Synergy of Risk Handling: Shaping Financial Performance in Sharia Cooperatives

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ABSTRACT

Sharia cooperatives in Indonesia remain vulnerable to various risks, particularly those that affect their financial performance. Therefore, this study aims to examine the influence of risk management in greater detail through the dimensions of identification, monitoring, and mitigation, as well as the role of Islamic governance in shaping the financial performance of sharia cooperatives. The sample was determined using purposive sampling and the Slovin method. Out of 118 cooperatives under *Baitul Maal wat Tamwil Bina Ummat Sejahtera* (BMT BUS), 105 met the eligibility criteria for analysis using Partial Least Squares (PLS). The findings reveal that risk identification, risk monitoring, risk mitigation, and Islamic governance have a significant positive impact on the financial performance of sharia cooperatives. These results provide valuable insights for cooperative managers, highlighting the importance of strengthening risk management systems—particularly in identification, monitoring, mitigation, and governance—to safeguard financial performance against potential losses arising from risks. This study offers original insights by providing a detailed exploration of risk management and Islamic governance within the context of sharia cooperatives in Indonesia.

Keywords: *Risk, Identification, Monitoring, Mitigation, Governance, Cooperatives*

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INTRODUCTION

Cooperatives are one of the key microfinance institutions in Indonesia, with significant growth, reaching approximately 127,000 cooperatives (Ministry of Cooperatives and Small and Medium Enterprises, 2021). However, uncertain social, economic, environmental, and political conditions in several countries, including Indonesia, have hindered the progress of these institutions (Tamanni, 2019). Supporting this view, Masyita and Ahmed (2013) argue that Islamic cooperatives in Indonesia have limited coverage and suffer from a lack of regulation and supervision. They further explain that external uncertainties have caused many Islamic cooperatives to become inactive, which in turn poses serious risks to depositors' savings.

Tamanni (2019) also highlights that the profit-and-loss sharing mechanism in Islamic finance makes Islamic cooperatives more vulnerable to risks compared to conventional microfinance institutions. Financing for individuals with low incomes presents challenges related to information asymmetry and high enforcement costs, particularly for those with high-risk profiles, such as clients who lack steady income and collateral. This situation is worsened by limited capabilities in risk detection and human resources, triggering various risks such as financing risk, liquidity risk, and sharia non-compliance risk, which often lead to premature bankruptcy (Wafie & Muhammad, 2023). These issues suggest that external uncertainty and internal limitations necessitate synergy in risk management to ensure the growth and sustainability of Islamic cooperatives.

Effective risk management can reduce potential risks and losses arising from external uncertainty (Lima et al., 2020). A higher level of managed risk contributes to better financial outcomes (Toufaili, 2021). Risk management has been recognized as one of the key success factors for Islamic cooperatives (Satar & Kasim, 2020). In the context of achieving objectives of *Maqāṣid al-Sharīʿa* (a basis for developing Islamic law, or in this context, financial systems), governance practices grounded in Islamic principles are essential for the sustainability of Islamic financial institutions, improving societal welfare (Prasojo et al., 2022b), and protecting property (hifz al-maal) from all potential harmful risks (Lesmana & Haron, 2019; Wafie & Muhammad, 2023). Moreover, the quality of governance through the Sharia Supervisory Board (SSB) strengthens the relationship between risk management and *Maqāṣid al-Sharīʿa*-based performance (Prasojo et al., 2022b). Building on the principles of *Maqāṣid al-Sharīʿa*, which emphasize the preservation

of faith, life, intellect, wealth, and ancestry, this study suggests that the institution's capacity to accomplish these goals is reflected in how well risk management and Islamic governance are implemented. Therefore, it is essential to understand how these mechanisms impact financial performance, ensuring that Islamic cooperatives maintain both their financial viability and their broader objectives in accordance with sharia.

Based on these considerations, the synergy between risk management and Islamic governance is crucial for protecting and enhancing the financial performance of Islamic cooperatives. Nevertheless, previous studies that specifically and quantitatively investigate the risk management process in Islamic cooperatives remain very limited. For instance, Manan and Shafiai (2015) identified risk management practices in Islamic microfinance products; Tamanni (2019) explored portfolio and default risks in Islamic microfinance institutions; Rahahleh et al. (2019) examined the latest developments in risk management, but within the Islamic banking literature, and Steinwand (2000) proposed a conceptual risk management framework for microfinance institutions without empirical validation.

