

SHARIAH SUPERVISORY BOARD AND ISLAMIC BANKS' FINANCIAL PERFORMANCE: AN EVIDENCE FROM SOUTHEAST ASIA

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Abstract

This study aims to find out the effect of SSB Characteristics on financial performance of Islamic Banks in Southeast Asia, particularly in Malaysia and Indonesia. To establish the relationship between SSB characteristics and financial performance, secondary data from banks' annual report was collected and then analysed using Panel data regression model and T test with the help of Eviews 10. Result shows that there is no significant effect of the observed characteristics (size, doctoral degree, number of meetings) on financial performance of Islamic banks Originality/value – the strength of this study is that it focuses on the two most prominent countries regarding Islamic finance in Southeast Asia.

Keywords : Islamic banks, financial performance, shariah supervisory board

THE INTRODUCTION

The growth of Islamic Financial Institutions (IFI), especially banks, is a result of the evolving nature of Islamic finance. Gulf Cooperation Council (GCC) assets led the way at USD 1.2 trillion, followed by Middle East and North Africa (MENA) at USD 755 billion and Southeast Asia at USD 685 billion, according to Islamic Finance Development Report 2020 by ICD Revinitiv. Global Islamic Finance assets increased by 14% y.o.y to a total of USD 2.88 trillion in 2019. The top five developed nations in terms of Islamic finance, according to the research, are Saudi Arabia, Malaysia, Indonesia, Bahrain, and the United Arab Emirates.

Islamic banks must abide by Shariah (Islamic law), which is the key distinction between them and ordinary banks (Aris et al., 2013). Each Islamic bank must set up a specific board, the Shariah Supervisory Board (SSB), whose job it is to ensure the banks' adherence to shariah in order to meet this requirement (Hisan, 2015). This board, together with the Board of Directors (BOD), is a prerequisite for the governance of Islamic banks. They function as "the guardians" of the bank, ensuring that its products and services are compliant with shariah (Alman, 2012).

Historically, the majority of studies have concentrated on how BODs affect banks' financial performance. The policies and choices made by the banks are significantly influenced by this board. Therefore, it has been proven beyond a reasonable doubt to have a significant impact on performance. The SSB in Islamic banks, however, might not be an exception. This second board plays crucial functions even though it is not in charge of managing or supervising the management to ensure that the banks are profitable since it is the one who ensures that the operations of the banks do not violate Shariah. It is crucial to ascertain whether the actions of this specific board have any effect on the operation of Islamic banks. It is still unclear if certain board characteristics, like as size, membership makeup (some members hold multiple posts), and the availability of doctoral-level academics, have an impact on the financial performance of banks.

Many people look at a company's profitability numbers when talking about the financial performance of the company. The most popular are Return on Asset (ROA). This ratio has been used in several prior studies on the influence of SSB on performance, including Hisan (2015) and Hakimi et al (2018). In order to measure financial performance, the ROA will also be used in this study.

As was said in the opening section of this chapter, the participants in Islamic finance are typically divided into three geographic regions: the GCC,

the MENA, and Southeast Asia. Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates are the six oil-producing nations that make up the GCC. In 2022, 11 nations will be Southeast Asian members, while 19 countries will be MENA members.

Due to the numerous countries, there are presently no established rules that are internationally relevant for the composition of SSB. Depending on the nation and jurisdiction, the requirements change. The size, academic credentials, and number of meetings held each fiscal year are among the characteristics that set one country apart from another, in addition to the religious requirements, which rely on the mazhab utilized by each country/region. In some countries, a small board may just include one scholar, while larger boards may have ten or more scholars. Contrarily, the majority of GCC nations have a strict requirement that the SSB have three members or more. Similar to this, a few of nations also allow SSB members to hold BOD positions. This dual position might not be usual in certain other nations, though. On the board of some regions, female academics may be represented, but not in others. The variations in SSB characteristics between nations are fascinating to learn about. There could be a big disparity in SSBs across neighboring nations even in Southeast Asia.

This study focuses on Malaysia and Indonesia, two Southeast Asian nations that are among the top two developed nations in terms of Islamic banking. In terms of Islamic finance in the area, both are the major participants. Malaysia takes pride in being the world's leader in the development of Islamic finance, while Indonesia is home to the largest Muslim population on earth. In addition, compared to other nations in the region, both nations have the highest concentration of Islamic banks. It is realistic to suppose that the two nations will offer more thorough research on how SSB affects the financial performance of Southeast Asian Islamic banks.



