islamic banking institutions require substantive governance practices supported by ethical leadership, effective internal controls, and continuous regulatory oversight to achieve long-term institutional sustainability and business growth.

Limitation of the Study

This study has several limitations that should be acknowledged when interpreting its findings. First, the research employs a qualitative single-case study design focusing exclusively on Sharia Rural Bank Saka Dana Mulia Kudus. Although this approach enables an in-depth understanding of governance failure, the findings may not fully represent governance practices across other Islamic rural banks or larger Islamic commercial banks operating under different organizational structures and market conditions. Second, the analysis relies primarily on secondary data obtained from regulatory documents, financial reports, public publications, and media sources. While extensive triangulation was conducted to enhance credibility, the absence of direct interviews with directors, commissioners, regulators, shareholders, and members of the Sharia Supervisory Board limits deeper exploration of internal decision-making processes and organizational dynamics.

Furthermore, this study concentrates primarily on governance violations related to board effectiveness, liquidity risk management, capital adequacy, and Sharia compliance. Other important governance dimensions, including organizational culture, internal audit effectiveness, anti-fraud systems, information technology governance, cybersecurity, human resource competence, and enterprise risk management integration, were not examined comprehensively. The research also focuses on the period immediately preceding the revocation of the bank’s operating license and therefore does not evaluate long-term post-resolution outcomes or compare governance recovery strategies across different institutions. These limitations provide opportunities to broaden future investigations and develop a more comprehensive understanding of governance effectiveness within Islamic banking institutions operating under diverse regulatory and institutional environments.

Recommendations for Future Research

Future studies should extend the scope of governance analysis by employing comparative research involving multiple Sharia Rural Banks, Islamic commercial banks, and conventional rural banks across different regions. Comparative evidence would enable researchers to distinguish institution-specific governance failures from broader structural challenges affecting the Islamic banking industry. Quantitative or mixed-method approaches incorporating governance indicators, financial performance measures, and stakeholder perceptions could further strengthen empirical validation of the relationships among governance quality, liquidity risk, capital adequacy, Sharia compliance, and sustainable business growth. In addition, future research should investigate the effectiveness of early warning systems, regulatory intervention mechanisms, and rehabilitation strategies in preventing institutional failure before supervisory authorities are required to revoke banking licenses.

Further investigation should also examine governance from a broader Islamic institutional perspective by integrating ethical leadership, organizational culture, digital governance, environmental and social governance practices, enterprise-wide risk management, and the effectiveness of the Sharia Supervisory Board within a unified governance framework. Future researchers are encouraged to explore how technological innovation, supervisory technology, artificial intelligence, and real-time risk monitoring can strengthen governance quality and improve regulatory oversight in Islamic banking institutions. Longitudinal studies tracking governance reforms before and after regulatory intervention would provide valuable evidence regarding institutional resilience and recovery. Such research would substantially enrich the literature on Islamic corporate governance while offering practical guidance for regulators, shareholders, and banking practitioners seeking to strengthen governance effectiveness, preserve financial stability, and promote sustainable growth throughout the Islamic banking sector.

Author Contributions

Conceptualization	S., M.Y., R.E.J., A.M., M.Z.E., & I.A.	Resources	S., M.Y., R.E.J., A.M., M.Z.E., & I.A.
Data curation	S., M.Y., R.E.J., A.M., M.Z.E., & I.A.	Software	S., M.Y., R.E.J., A.M., M.Z.E., & I.A.
Formal analysis	S., M.Y., R.E.J., A.M., M.Z.E., & I.A.	Supervision	S., M.Y., R.E.J., A.M., M.Z.E., & I.A.
Funding acquisition	S., M.Y., R.E.J., A.M., M.Z.E., & I.A.	Validation	S., M.Y., R.E.J., A.M., M.Z.E., & I.A.
Investigation	S., M.Y., R.E.J., A.M., M.Z.E., & I.A.	Visualization	S., M.Y., R.E.J., A.M., M.Z.E., & I.A.
Methodology	S., M.Y., R.E.J., A.M., M.Z.E., & I.A.	Writing – original draft	S., M.Y., R.E.J., A.M., M.Z.E., & I.A.
Project administration	S., M.Y., R.E.J., A.M., M.Z.E., & I.A.	Writing – review & editing	S., M.Y., R.E.J., A.M., M.Z.E., & I.A.

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Informed Consent Statement

Informed consent was not required for this study.

Data Availability Statement

The data presented in this study are available on request from the corresponding author.

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Conflicts of Interest

The authors declare no conflicts of interest.

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