The existence of this research gap is further supported by recent literature published over the last five years. Hossain et al. (2025) demonstrate that, despite extensive research on risk management in Islamic finance, innovative risk management techniques specific to Islamic microfinance and cooperatives remain lacking, and the discourse is still dominated by quantitative research in Islamic banking. Similarly, Heravia and Sharofidin (2025) emphasize the crucial role that sharia governance and regulatory frameworks play in establishing sustainable Islamic financial systems. However, their analysis is conceptual in nature and concentrates on the creation of national policies rather than institutional operational risk practices. Studies on Islamic microfinance, such as those by Awais et al. (2021) and Wafie and Muhammad (2023), reveal that Islamic microfinance institutions are consistently exposed to risks related to credit, operations, and sharia compliance.

However, these studies typically employ qualitative or case-based methodologies that do not provide quantitative evaluations of the impact of risk management procedures on financial performance. Effective risk management promotes the sustainability of microfinance institutions, according to research by Illangakoon et al. (2021) and Illangakoon (2024). However, their analysis does not incorporate Islamic governance factors, and their focus is on general microfinance rather than Islamic cooperatives. While more recent studies like Nengsih et al. (2024) and Nambie et al. (2024)

emphasize the importance of regulatory frameworks, Islamic social finance tools, and institutional resilience in bolstering risk management in times of crisis, they do not directly investigate how risk identification, analysis, mitigation, and monitoring affect cooperative financial performance. Additionally, new methods, such as AI-based risk assessment frameworks (Katterbauer & Moschetta, 2022), offer fresh opportunities to enhance risk assessment in Islamic microfinance; however, there is currently no empirical data on how these methods are applied in Islamic cooperatives. When taken as a whole, these recent studies demonstrate the limited empirical research that has been conducted to explain financial performance in Islamic cooperatives, particularly in terms of combining Islamic governance and comprehensive risk management aspects.

Therefore, this study aims to address this gap by empirically analyzing how risk management—through risk identification, monitoring, and mitigation—along with Islamic governance, influences the financial performance of Islamic cooperatives, aligning the discussion with *Maqāṣid al-Sharīʿa* principles and objectives.

LITERATURE REVIEW

Maqāṣid al-Sharīʿa Theory in Relation to Risk Management and Islamic Governance

Maqāṣid al-Sharīʿa serves as a normative foundation that emphasizes the protection of religion, life, intellect, lineage, and wealth, while simultaneously guiding Islamic financial institutions in safeguarding public welfare (Prasojo et al., 2022a; Sheikh et al., 2023). This theoretical foundation not only defines the ethical objectives of Islamic finance but also provides a framework for managing institutional risks in a way that upholds justice and social benefit.

In practice, financial institutions inevitably face operational, strategic, or financial risk, including financing risks that may lead to losses or even bankruptcy (Tamanni, 2019). Within the *maqāṣid* perspective, managing these risks is not merely a technical process but a moral obligation to prevent harm (Mukhibad, 2019). Therefore, the implementation of risk management aligned with *maqāṣid* principles does more than mitigate potential losses- it enhances institutional accountability and credibility, while promoting long-term sustainability (Widiyanto et al., 2021; Boadi et al., 2019).

Moreover, *Maqāṣid al-Sharīʿa* is inherently linked to sharia governance. The Sharia Supervisory Board plays a pivotal role in ensuring that risk management practices remain consistent with Islamic ethical standards, including contractual compliance and transparency (Prasojo et al., 2022b). However, effective governance in Islamic institutions cannot rely solely on conventional corporate governance models. Ahmad and Ishak (2020) stress that sharia governance must be infused with *maqāṣid* values to move beyond formal compliance, ensuring that institutions contribute to societal welfare and ethical integrity.

Since risk management assures operational prudence, governance ensures accountability and sharia compliance, and *Maqāṣid al-Sharīʿa* provides ethical guidance, the combination of these three components creates a comprehensive framework. By aligning financial performance with the higher objectives of sharia and the pursuit of social justice, they collectively establish a solid foundation for Islamic financial institutions.

Financial Performance of Sharia Cooperatives

The concept of financial performance is multifaceted. Fersi and Boujelbene (2016) define it as the ability of an organization to cover a series of expenses with the revenues earned. Bayai and Ikhide (2016) view it as the institution's capacity to sustain operations in line with financial viability ratios. Meanwhile, Ascarya (2014) relates financial performance to the long-term fulfillment of operational and financial costs. Financial performance in Islamic cooperatives is a measure of the organization's ability to successfully accomplish *Maqāṣid al-Sharīʿa* goals through moral and open financial practices, in addition to reflecting managerial effectiveness (Widiyanto et al., 2021).

Financial performance can be assessed through various indicators, such as Return on Assets (ROA), Return on Equity (ROE), profitability, Risk-Adjusted Return on Capital (RAROC), and cash flow ratios (Wanjohi et al., 2017; Fersi & Boujelbene, 2016). Complementing prior studies, Widiyanto et al. (2016) employ broader measures beyond financial ratios, including profitability, non-performing financing (NPF), customer growth, asset growth, financing growth, social benefits (as measured by ZISWAF), and social responsibility.

