



Implementation of Tawazun Agency Cost in Managing Financial Risk to Improve the Financial Performance of Islamic Boarding Schools: A Case Study of Islamic Boarding Schools in Central Java

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ABSTRACT

This study examines the influence of implementing Tawazun Agency Cost on the management of Financial Risk and its impact on the Financial Performance of Islamic boarding schools in Indonesia. Tawazun Agency Cost is a concept that emphasizes balancing agency costs with prudence and fairness in decision-making between managers and the owners of Islamic boarding schools. Using a quantitative approach, this research employed questionnaires distributed to 100 respondents from Islamic boarding schools registered with the Ministry of Religious Affairs during the 2019–2024 period. Data analysis was conducted using multiple regression and classical assumption tests to ensure the validity of the results. The findings indicate that the application of Tawazun Agency Cost significantly contributes to reducing Financial Risk, which indirectly improves the Financial Performance of Islamic boarding schools. In addition, financial risk was also found to have a negative effect on financial performance, highlighting the importance of effective risk management. This study provides important implications for the management of Islamic boarding schools in optimizing agency costs and risk management to achieve optimal financial performance. The results of this research are expected to serve as a reference for academics and practitioners in developing more effective financial management strategies based on the principles of balance and fairness.

A. INTRODUCTION

Agency Theory is one of the key theories in management and finance that explains the relationship between the owner (principal) and the manager (agent). Jensen and Meckling



(1976) introduced this theory to describe the potential conflicts of interest that arise when owners entrust the management of resources to managers. In this context, owners aim to maximize organizational value, whereas managers often pursue personal interests that may not always align with the principal's objectives.

Such conflicts give rise to what is known as agency costs. These costs emerge from the need for monitoring by principals, control efforts by agents, and residual losses resulting from differences in decision-making between owners and managers. Eisenhardt (1989) emphasized that agency costs cannot be completely eliminated but can be minimized through contractual mechanisms, supervision, and incentives aligned with the principal's goals.

In research development, agency theory is not only relevant to commercial companies but is also applied to various non-profit institutions, including educational institutions and Islamic boarding schools (pesantren). This is because pesantren also manage financial resources from the community, donors, and the government, requiring transparent and accountable governance. The separation between ownership and control functions increasingly demands a strong oversight system to prevent the misuse of authority.

Furthermore, recent studies highlight the need to integrate spiritual values into agency theory. For instance, Al-Mamun (2014) emphasized that governance based on ethics and moral values can reduce information asymmetry between principals and agents. In the Islamic context, the concept of **Tawazun** or balance can serve as a foundation for reducing agency costs. **Tawazun** underscores the importance of harmonizing worldly interests (profit, efficiency, and performance) with spiritual interests (trustworthiness, honesty, and blessings).

Thus, integrating Agency Theory with the principle of **Tawazun** becomes crucial in the financial management of Islamic boarding schools. This integration not only helps reduce agency costs but also fosters sustainable, fair, and Sharia-compliant financial performance. At the same time, this approach responds to criticisms of conventional agency theory, which is often seen as overly focused on material interests alone..

A. Literature Review & Methods

Financial Management Changes

The financial management of Islamic boarding schools faces complex challenges due to the institution's dual nature, which is not only economically oriented but also social and spiritual. Conflicts of interest between managers (agents) and owners (principals) give rise to agency costs, which include monitoring costs, bonding costs, and residual losses incurred to control agent behavior and prevent deviation from organizational goals. This condition is further exacerbated by information asymmetry and weak oversight mechanisms, which may reduce the financial performance of Islamic boarding schools and threaten the sustainability of business units such as Sharia cooperatives and microfinance institutions.

In addition to agency costs, financial risks such as liquidity and solvency risks also affect the financial stability of Islamic boarding schools. Many pesantren struggle to manage these risks due to inadequate financial planning and limited professional management support. Therefore, effective financial management must integrate Islamic values as moral and spiritual foundations to maintain institutional harmony and sustainability.



The principle of **tawazun**, which teaches balance between worldly and spiritual aspects, justice, transparency, and spiritual commitment, becomes a strategic solution to mitigating the negative impact of agency costs and enhancing the sustainable financial performance of Islamic boarding schools. Fama and Jensen (1983) emphasized that applying the value of **tawazun** as a moderating variable can improve efficiency, effectiveness, and integrity in managing pesantren funds in accordance with Islamic principles, enabling pesantren to optimally contribute to community economic empowerment without losing their social and spiritual characteristics.