LITERATURE REVIEW

Islamic financial institutions must make sure that all of their goods, instruments, operations, procedures, and administration adhere to Shariah, which can be done by putting in place an effective Shariah governance framework (Elasrag, No year). As a result, a crucial part of the Shariah governance framework for Islamic financial institutions is Shariah board monitoring.

Good Shariah governance is essential to the dynamism of Islamic finance. Stakeholders' interests may extend beyond solely financial reasons to take into account such as moral, religious, or other values when calling for excellent company governance. All services provided by Islamic banks must be carried out in line with Shariah law, according to shareholders and Islamic experts; otherwise, they risk legal action and will not be authorized. As a result, shariah-compliant corporate governance is essential.

The corporate governance structures in Islamic banks differ significantly from traditional ones due to the inclusion of the SSB and BOD. The relationship between the principal and the agent gets a great deal more complicated when it is tied to agency theory. Due to the additional board requirements, as well as the distinct types of contracts and operations, Islamic banks require various control mechanisms. In some cases, the unusual structure may also help with agency-related issues (Bukhari et al., 2013). Since SSB is a component of Islamic banks' control mechanisms, investigating how it affects such banks' performance falls under the purview of agency theory in the context of Islamic corporate governance.

Shariah Supervisory Board

The primary institutional feature that sets apart Islamic banks from traditional ones is the Shariah Supervisory Board (SSB), also known as the

Shariah Board, Shariah Committee, Shariah Advisory Board, or Shariah Council. The shareholders appoint the board of scholars with expertise in Shariah law, and their main responsibility is to ensure that the banks' operations, goods, and services are legal under shariah. All Islamic banks must have this board in place, whether they are commercial, fully-fledged Islamic banks or any other conventional banks wishing to create an Islamic window (Yaqubi, 2005).

SSB Size and performance

A study on the impact of board qualities on the financial performance of Bahraini Islamic Banks was undertaken by Hakimi et al. (2018). They discovered that SSB size had a favorable but not very significant impact on the ROE but no impact on the ROA using panel data analysis of 13 banks. Similar to this, a study by Nowroz (2018) discovered that SSB characteristics have less of an impact on the performance of Malaysian firms. Contrary to what Nomran et al. (2018) discovered in Malaysia, financial performance is significantly impacted by certain SSB characteristics (size, cross-membership, reputation, among others) according to the GMM estimation. Li, et al. (2014) in their study found that Islamic banks often perform better financially if the SSB is large and composed of notable scholars. The same is true for Mallin, et al. (2014), who used OLS regression to confirm the connection between the size of SSBs and the Corporate Social Responsibility (CSR) disclosure index.

The results of earlier studies on the effect of board size on bank performance have not been clear-cut, which brings us to the first hypothesis:

H1: SSB size affects financial performance

SSB Doctoral qualification and financial performance

Nomran et al. (2018) discovered that having doctoral-qualified members in an SSB has a positive impact on financial success. Elgadi (2016) has demonstrated that giving PhD holders governance positions improves their

ability to lead and make decisions. According to Hasan et al. (2017), the SSB significantly affects the banks' performance in Pakistan when measured using the CAMEL technique. The same is true for Indonesia; according to a study by Darwanto and Chairiri (2019), SSB has a beneficial impact on the return on assets and capital adequacy ratios of Islamic banks while having a negative impact on non-performing financing. Gati and Basuki (2020) emphasized that such impact was restrained by the political ties of SSB members.

High profitability is a result of SSB education's high standards (Musibah and Alfattani, 2014). SSB members with doctorates are clearly more informed in the fields of Islamic banking and finance, claim Farook et al. (2011) and Rahman and Bukair (2013).

H2: SSB Doctoral qualification affect financial performance

SSB number of meetings and financial performance

As many as 48 Islamic banks in the GCC performed poorly, and this was found to be significantly and negatively impacted by the SSB composition (independence and frequency of meetings) (Alsartawi, 2019). According to Shittu et al. (2016), the SABs work through difficulties that unforeseenly develop for the Islamic Banks more quickly the more frequently they meet. The SSB has increased the number of its meetings significantly, providing more control and stimulation of the financial performance of Islamic banks. The financial success of Islamic banks is influenced by the SSB's characteristics, particularly the frequency of meetings, according to research done by Baklouti (2020) on 42 Islamic banks in the Middle East and North Africa (MENA).

Similar to this, Fitriana et al. (2019) looked into how SAB meetings affected the financial success of Islamic banks in Indonesia from 2012 to 2017. They showed that the quantity of SSB supervisory days had a favorable impact on the financial performance of Indonesian Islamic banks. Haddad & Souissi (2022),

who studied 180 Islamic banks in 56 countries at the time, came at the same conclusion. They discovered that more meetings lead to better financial results.

