

*SHARĪ'AH* GOVERNANCE AND PERFORMANCE OF  
SOUTHEAST ASIA AND GCC ISLAMIC BANKS: THE  
MODERATING EFFECT OF INSTITUTIONAL  
SHAREHOLDING

BY

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## ABSTRACT

Islamic banks (IBs) are required to comply with *Sharī'ah* rules and principles, which require the establishment of a *Sharī'ah* supervisory board (SSB) to safeguard *Sharī'ah* governance (SG). The SG system in IBs refers to institutional and organisational arrangements to ensure effective and independent *Sharī'ah*-compliance oversight. This study aims to fill some of the gaps in the literature. To this end, this study investigates the impact of SSB attributes on the performance of 60 IBs located in the GCC and Southeast Asia countries over the 2006-2021 period using the Generalized Least Squares (GLS) estimator to analyse the data. In particular, the effect of SSB independence, busyness, remuneration, and overall SSB effectiveness on the performance of IBs is assessed. Moreover, the study explores the moderating effects of SG models (i.e., Centralised and Decentralised *Sharī'ah* Governance Models) on SSB effectiveness and the impact of SSBs on performance in crisis periods (i.e., during the 2008 global financial crisis and the COVID-19 pandemic crisis). Finally, the present study scrutinises the moderating effect of institutional shareholding on the relationship between SSB effectiveness and the performance of IBs. This study employs different performance metrics including accounting-based financial performance measurements (i.e., ROA and ROE) and an Islamic social performance measurement (i.e., Zakat payments). The empirical results show that SSB independence adversely affects performance while SSB busyness and remuneration enhance performance. In addition, the overall SSB effectiveness (captured by a SSB score) has a significant positive influence on the performance of IBs. The results also suggest that SG models do not significantly affect the relationship between SSB effectiveness and performance. Regarding periods of crisis, effective SSBs enhanced the Islamic social performance of IBs during the 2008 global financial crisis, while during the COVID-19 pandemic period, they enhanced financial performance. Furthermore, the moderation tests indicate that controlling institutional shareholders positively moderate the relationship between effective SSBs and the performance of IBs in terms of ROA and ROE and negatively in terms of Zakat payments. The findings of this study contribute to the body of knowledge by demonstrating how the *Sharī'ah* governance mechanism, as represented by SSBs, influences the performance of IBs. The findings of this study have important practical implications for various stakeholders, including the policymakers, regulators, and IBs. First, IBs and regulators should enhance the autonomy of SSBs as findings demonstrate that currently, SSBs lack real independence. Additionally, the study offers evidence for IBs and regulators to help understand the role of effective SSBs in crisis non-crisis periods and how IBs can adopt an appropriate SSB structure to improve performance. Concerning SG models, the current study concludes that improvements in the SG framework are needed to be put in place by policymakers and regulatory bodies. Lastly, the current study reveals the role of large institutional shareholders in the SSB-performance association and presents recommendations to IBs and regulators.

## ملخص البحث

يجب على المصارف الإسلامية الالتزام بمتطلبات ومبادئ الشريعة الإسلامية، الأمر الذي يتطلب إنشاء هيئة رقابة شرعية للإشراف على الحوكمة الشرعية. يشير نظام الحوكمة الشرعية في المصارف الإسلامية إلى الترتيبات المؤسسية والتنظيمية لضمان الرقابة الفعالة والمستقلة على عملية الالتزام بأحكام الشريعة الإسلامية. تهدف هذه الدراسة إلى سد بعض الفجوات في الأدبيات ذات الصلة. ولذلك تبحث هذه الدراسة في أثر خصائص هيئة الرقابة الشرعية على أداء 60 مصرفاً إسلامياً في دول مجلس التعاون الخليجي، وجنوب شرق آسيا، وذلك خلال الفترة (2006-2021)، باستخدام طريقة المربعات الصغرى المعممة (Generalized Least Squares) لتحليل البيانات. وقد تم على وجه الخصوص تقييم تأثير استقلالية هيئة الرقابة الشرعية، وانشغالها، ومكافآتها، وفعالية هيئة الرقابة الشرعية بشكل عام على أداء المصارف الإسلامية. إضافة إلى ذلك، تستكشف هذه الدراسة التأثيرات المعتدلة لنماذج الحوكمة الشرعية (أي نماذج الحوكمة الشرعية المركزية واللامركزية)، على فعالية هيئة الرقابة الشرعية، وتأثير هيئات الرقابة الشرعية على الأداء المالي في فترات الأزمات (أي خلال الأزمة المالية العالمية عام 2008 وخلال جائحة كوفيد-19). وأخيراً، تبحث هذه الدراسة في التأثير المعتدل للمساهمة المؤسسية على العلاقة بين فعالية هيئة الرقابة الشرعية، وأداء المصارف الإسلامية. تستخدم هذه الدراسة مقاييس أداء مختلفة، بما في ذلك قياسات الأداء المالي (العائد على الأصول والعائد على حقوق الملكية)، وقياس الأداء الاجتماعي الإسلامي (أي مدفوعات الزكاة). وقد أظهرت النتائج التجريبية أن استقلال هيئة الرقابة الشرعية يؤثر سلباً على الأداء، في حين أن انشغال هيئة الرقابة الشرعية، والمكافآت، يعززان الأداء. وبالإضافة إلى ذلك، فإن فعالية هيئة