Tawazun: The Key to Financial Balance

In the Islamic perspective, **tawazun** is the principle of balance that places harmony between worldly and spiritual aspects in the financial management of Islamic boarding schools (**pesantren**) (Ulya, Himmatul, 2018). This concept emphasizes moderation, justice, and transparency so that economic decision-making is not only focused on material gains but also on spiritual and social values. **Tawazun** serves as a strategic foundation to address conflicts of interest between managers and owners of institutions that lead to agency costs.

In practice, **tawazun** functions as a moderating variable that mitigates the negative impact of agency costs on the financial performance of pesantren by enhancing transparency, accountability, and the spiritual commitment of managers. Principles of **tawazun** – such as balancing worldly profits with blessings, ensuring justice in resource distribution, and upholding religious and ethical values – not only strengthen the effectiveness of financial management but also reinforce the social and spiritual values of pesantren as institutions of education and community empowerment.

Moreover, **tawazun** helps pesantren face financial risks by providing moral guidance that restricts opportunistic behavior and the misuse of authority, in line with Agency Theory, which emphasizes effective supervision and control to reduce agency costs. By internalizing the values of **tawazun**, pesantren can establish sound and sustainable governance while strengthening stakeholder trust, thereby maintaining a balance between profit orientation and socio-spiritual values to support institutional sustainability and their role in the economic development of the community.

This study employs a quantitative approach with a survey method as the main data collection technique. The quantitative approach was chosen because it allows for objective and systematic testing of relationships among variables, as well as results that can be generalized in the context of financial management of Islamic boarding schools in Central Java. The survey method was used to ensure that the data collected reflects a broad perspective of financial management practices from various respondents directly involved in institutional management. The methodological review steps can be described as follows :

A. Population and Sample

The population in this study consists of all Islamic boarding schools (*pesantren*) in the Central Java region that operate active economic units, such as cooperatives, shops, and Sharia microfinance institutions. The sampling technique applied was purposive sampling, with



criteria including pesantren that independently manage their business finances and are willing to participate in the study. A total of 100 respondents were obtained, consisting of administrators and financial managers of pesantren who possess knowledge and experience in institutional financial management.

B. Research Instrument

The research instrument used was a structured questionnaire developed based on the indicators of the study variables. The **Agency Cost** variable was measured through three main indicators: monitoring costs, bonding costs, and residual loss, adjusted to the context of Islamic boarding schools (*pesantren*) and Sharia-based economic institutions. The **Tawazun** variable was measured using indicators of balance between worldly and spiritual aspects, justice, and spiritual commitment in financial management. Meanwhile, **financial performance** was measured using indicators of liquidity, solvency, profitability, and efficiency in the use of funds, in line with the standards of microfinance and Sharia institutions..

C. Data Collection

Data were collected through the direct distribution of questionnaires to respondents selected based on predetermined criteria. The data collection process was carried out over a two-month period in early 2025 across various Islamic boarding schools (*pesantren*) in Central Java. To complement the survey, brief interviews were also conducted to obtain additional information that supports a deeper understanding of the financial management context in pesantren.

D. Teknik Analisis Data

The collected data were analyzed using the Structural Equation Modeling (SEM) method with the assistance of the latest version of SmartPLS software. This analysis was conducted to examine the relationships among the research variables, including the effect of Agency Cost on financial performance and the role of *tawazun* as a moderating variable. The moderation test was carried out to determine the extent to which *tawazun* influences the strength of the relationship between Agency Cost and the financial performance of Islamic boarding schools (*pesantren*).

In addition, descriptive analysis was conducted to illustrate the characteristics of the respondents and provide an overview of financial management practices in pesantren. This analytical approach is expected to provide a comprehensive and valid understanding of the dynamics of financial management as well as the contribution of *tawazun* values in enhancing the sustainable financial performance of these institutions.

B. RESULTS AND DISCUSSION

Proposed Propositions and Conceptual Model

Based on the SOTA (State of the Art) table below, it can be observed that previous studies have largely emphasized the conventional aspects of Agency Theory, particularly agency costs a financial performance. However, research that integrates the value of *Tawazun* into the management of Agency Cost remains very limited. Therefore, this study aims to offer



a new perspective through the concept of *Tawazun Agency Cost*, which balances financial aspects with Islamic values.