H3: SSB number of meetings affect financial performance

METHODOLOGY

General method

The majority of the literature reviewed in this study uses statistical tools to analyze data, indicating that the investigations are quantitative. Quantitative data is regarded to be preferable for analyzing an organization's financial success because a company's profit is always a number. The fact that these yearly reports are readily available online, on the websites of the banks, allows this study to additionally use quantitative and secondary data, gathering information from them. This time period of 2016 to 2020 is utilized since it represents the most recent data available at the time this study was done.

The primary methods for gathering data in this study involve documentation. The documentation approach involves gathering annual financial information from the websites of all Islamic commercial banks in Indonesia and Malaysia for the years 2016 through 2020. This method is used to learn information on the size, PhD members, and number of meetings held by the SBB annually. This technique is also used to collect the data for the financial ratio of ROA.

Sample selection

In all, there are 35 fully-fledged Islamic banks located in six Southeast Asian nations, with the following distribution: 16 in Malaysia, 14 in Indonesia, 2 in Brunei Darussalam, 1 in Singapore, Thailand, and the Philippines. 26 Islamic banks from Malaysia and Indonesia make up the study's sample. These two nations were chosen because they have the bulk of Islamic banks in the area



and because Muslims make up the majority of their populations. Brunei Darussalam is a Muslim nation, but it has a small population and only two Islamic banks. Three additional nations each have one, making them insignificant. As a result of their more competitive operating environments, Islamic banks in Malaysia and Indonesia are presumed to be more experienced and to have stronger management.

Variables

Dependent variable

Return on Asset, which measures performance of Islamic banks, is the only dependent variable in this research (ROA). This profitability ratio will be calculated by dividing net income by the typical total assets.

Independent variables

This study makes use of three independent variables. The size of the SSB, which represents the total number of board members, is the first independent variable. The second one is the SSB's doctoral qualification, as determined by the proportion of board members who have earned this degree. The third independent variable is the quantity of meetings the SSB has each fiscal year.

Data analysis

Panel Data Regression Analysis using Eviews 10 is the data analysis method employed in this study.

RESULT AND DISCUSSION

Regression model

After conducting data analysis, it is concluded that the panel data regression equation for SSB Size, SSB doctoral qualification, and SSB number of meetings on ROA can be written as follows:

$$ROA_{it} = 2.8532 + 0.0839SSBS_{it} - 0.13356SSBD_{it} - 0.00512SSBM_{it} + e$$

It is possible to interpret the regression equation model above as follows:

1. The constant coefficient is 2.8532, which means that if the SSB size, SSB doctoral qualification, and SSB meeting number are all zero, the Return on Assets of Islamic Commercial Banks will be equal to 2.8532.
2. 0.0839 is the regression coefficient for SSB size. Accordingly, ROA will rise by 0.0839% for every unit increase in SSB size.
3. The coefficient for SSB doctorate qualification is -0.13356. Therefore, a projected loss in ROA of 0.12256% will result from every increase in SSB doctorate qualification.
4. The coefficient for the number of meetings is -0.00512, meaning that as the number of meetings rises, the value of ROA will decrease by 0.00512.

Hypotheses testing

T test was used to examine the hypotheses proposed in this study. Below is the result of t test

Table 1. Results of Partial Test (Uji t)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
X1	0.000839	0.002456	0.341458	0.7333
X2	-0.013356	0.013508	-0.988765	0.3247
X3	-0.000512	0.000408	-1.254222	0.2121
C	0.028532	0.014609	1.952975	0.0530

Source: Data Analyzed

If $t_{test} > t_{table}$, H_0 is approved and H_a is rejected. It indicates that the independent and dependent variables don't have a consistent relationship. On the other hand, if $t_{test} < t_{table}$, H_0 is rejected and H_a is approved. It shows that the independent and dependent variables have a significant association.



Second, since the p value shows how well the independent variable predicted the dependent variable, H_0 is ignored and H_a is accepted if the value is less than 0.05. The H_0 is accepted and the H_a is ignored, however, if the p value is greater than 0.05 since the independent variable does not exceed the 95% confidence level.

SSB size and financial performance

The board size investigation produced no conclusive results. According to numerous studies, size has a favorable effect on performance (for example Dalton, et al., 1999; Uadiale, 2010; and Adams & Mehran, 2012). They assert that increasing the number of minds will provide a company access to more ideas. Empirical research shows that larger boards are associated with better corporate performance in the banking industry, particularly for major bank holding companies (Belkhir, 2009). However, Jensen (1993), Guest (2009), and Al Saidi & Al Shammari (2013) support smaller boards. They claim that a large board is less successful since it becomes more difficult to reach consensus as it grows in size.