الرقابة الشرعية بشكل عام، لها تأثير إيجابي على أداء المصارف الإسلامية. كما أظهرت النتائج أن نماذج الحوكمة الشرعية لا تؤثر على العلاقة بين فعالية هيئة الرقابة الشرعية وأداء المصارف الإسلامية. وفيما يتعلق بفترات الأزمات، عززت هيئات الرقابة الشرعية الفعالة الأداء الاجتماعي الإسلامي للمصارف الإسلامية، خلال الأزمة المالية العالمية عام 2008، بينما خلال فترة جائحة كوفيد-19، عززت الأداء المالي. بالإضافة إلى ذلك، تشير اختبارات الاعتدال إلى أن السيطرة على المساهمين المؤسسين تؤثر إيجابياً على العلاقة بين هيئات الرقابة الشرعية الفعالة وأداء المصارف الإسلامية من حيث العائد على الأصول، والعائد على حقوق الملكية، وتؤثر سلباً من حيث دفع الزكاة. ستسهم نتائج هذه الدراسة في تعزيز المعرفة من خلال توضيح كيفية تأثير آلية الحوكمة الشرعية، ممثلة في هيئات الرقابة الشرعية، على أداء المصارف الإسلامية. أولاً، يجب على المصارف الإسلامية والهيئات التنظيمية تعزيز استقلالية هيئات الرقابة الشرعية، حيث تظهر النتائج أن هيئات الرقابة الشرعية تفتقر حالياً إلى الاستقلال الحقيقي. بالإضافة إلى ذلك، تقدم الدراسة أدلة للمصارف الإسلامية والهيئات التنظيمية، للمساعدة في فهم دور هيئات الرقابة الشرعية الفعالة في فترات الأزمات وغير الأزمات، وكيف يمكن للمصارف الإسلامية اعتماد هيكل هيئات الرقابة الشرعية المناسب لتحسين أدائها. وفيما يتعلق بنماذج الحوكمة الشرعية، توصي الدراسة صانعي السياسات والهيئات التنظيمية بضرورة تنفيذ تحسينات في إطار الحوكمة الشرعية. وأخيراً، تكشف الدراسة الحالية عن دور المساهمين المؤسسين في العلاقة بين هيئات الرقابة الشرعية والأداء، وتقدم توصيات إلى المصارف الإسلامية والجهات الرقابية.

## APPROVAL PAGE

The thesis of Yasin Ahmed Sulub has been approved by the following:

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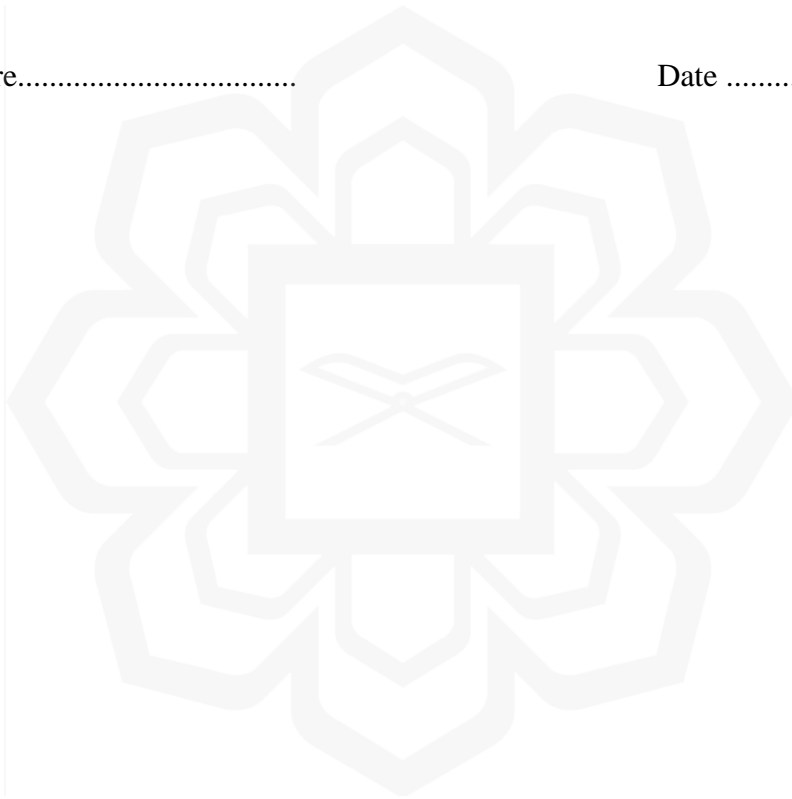
## DECLARATION

I hereby declare that this thesis is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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## DEDICATION

*I dedicate this thesis to my beloved parents, my brothers and sisters, and all of my family.*



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In the name of Allah, the most gracious, the most merciful. May the Peace and blessings of Allah (S.W.T) be upon His blessed messenger, Prophet Muhammad (SAW), and on his family and companions. All praise and gratitude are for Allah, who, through his infinite mercy, has granted me excellent health, opportunity, and determination to complete this thesis.