Table 1. SOTA (State of the Art) Agency Theory

No	Author(s)	Findings	Weaknesses (Critiques)	Solution
1	(Jensen, M. C., & Meckling, 1976)	Agency cost arises from conflicts of interest between principals and agents.	Too normative, focusing solely on the economic model.	By linking the research to Islamic values, conflicts of interest can be directed toward a fairer balance between principals and agents.
2	(Fama, E. F., & Jensen, 1983)	The separation of ownership and control gives rise to the agency problem.	It does not take into account cultural, value-based, and ethical factors.	The emphasis on Islamic values adds intrinsic awareness, ensuring that the effectiveness of control does not rely solely on formal structures.
3	Eisenhardt (1989)	Conflicts arise from information asymmetry and differing objectives.	Placing too much emphasis on economic incentives while neglecting the moral and spiritual dimensions.	Islamic values serve as moral guidelines that can suppress opportunistic behavior, ensuring that incentive mechanisms are not the sole controlling instrument
4	(Shleifer, A., & Vishny, 1997)	Weak corporate governance increases agency cost.	Limited to formal governance mechanisms.	An approach grounded in Islamic values creates space for non-material control, encouraging managers to act proportionally.
5	(Porta, 2000)	Legal protection affects agency cost across countries.	Not relevant in countries with weak legal institutions.	In the context of diversity, Islamic values can serve as a universal framework that unites cultural differences in



				organizational governance.
6	(Daily, C. M., Dalton, D. R., & Cannella, 2003)	The board of directors plays a role in reducing agency cost through corporate governance.	Still limited to formal and structural mechanisms.	The application of Islamic values can provide a foundation of justice within the ownership structure, thereby achieving greater efficiency in agency costs.
7	(Lubatkin, 2005)	Agency cost in multinational companies is more complex due to differences in culture, coordination, and geographic distance.	The focus is still on the formal organizational level, without addressing values and moral aspects.	Implementing governance guided by Islamic values will create oversight that is not only legal-formal but also based on justice and moral responsibility.

Previous studies indicate that discussions on Agency Cost have generally focused on the financial relationship between principals and agents, while the integration of moral values and balance has received limited attention. Therefore, this study proposes the concept of *Tawazun Agency Cost* as a new framework that emphasizes the balance between financial efficiency, risk management, and ethical values, providing a more comprehensive perspective on financial performance. Consequently, this research contributes to the development of literature by offering a more holistic approach that evaluates agency costs not only from an economic standpoint but also from behavioral and value-based dimensions of balance.