In ensuring operational sustainability, financial performance serves not only as a measure of management's success in financial management but

also as a benchmark of the organization's ability to utilize its assets efficiently in generating profits (Fersi & Boujelbene, 2016); Moreover, it contributes to enhancing operational effectiveness and efficiency (Berguiga et al., 2017).

Risk Identification and Financial Performance

Risk identification is the process undertaken by management to record the types of risks and their potential impacts (George, 2020). It can also be defined as a step to uncover potential risks that may hinder organizational goals (Rahahleh et al., 2019). Similarly, Falkner and Hiebl (2017) describe it as the documentation of risks that may obstruct the implementation of organizational programs.

Previous studies have applied various indicators in identifying risks, such as risk sources, frequency, and severity (Rosman, 2009); risk profiles and handling priorities (Widiyanto et al., 2021); frequency intervals and identification techniques (Falkner & Hiebl, 2017); as well as sources and categories of risks (Ahmed et al., 2019).

Risk identification plays a crucial role in improving organizational performance, particularly financial performance. It helps classify risks according to priorities and supports the development of risk management strategies for efficient resource allocation (Rosman, 2009). As an essential first step, it helps prevent major losses (Widiyanto et al., 2021). Moreover, effective identification ensures the overall effectiveness of risk management, prevents risks from becoming more complex, facilitates debt collection, supports credit sanctions, and identifies potential borrowers to minimize financing risks (Lagat & Tenai, 2017). According to *Maqāṣid al-Sharīʿa*, early risk identification promotes institutional stability and prevents financial loss, which is consistent with the goal of wealth preservation (hifz al-maal) (Mukhibad, 2019). Based on the above discussion, the first hypothesis is proposed:

H1: There is a positive and significant effect of risk identification and the financial performance of sharia cooperatives

Risk Monitoring and Financial Performance

Risk monitoring refers to the oversight and control of risk management practices (Ebrahim, 2018). It also involves tracking and evaluating the implementation of risk management (Ariffin & Kassim, 2014). Rhanoui and

Belkhoutout (2019) further describe risk monitoring as the process of ensuring that risk management is implemented in accordance with established plans and procedures.

Ahmed et al. (2019) identify three indicators of risk monitoring: internal control, risk tracking, and risk ranking. Meanwhile, Widiyanto et al. (2021) highlight the importance of senior management involvement, risk management committees, consistency in financing supervision, periodic reviews, and evaluations.

As Angote et al. (2015) argue, risk monitoring is a crucial process that ensures the effective execution of risk management and facilitates the early detection of problems. A lack of monitoring may result in losses and poor performance. Effective risk monitoring enables organizations to identify and manage risks (Muriithi, 2016), contributing to enhanced organizational performance (Alshatti, 2015). In financing risks, monitoring follows risk identification and analysis, ensuring that outputs are implemented in accordance with established procedures and guidelines. It also involves evaluation, enabling management to respond swiftly with alternative strategies when deficiencies or inconsistencies are detected. As it ensures that decisions are made logically and within the framework of Islamic ethical bounds, continuous risk monitoring reflects the *maqāṣid* principle of preserving intellect (hifz al-'aql) (Ahmad & Ishak, 2020). Thus, the second hypothesis is formulated:

H2: There is a positive and significant effect of risk monitoring and the financial performance of sharia cooperatives

Risk Mitigation and Financial Performance

Risk mitigation constitutes a component of risk management that seeks to reduce the negative impact and severity of risks (Widiyanto et al., 2021). It is also understood as measures taken to minimize losses (Abeywardhana, 2017) or to reduce the likelihood or severity of risks (Battiston et al., 2021).

Within organizational contexts, risk mitigation can be carried out through sanctions, collateral enforcement, or credit restructuring (Farhan et al., 2020). It may also involve rescheduling credit, adjusting repayment schedules, granting grace periods, or modifying installment amounts (Widiyanto et al., 2016).

Effective financial management depends heavily on the organization's ability to manage risks. Ahmed et al. (2019) found that risk mitigation

mechanisms, such as risk acceptance and avoidance, have a positive impact on profitability. This aligns with the practices of Indonesian financial institutions, which minimize exposure and enhance financial performance through risk reduction strategies. The more organizations understand methods of reducing financial risks, the better their financial performance will be. Continuous risk monitoring reflects the *maqāṣid* principle of preserving intellect (hifz al-'aql) because it ensures that decisions are made rationally and within the framework of Islamic ethical bounds (Ahmad & Ishak, 2020). Therefore, the third hypothesis is stated as follows:

H3: There is a positive and significant effect of risk mitigation and the financial performance of sharia cooperatives

Islamic Governance and Financial Performance

Islamic governance is an organizational management system rooted in Islamic principles (Mansour & Bhatti, 2018). Al-Azdi et al. (2023) define it as a value-based system grounded in sharia that governs relationships among organizational stakeholders. Islamic governance further entails not only material accountability to stakeholders but also spiritual accountability to Allah Al-Mighty (Jan et al., 2021).