A third conclusion from prior research suggests that the size of the board has no direct effect on performance, or that the effect has not been consistent and relevant, except from the two factors already discussed (Zahra & Pearce, 1989). The multiple regression analysis of this study demonstrates that the SSB size negatively affects the ROA, however this effect is not statistically significant ($p > 0.05$).

According to earlier studies by Li et al. (2014) and Mallin et al. (2014), who find a positive correlation between SSB size and CSR disclosure index, and Li et al. (2014), larger SSB and top scholars are typically associated with better financial performance, the findings are in direct opposition to each other. However, the three studies are not fully comparable because this study only takes into account the effect of SSB size as it is, neglecting the caliber and

reputation of the professors.

This study further supports Garas' (2012a) contention that, contrary to popular belief, having a larger board does not automatically suggest that the SSB has better control over the activities, which is a drawback of having a large SSB board. The smaller boards may operate as effectively and efficiently as the larger boards because the board is believed to have no direct impact on performance (Zahra & Pearce, 1989). To sum up, the size of the SSB has a marginally negative effect on the ROA performance of Islamic banks in Southeast Asia. The t test and p value findings reveal that the response disagrees with the claim made in H₁, which has also been ignored.

SSB doctoral qualification and financial performance

There has not been much research done specifically on the number of doctoral-qualified scholars on the SSB. Regardless of formal academic degree, the most varied method of evaluating the knowledge or academic caliber of scholars considers the mastery of accounting and finance or fiqh al muamalat.

Numerous studies involving PhD holders sitting on the board have found a beneficial impact on performance. For instance, Nomran et al. (2018) found that an SSB's financial success is positively impacted by the presence of doctoral-qualified members. It has been shown by Elgadi (2016) that granting PhD holders governance posts enhances their capacity for decision-making and leadership. The high standards of SSB education lead to tremendous profitability (Musibah and Alfattani, 2014). According to Farook et al. (2011) and Rahman and Bukair (2013), SSB members with doctorates are categorically more knowledgeable in the disciplines of Islamic banking and finance.

However, this study's findings demonstrated that having a doctorate from the SSB has no discernible impact on performance, with a p value better than 0.05. In contrast to the favorable effects discovered in other studies, it even

has a somewhat negative effect. This finding would suggest that there are more moderating factors influencing the relationship between financial performance and SSB PhD qualification. One of them can be the SSB's political ties (Gati & Basuki, 2020).

SSB number of meetings and financial performance

According to Shittu et al. (2016), the more frequently the SSBs meet, the quicker they are able to tackle unforeseen issues for the Islamic Banks. Furthermore, Baklouti (2020) examined 42 Islamic banks in the Middle East and North Africa (MENA) and found that the SSB's features, such as the frequency of its meetings, had an effect on the financial performance of Islamic banks.

On the other side, it was discovered that the SSB's regular meetings had a negative and significant impact on the performance of 48 Islamic banks in the GCC (Alsartawi, 2019). This outcome is consistent with the research's findings, which showed that the quantity of meetings had a detrimental but not statistically significant impact on performance. The inefficiency of the established meetings' agendas or the fact that there weren't enough typical meetings in relation to the required number of meetings may be responsible for these contradicting outcomes (Haddad & Souissi, 2020)

CONCLUSIONS

The purpose of this study was to experimentally examine how SSB affected the performance of Islamic banks in Southeast Asia. The objective was then divided into three more detailed ones that dealt with the size, doctoral requirement, and frequency of meetings of the SSB. Overall statistical test results show that SSB has little to no influence on how Islamic banks operate in Southeast Asia.

Among the limitation of this study was that no control variables were employed. It only considered how the three independent criteria affected the

ROA, disregarding any special characteristics the SSB members might have, such as their notoriety or their numerous memberships. The same concepts were also applied to all of the observed banks, even though some were bigger or older than others or had more experience.

In order to better evaluate the performance of the banks, the future researcher may employ a variety of performance measurements, including a combination of other measurements and other financial ratios. In order to fully comprehend the effect of SSB on performance, the researcher may then use additional independent factors as opposed to just the three that were used in this study, as it has been demonstrated that they are only weakly predictive of performance.

Additionally, it is critical to consider a few factors that can influence the study in a controlling or intervening way, such as the status of the banks or the standing of the academics. Because the three independent variables in this study did not have a direct impact on performance, there are probably many hidden factors existing between the ones that were identified.

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