Integration and Internalization of Tawazun Values in Financial Management

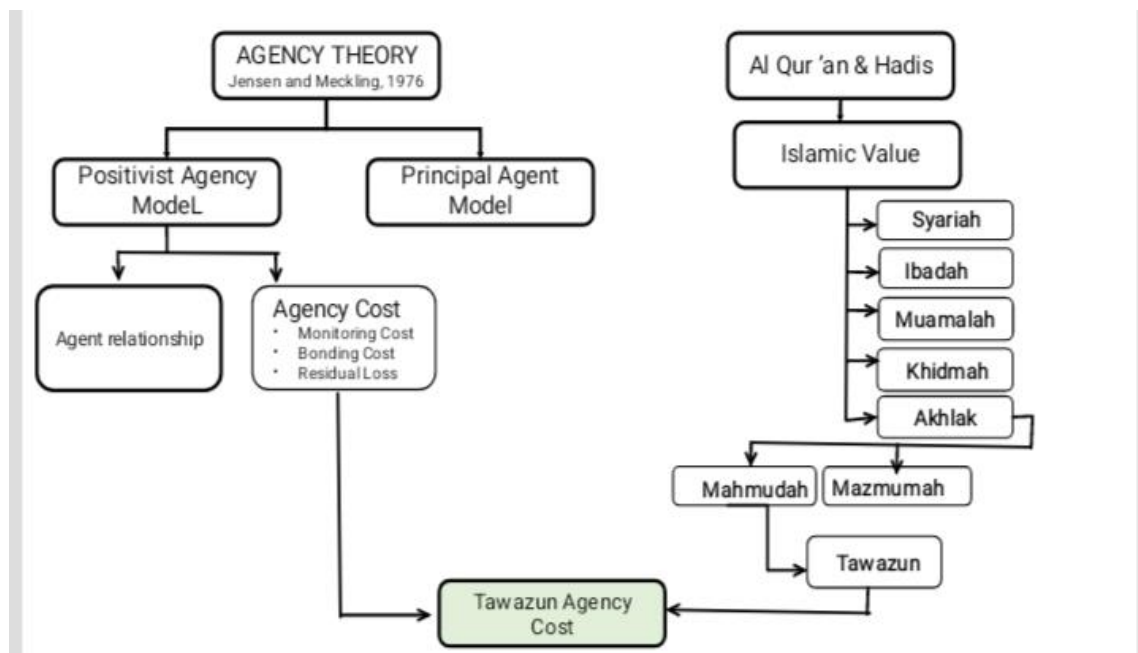


Figure 1. Integration of Tawazun Behavior for Financial Management Transformation

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Figure 1 illustrates the conceptual flow integrating the Agency Cost concept, *tawazun* values as a moderating variable, and the financial performance of pesantren. In this model, *tawazun* acts as a balancing value that internalizes principles of justice, transparency, and spiritual responsibility in financial management.

Proposition Development

The concept of Agency Cost introduced by Jensen and Meckling (1976) explains that agency costs arise from conflicts of interest between principals and agents, often triggering opportunistic behavior, moral hazard, and information asymmetry. Traditionally, controlling agency costs has relied on contracts, financial incentives, and supervision; however, these approaches tend to produce only formal compliance without fostering genuine commitment. Islamic perspectives offer a solution through the principle of *tawazun*—the balance between rights and obligations, worldly and spiritual concerns, material and moral interests—grounded in the values of trustworthiness (*amanah*), justice, and excellence (*ihsan*) as taught in the Qur'an and Hadith.

By integrating *tawazun* values into agency cost management, the relationship between principals and agents is based not only on formal contracts but also on moral and spiritual awareness. The *Tawazun Agency Cost* model views efficiency not merely as cost minimization, but as the creation of blessing and sustainability in performance according to *maqashid* al-sharia. This study proposes that applying *tawazun* principles will reduce conflicts and opportunistic behavior, enhance trust and harmonious relationships among stakeholders, and



strengthen sustainable financial performance in Islamic value-based institutions such as pesantren.

Tawazun Agency Cost

Tawazun Agency Cost is an innovative concept developed to address the limitations of conventional Agency Theory, which primarily focuses on financial aspects. This concept combines Agency Theory principles with *tawazun* values in Islam, emphasizing balance between rights and obligations, efficiency and blessing, as well as worldly and spiritual concerns. The approach does not rely solely on formal mechanisms like contracts and supervision but also stresses the internalization of moral and spiritual values so that agency cost management is more comprehensive, encompassing organizational efficiency, sustainable working relationships, and achievement of spiritual fulfillment.

Tawazun Agency Cost consists of three main dimensions:

1. Fair Financial Efficiency – Minimizing agency costs without neglecting justice and sustainability.
2. Balanced Principal-Agent Relationships – Building trust, open communication, and mutual respect.
3. Islamic Spiritual and Moral Values – Internalizing *amanah*, *ihsan*, and sincerity (*ikhlas*) in organizational management with the intention of seeking Allah's approval.

Through this concept, working relationships are expected to become more harmonious and oriented toward collective welfare.

Financial Performance

According to Brigham and Houston (2019), financial performance reflects the outcome of resource management within an organization, as shown in financial statements, indicating the company's ability to generate profit and maintain liquidity. Financial performance serves as a measure of operational success and an important indicator for investors and stakeholders to assess future prospects. Munawir (2018) adds that performance can be evaluated through financial ratio analysis reflecting the organization's condition and resource use efficiency.

From an Islamic perspective, financial performance is not measured solely by profit maximization but must also prioritize justice, blessing, and the permissibility (*halal*) of all transactions, in line with QS. Al-Baqarah verse 282, which emphasizes fair and transparent transaction recording as a form of accountability. In this study, financial performance is assessed through several key dimensions: profitability (net profit and return on assets), liquidity (ability to meet short-term obligations), solvency (ability to meet long-term obligations), and operational efficiency (comparing operational costs to revenue).