Prior studies have utilized several indicators to measure Islamic governance, including the role of the Sharia Supervisory Board (Halim & Buana, 2020); audit committees, and audit quality (Vidiyastutik & Hendra, 2020). Additional indicators include risk monitoring committees, nomination and remuneration committees, and integrated governance committees (Widiyanto et al., 2021). By ensuring that financial decisions promote social welfare and justice (maslahah), rather than merely adhering to formal sharia standards, Islamic governance operationalizes *Maqāṣid al-Sharīʿa* (Ahmad & Ishak, 2020). Accordingly, the fourth hypothesis is formulated:

H4: There is a positive and significant effect of Islamic governance and the financial performance of sharia cooperatives

Based on theoretical foundations and prior empirical studies, Figure 1 presents the empirical model of this research.

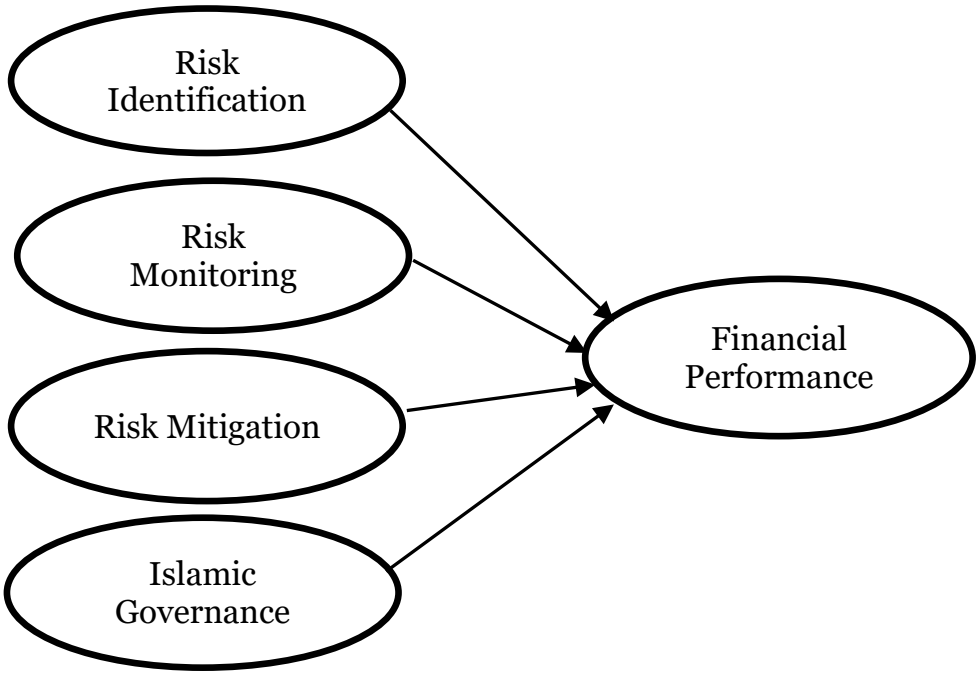


Figure 1. *Proposed Model*

RESEARCH METHOD

This study is quantitative research that aims to examine the effect of four independent variables—risk identification, risk monitoring, risk mitigation, and Islamic governance—on the dependent variable, financial performance.

In the context of sharia cooperatives in Indonesia, the study focuses on *Baitul Maal wat Tamwil Bina Ummat Sejahtera* (BMT BUS), which has experienced significant growth with a total of 118 branch offices across seven cities in Indonesia. The sample was determined using purposive sampling with two criteria: (1) the cooperative must be of the BMT BUS type, and (2) it must have been in operation for at least five years, which indicates adequate experience in risk management.

We used the Slovin formula to figure out the minimum sample size for this study. The formula $n = N / (1 + N\alpha^2)$, or $118 / (1 + 118 \times 0.05^2)$, gave a value of 91.11 when the population was 118 BMTs, and the error rate (α) was 5%. The final sample size was adjusted to 105 BMTs to ensure greater representativeness. In this case, a stand for the sample size, N stands for the whole population, and α stands for the error rate, which is set at 5 percent. Data collection was carried out using questionnaires with a Likert scale. Table 1 presents the variables and measurement indicators employed in this study.

Table 1. *Definition and Indicators of Variables*

Variable	Indicators
Risk Identification: The documentation and recording of risks aimed at preventing escalation and expansion of risks that threaten organizational sustainability.	Source of Risk (RI.1); Profile of Risk (RI.2); Method of Risk (RI.3) Sources: (Ahmed et al., 2019); (Widiyanto et al., 2021); (Falkner & Hiebl, 2017)
Risk Monitoring: Supervision, assurance, tracking, and evaluation of the risk management process.	Periodic Review (RMo.1); Top Management Involvement (RM.02); Policy Effectiveness Evaluation (RMo.3) Sources: (Ahmed et al., 2019); (Widiyanto et al., 2021)
Risk Mitigation: Planned and continuous actions taken by management to reduce the impact of potentially harmful or damaging events.	Risk Avoidance (RMi.1); Risk Sharing (RMi.2); Risk Deferral (RMi.3). Sources: (Srinivas, 2019)
Islamic Governance: A system of organizational management based on Islamic principles applied to both operations and products, which entails accountability not only materially to stakeholders but also spiritually to Allah.	Sharia Supervisory Board (IG.1); Audit Committee (IG.2); Audit Quality (IG.3); Risk Management Committee (IG.4) Sources: (Halim & Buana, 2020); (Vidiyastutik & Hendra, 2020) ; (Widiyanto et al., 2021)
Financial Performance: The financial soundness of an organization over a certain period, including profitability and operating expense ratios.	Profitability (FP.1); Non-Performing Financing (FP.2); Asset Growth (FP.3); Financing Growth (FP.4) Sources: (Stephen Muthii Wanjohi et al., 2017); (Fersi & Boujelbene, 2016); (Widiyanto et al., 2016)

The testing process consisted of three steps: hypothesis testing, inner model testing, and outer model testing. The goal of the measurement model, also known as the outer model, is to assess the validity and reliability of the latent variable constructs. Convergent validity and internal consistency reliability were tested as part of the evaluation of the outer model. If the research model satisfies the following requirements, it is deemed valid and reliable: loading factor > 0.70 (Ghozali & Latan, 2020); average variance extracted (AVE) > 0,50 (Chin, 1998); Cronbach's Alpha and Composite Reliability > 0.70 (Ghozali & Latan, 2020); and the Fornell–Larcker criterion, which stipulates that the square root of AVE (diagonal) must be greater than the correlations with other latent variables (Henseler et al., 2016).

R-squared values are used in the inner model testing to assess how exogenous latent variables affect endogenous latent variables. R-squared values were divided into three groups by Hair et al. (2011): significant (0.75), moderate (0.50), and weak (0.25). Lastly, partial least squares (PLS), a regression-based technique initially proposed by Herman O.A. Wold in the 1960s to develop models and procedures for the social sciences with a prediction-oriented approach, was used to test hypotheses. In accordance with the standards proposed by Hair et al. (2010), PLS was chosen because of the comparatively small sample size of 30 to 100.

The structural equation model $FP = \alpha + \beta_1 RI + \beta_2 RMo + \beta_3 RMi + \beta_4 IG + e$ is employed in this study to demonstrate how Islamic governance, risk identification, risk monitoring, and risk mitigation impact financial performance. The intercept in this model is represented by α, the coefficients of each variable are represented by β_1 through β_4, and the error term, or unexplained variance, is denoted by e.

RESULTS

Descriptive Statistics of Sharia Cooperatives

The respondents were drawn from BMT BUS cooperatives, a type of sharia cooperative spread across seven provinces in Indonesia. Table 2 presents the data collection stages and the regional distribution of BMT BUS.

Table 2. *Cooperative Selection and Region*

Selection Stage	Total	No	Region	Province	Total
Questionnaires distribution	118 (100%)	1	Banyumas	Central Java	1 (0.95%)
Returned questionnaires	110 (93,02%)	2	Batang	Central Java	1 (0.95%)
Unreturned questionnaires	8 (6,78%)	3	Brebes	Central Java	5 (4.76%)
Questionnaires not meeting the criteria	5 (4.55%)	4	Blora	Central Java	7 (6.67%)
Final Number of questionnaires meeting the criteria	105 (95.45%)	5	Bojonegoro	East Java	1 (0.95%)
		6	Boyolali	Central Java	1 (0.95%)
		7	Demak	Central Java	6 (5.71%)
		8	Gresik	East Java	1 (0.95%)
		9	Grobogan	Central Java	8 (7.62%)
		10	East Jakarta	The Special Capital Region of Jakarta	1 (0.95%)
		11	Jepara	Central Java	7 (6.67%)
		12	Yogjakarta	Yogyakarta	6 (5.71%)
		13	Jombang	East Java	3 (2.86%)
		14	Kendal	Central Java	2 (1.90%)
		15	Kudus	Central Java	6 (5.71%)
		16	Lamongan	East Java	4 (3.81%)
		17	Nganjuk	East Java	1 (0.95%)
		18	Pati	Central Java	4 (3.81%)
		19	Rembang	Central Java	11 (10.48%)
		20	Solo	Central Java	7 (6.67%)
		21	Semarang	Central Java	6 (5.71%)
		22	Tegal	Central Java	5 (4.76%)
		23	Tuban	East Java	10 (9.52%)
		24	Wonogiri	Central Java	1 (0.95%)
		Final Number of Cooperative			105 (100%)