Proposition 1

Proposition 1: In the Islamic context, the legal form of a company or business contract is determined by how labor is balanced with outcomes, how employment is aligned, how justice is applied across various factors, who makes decisions, how many companies or contracts are consolidated, and who bears the risk of failure. Profit maximization is pursued simultaneously with maximizing balance (*tawazun*). Stakeholders—including capital owners, managers, employees, suppliers, consumers, and other parties—interact and mutually benefit. The *Tawazun Agency Cost* (TAC) framework is prominent in Islamic financial

management literature. Increasing TAC can enhance organizational performance and reduce financial risk.



Figure 2. Proposition 1

Proposisi 2

Proposition 2: Capital structure shapes Agency Cost in relation to a company's financial performance. In other words, a neglectful attitude toward Agency Cost can reduce the achievement of competitive profits, negatively impacting financial performance. An optimal capital structure can enhance *Tawazun Agency Cost*.



Figure 3. Proposition 2

Konseptual Model

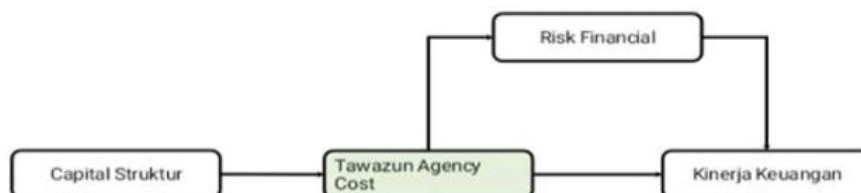


Figure 4. Conceptual Model

The grand theory of this study is **Agency Theory**, which examines the relationship between owners (principals) and managers (agents) as well as the costs arising from conflicts of interest. In this research, the theory is modified into **Tawazun Agency Cost**, a Sharia-based strategic framework that integrates Islamic values, particularly the concept of *tawazun* (balance). This model assesses the impact of agency costs on financial performance while considering capital structure and financial risk in an ethical and balanced manner.



C. CONCLUSION

The grand theory of this study is based on Agency Theory, introduced by Jensen and Meckling (1976), which examines the relationship between owners (principals) and managers (agents) as well as the costs arising from conflicts of interest. In the context of this research, this relationship is reflected in the interaction between the caretakers of Islamic boarding schools (*pesantren*) as principals and the managers of *pesantren* business units as agents.

This concept is then modified into Tawazun Agency Cost, an approach that integrates the principle of balance (*tawazun*) in Islam to manage and minimize agency costs. This approach not only considers economic efficiency but also bases decision-making on ethical and Sharia values. Consequently, Tawazun Agency Cost is expected to create harmonious, transparent, and sustainable working relationships within *pesantren*, positively impacting the improvement of institutional financial performance.

D. AUTHOR CONTRIBUTIONS

Each author in this study played an active role according to their expertise and respective fields, resulting in a complete and high-quality manuscript.

1. Yunita Niqrisah Dwi Pratiwi

Served as the principal researcher who initiated the study concept on integrating the *Tawazun* concept into the Agency Theory framework. Responsible for formulating the research background, objectives, and designing the quantitative methodology employed. Additionally, prepared the research instrument in the form of a questionnaire, conducted field data collection across various Islamic boarding schools (*pesantren*) in Central Java, and performed data processing and analysis using Structural Equation Modeling (SEM) with SmartPLS software. Also drafted the initial manuscript, including the introduction, methodology, and empirical analysis sections.

2. Budi Cahyono

Contributed substantially to the conceptual and theoretical aspects of the research. Played a role in developing the theoretical framework, preparing a comprehensive literature review, and integrating relevant literature on Agency Cost, Corporate Governance, and Islamic values in financial management. Additionally, supervised the methodological design to ensure research validity and reviewed data analysis to ensure results adhered to academic standards. Provided critical input in formulating the discussion of findings, particularly in linking empirical results with existing theory, thereby ensuring the study offers a clear theoretical contribution.

3. Dasmadi

Played a role in strengthening the practical relevance of the research, particularly in the context of financial management implementation in Islamic-based educational institutions. Contributed to refining the conceptual model of *Tawazun Agency Cost* and provided critical perspectives on the managerial implications of the study. Additionally, reviewed the analysis and discussion results to ensure alignment with the practical needs of *pesantren* financial management and ensured that the research delivers tangible benefits for practitioners, institution managers, and regulators. In the final stage,



conducted a thorough review, substantive editing, and gave final approval of the manuscript prior to submission for publication.

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