Source: Processed primary data by authors (2025)

Following the methodological criteria, the final sample consisted of 105 BMT BUS cooperatives from 24 regions across four provinces: Central Java,

East Java, Yogyakarta, and the Special Capital Region of Jakarta. Among them, 78 cooperatives (74.30%) were located in Central Java, 20 (19.04%) in East Java, 6 (5.71%) in Yogyakarta, and 1 (0.95%) in Jakarta. This indicates that the majority of sharia cooperatives of the BMT BUS type—operating for at least five years and thus considered experienced in risk management—are concentrated in Central Java, Indonesia.

Measurement & Structural Model Assessment

As shown in Table 3, the research model meets the criteria of convergent validity and reliability. The evidence is as follows: (1) all indicator loadings exceed 0.70, confirming that each indicator adequately represents its construct; (2) all Average Variance Extracted (AVE) values are greater than 0.50, indicating that over 50% of the indicator variance is explained by its latent construct; and (3) Cronbach's Alpha and Composite Reliability values for all constructs are above 0.70, signifying strong internal consistency.

Table 3. *Output Measurement Model*

Variables and Indicators	Loading Factors	AVE	Cronbach's Alpha	Composite Reliability
Risk Identification		0,717	0,804	0,833
RI.1 The BMT classifies risks based on their sources	0,843			
RI.2 The BMT classifies risks based on their types	0,838			
RI.3 The BMT identifies risks using various methods	0,853			
Risk Monitoring (RMo)		0,825	0,898	0,934
RMo.1 The BMT promptly evaluates the effectiveness of its policies	0,952			
RMo.2 The BMT involves senior management in conducting supervision and making appropriate policies	0,941			

Variables and Indicators	Loading Factors	AVE	Cronbach's Alpha	Composite Reliability
RMo.3 The BMT provides guidance and conducts regular visits to financing customers	0,827			
Risk Mitigation (R.Mi)		0,706	0,802	0,878
RMi.1 The BMT reduces risks by avoiding risk-related activities	0,849			
RMi.2 The BMT reduces risks by involving other parties	0,886			
RMi.3 The BMT reduces risks by postponing certain programs or activities	0,782			
Islamic Governance (IG)		0,800	0,918	0,941
IG.1 The BMT has a Sharia Supervisory Board to oversee sharia operations and products	0,922			
IG.2 The BMT has an internal audit committee responsible for monitoring business operations	0,931			
IG.3 The BMT engages external audit committees, such as Public Accounting Firms or other qualified experts	0,860			
IG.4 The BMT has a special committee or unit dedicated to managing risks	0,863			
Financial Performance (FP)		0,877	0,953	0,966
FP.1 The profitability of the BMT increases year by year	0,949			

Variables and Indicators	Loading Factors	AVE	Cronbach's Alpha	Composite Reliability
FP.2 The BMT's NPF (non-performing financing) decreases year by year	0,895			
FP.3 The total assets of the BMT increase year by year	0,956			
FP.4 The BMT's financing portfolio increases year by year	0.945			

Source: Proceed PLS Data (2025)

Additionally, the Fornell–Larcker Criterion results (Table 4) indicate that the square root of AVE for each construct is greater than its correlations with other constructs, fulfilling discriminant validity requirements. All HTMT values were also < 1, further confirming discriminant validity. Hence, the measurement model in this study is deemed both valid and reliable.

Table 4. *Fornell-Larcker*

	FP	IG	RI	RMi	RMo
FP	0,937				
IG	0,356	0,895			
RI	0,491	0,116	0,846		
RMi	0,246	0,110	0,092	0,840	
RMo	0,295	0,081	0,057	-0,001	0,908

Source: Processed PLS data by authors (2025)

Structural Model (Inner Model)

Table 5 reports the R-squared value of 0.422, indicating a moderate predictive power. This means that 42% of the variance in financial performance is explained by risk identification, risk monitoring, risk mitigation, and Islamic governance, while the remaining variance is attributed to other factors outside the scope of this study.

Table 5. *R-Squared Values*

	R Square	Adjusted R Square
Financial Performance	0,422	0,399

Source: Processed PLS data by authors (2025)

Analysis of Hypothesis

Table 6 presents the hypothesis testing results derived from the inner model. All path relationships were statistically significant at the 0.05 level. The interpretations are as follows:

Table 6. Result of Hypothesis Analysis

	Original Sample (O)	T Statistics (|O/ STDEV|)	P Values	Results
RI -> FP	0,429	5,187	0,000	Accepted
RMo -> FP	0,249	3,229	0,001	Accepted
RMi -> FP	0,178	2,199	0,028	Accepted
IC -> FP	0,266	3,407	0,001	Accepted

Source: Processed PLS data by authors (2025)

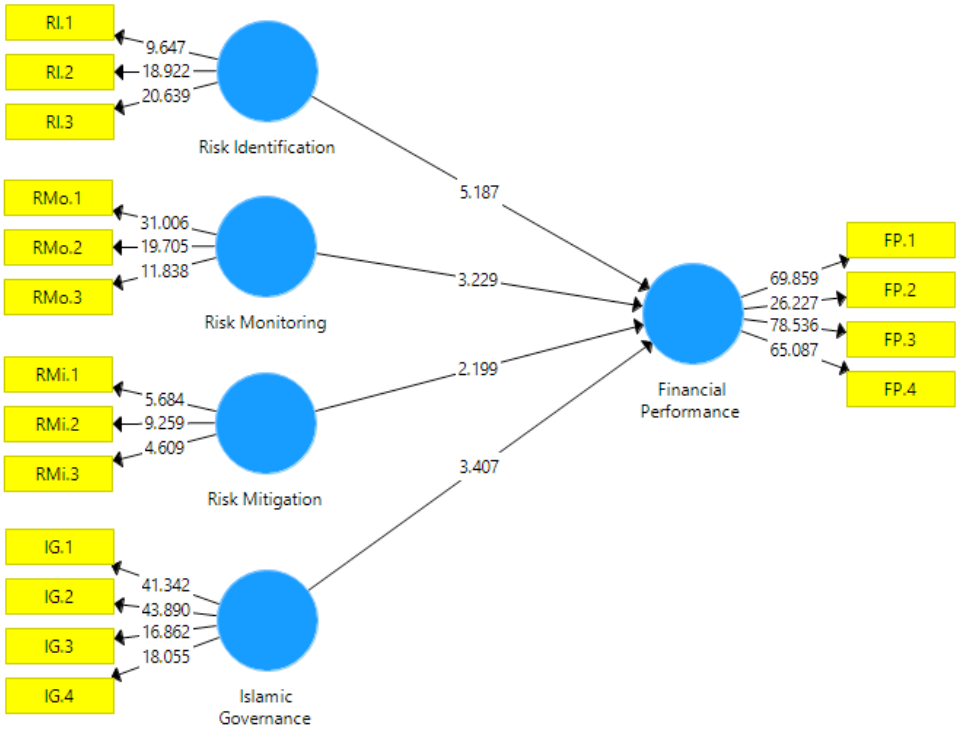


Figure 2. *Structural Model Measurement*

DISCUSSION

Risk Identification to Financial Performance

The path coefficient of 0.429, with a t-statistic of 5.187 and a p-value of 0.000 (< 0.05), indicates that risk identification has a significant positive effect on financial performance. This finding aligns with previous studies that highlight risk identification as a critical stage in risk management, as it determines the effectiveness of subsequent steps, such as monitoring and mitigation (Falkner & Hiebl, 2017; Widiyanto et al., 2021). Effective risk identification enables BMT cooperatives to anticipate financing risks that may threaten sustainability, thereby allowing timely and precise strategies (Lagat & Tenai, 2017).

The results confirm that identifying risks significantly enhances the financial performance of sharia cooperatives. This demonstrates how BMTs can increase profitability and more efficiently allocate resources when possible risks, like credit defaults, operational inefficiencies, and regulatory non-compliance, are identified early (Rosman, 2009; Ahmed et al., 2019). The outcome demonstrates that proactive identification is a strategic element in ensuring financial sustainability, rather than merely a technical step in risk management.

According to *Maqāṣid al-Sharīʿa*, this result supports the concept of *hifz al-maal*, or the protection of wealth, by demonstrating that prudent risk assessment safeguards both institutional assets and the welfare of members (Prasojo et al., 2022a; Sheikh et al., 2023). In reality, it means that to maintain economic justice and increase resilience against market fluctuations, BMTs should incorporate risk identification as a fundamental component of their governance function. Therefore, to advance sustainable sharia-compliant cooperatives, effective risk identification is both a financial necessity and an ethical obligation.

Risk Monitoring to Financial Performance

The path coefficient of 0.249, with a t-statistic of 3.229 and a p-value of 0.001 (< 0.05), confirms that risk monitoring has a significant impact on enhancing financial performance. This supports earlier views that monitoring is crucial to ensure proper implementation of risk management (Ariffin & Kassim, 2014; Rhanoui & Belkhoutout, 2019). Beyond tracking, effective

monitoring also evaluates weaknesses in the system and facilitates corrective actions (Muriithi, 2016).

The results indicate that risk monitoring has a significant and favorable impact on the financial performance of sharia cooperatives. This demonstrates how BMTs can identify deviations early, take corrective action, and maintain financial stability through ongoing supervision and assessment of risk management procedures (Angote, Malenya, & Musiega, 2015). In a dynamic market, efficient monitoring serves as a "control tower," ensuring that all risk management initiatives are executed as planned. This improves internal control and operational effectiveness.

This finding is consistent with the principles of fairness (adl) and transparency (amanah) in financial dealings, which are essential for preserving members' trust and safeguarding their wealth, according to *Maqāṣid al-Sharīʿa*. In addition to preventing financial irregularities, strict oversight strengthens institutional accountability to Allah the Almighty. In order to ensure responsible governance and long-term profitability, BMTs should institutionalize continuous monitoring as a managerial and ethical tool. In the end, efficient oversight helps maintain long-term financial stability and raises public trust in the legitimacy of sharia-based cooperative organizations.

Risk Mitigation to Financial Performance

The path coefficient of 0.178, with a t-statistic of 2.199 and a p-value of 0.028 (< 0.05), indicates that risk mitigation has a significant positive effect on financial performance, albeit smaller compared to identification and monitoring. This aligns with Ahmed et al. (2019), who demonstrated that strategies such as risk acceptance, avoidance, and restructuring contribute to improved profitability. In the context of BMT cooperatives, mitigation practices include rescheduling installments, requiring collateral, or imposing penalties (Farhan et al., 2020; Widiyanto, Ismail, & Wibowo, 2016).

The results show that, in comparison to risk identification and monitoring, risk mitigation has a positive but less significant impact on financial performance. This suggests that mitigation primarily serves as a corrective mechanism, maintaining institutional stability and reinforcing earlier phases of risk management. BMTs employ mitigation techniques such as rearranging payment plans, requiring collateral, penalizing non-compliance, and providing financial advice to members in need (Farhan

et al., 2020). By mitigating default risks and fostering enduring member relationships, these steps ensure business continuity even in the face of financial instability.

From the perspective of *Maqāṣid al-Sharīʿa*, the outcome is consistent with the precepts of preventing harm (dar' al-mafasid) and advancing benefit (jalb al-masalih), especially when it comes to safeguarding wealth and life. It follows that efficient risk management enhances member trust and the cooperative's resilience, in addition to stabilizing its financial performance. In order to preserve sustainability and social welfare within sharia-based financial systems, mitigation should be seen as a strategic and moral commitment.

Islamic Governance to Financial Performance

The path coefficient of 0.266, with a t-statistic of 3.407 and a p-value of 0.001 (< 0.05), indicates that Islamic governance has a significant influence on financial performance. This finding corroborates prior studies that have shown governance grounded in Islamic values enhances accountability, integrity, and public confidence (Mansour & Bhatti, 2018; Al-Azdi, Ismail, & Basir, 2023). The role of the Sharia Supervisory Board in overseeing contracts, monitoring risks, and ensuring ethical compliance directly contributes to institutional performance (Prasojo et al., 2022b; Ahmad & Ishak, 2020).

This research highlights how Islamically based governance promotes financial sustainability by improving accountability, compliance, and institutional credibility (Mansour & Bhatti, 2018). The active supervision of contracts, risk monitoring, and ethical conduct by Sharia Supervisory Boards (SSB) enhances transparency and deters opportunistic behavior (Prasojo et al., 2022b).

According to *Maqāṣid al-Sharīʿa*, the outcome reveals that governance encompasses more than just following the law; it also encompasses the loftier goals of safeguarding wealth, upholding the rule of law, and advancing social welfare. It follows that to strengthen public confidence and long-term viability; Islamic governance must incorporate moral and spiritual considerations into its managerial procedures. When properly applied, it not only acts as a deterrent to unethical behavior but also as a catalyst for better social and financial outcomes, aligning cooperative operations with sharia's overarching goal.

CONCLUSION

This study demonstrates that robust Islamic governance and effective risk management—encompassing risk identification, monitoring, and mitigation—significantly enhance the financial performance of Indonesian sharia cooperatives. These results demonstrate how institutional stability and financial sustainability are strengthened when good risk management is combined with governance based on *Maqāṣid al-Sharīʿa* principles. It follows that sharia cooperative managers should prioritize systematic risk management procedures and strengthen governance mechanisms by involving stakeholders, developing their capacity, and establishing clear operational guidelines. Such initiatives can promote long-term sustainability and increase resilience against financial risks. These findings might be expanded in future studies by incorporating different institutional contexts or other factors that influence financial performance.

LIMITATION

As part of this research, several limitations should be acknowledged. The use of purposive sampling and the Slovin formula in sample selection may impose constraints on the representativeness of the overall population. Furthermore, the study's focus on sharia cooperatives in Indonesia may limit the generalizability of its findings to other contexts of Islamic financial institutions.

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