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## LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organisation for IFIs
AGT	Agency Theory
BOD	Board of Directors
BODs	Board of Directors
CB	Conventional Bank
CBs	Conventional Banks
CG	Corporate Governance
CSGM	Centralised <i>Sharī'ah</i> Governance Model
CEO	Chief Executive Officer
CSR	Corporate Social Responsibility
DSGM	Decentralised <i>Sharī'ah</i> Governance Model
GCC	Gulf Cooperation Council
GFC	Global Financial Crisis
GLS	Generalized Least Squares
IAHs	Investment Account Holders
IB	Islamic Bank
IBs	Islamic Banks
ICLR	Islamic Commercial Law Report
IFI	Islamic financial institution
IFIs	Islamic Financial Institutions
IFSB	Islamic Financial Services Board
OLS	Ordinary Least Squares
ROA	Return on Assets
ROE	Return on Equity
RDT	Resource Dependence Theory
SG	<i>Sharī'ah</i> Governance
SKT	Stakeholder Theory
SSB	<i>Sharī'ah</i> Supervisory Board
SSBs	<i>Sharī'ah</i> Supervisory Boards
SEA	Southeast Asia

# **CHAPTER ONE**

## **INTRODUCTION**

Corporate Governance (CG) refers to the variety of internal and external control processes that induce senior corporate executives to make decisions expected to improve the firm's value and its stakeholders' wealth (Wahl, 2008). It is also concerned with maintaining balanced relationships with interest groups and associated stakeholders (Alagha, 2016; Vieira et al., 2021). An effective CG framework increases confidence in the company; therefore, it attracts investment and talent, resulting in better firm performance (Pucheta-Martinez and Gallego-Alvarez, 2020). Good CG is an effective tool for protecting the interests of shareholders and stakeholders, while poor CG may put all parties at risk. Consequently, because of the importance of CG practices on business firms, CG has become a growing topic of concern in both the developing and developed world.

### **1.1 BACKGROUND OF THE STUDY**

In recent decades, many companies such as Enron, World Com, and Lehman Brothers in the USA, Carillion in the UK, Ahold in the Netherlands, Parmalat in Italy, Olympus in Japan, and many others worldwide have experienced a series of corporate failures. These past financial collapses of the major corporate institutions have distressed investors' confidence in the capital markets and the effectiveness of the existing CG practices in fostering transparency and accountability, bringing the need for well-constructed CG. Accordingly, many countries have effectuated many reforms and codes for best governance to promote transparency and revive confidence in financial markets (Barros et al., 2013). For instance, after the dissolution of Arthur Anderson in 2002, one of the five major audits and accountancy cooperation globally, and the financial failure of Enron in 2001, the U.S enforced the Sarbanes-Oxley Act of 2002; Australia enacted the Corporate Law Economic Reform Program act of 2004, generally known as (CLERP 9). Similarly, many other countries have also initiated or reformed regulations in the aftermath of substantial corporate scandals.

The extensive CG debate is centred around the agency theory, which is described as an agency relationship in which a party or group (the agent) has certain obligations to be fulfilled for another party or group (the principal) (Jensen and Meckling, 1976; Shankman, 1999; Roberts, 2005; Mitnick, 2015). This relationship's fundamental mechanism is based on a contract between the principal and the agent; thus, the firm is viewed as a nexus of contracts between principals and agents (Shankman, 1999). As a result of the separation between ownership and control, this agency relationship is typically related to the agency conflict between managers (agents) and shareholders (principals) (Jensen and Meckling, 1976).

This problem arises because the principal cannot ideally and without a cost monitor the agent's actions and information (Shapiro, 2005; Poppo and Schepker, 2010), and agents do not necessarily make the best decisions on behalf of the principal (Solomon and Solomon, 2004; Yuan et al., 2021). Therefore, the existence of a sound CG mechanism in firms is vital to reduce agency problems by monitoring the performance of managers and associating management's goals with those of the stakeholders (Brickley and James, 1987; Ruangviset et al., 2014; García-Sánchez et al., 2019; AlHares, 2020), and hence, lower information asymmetry<sup>1</sup>, reduced agency costs (Davis et al., 1997; Salehi et al., 2021), increased transparency and disclosure (Al-Tamimi, 2012; Rustam and Narsa, 2021), and prevent the opportunity for corporate scandals and frauds (Todorovic, 2013). Furthermore, it was reported that firms with weaker governance systems have greater agency problems (Core et al., 1999; Basu et al., 2007; Masulis and Reza, 2015; Olaniyi, 2019; Ozili, 2021), and therefore the importance of well-constructed CG.

Although the CG issue is widely studied as a crucial indicator and component for all firms, Islamic banking's distinctiveness brings a substantial interest in the governance structure of Islamic Financial Institutions (IFIs). The uniqueness of IFIs arises from their compliance with *Shari'ah* (Islamic law) in all their activities. Their unique cooperation with partners in businesses includes profit and loss (risk) sharing and not coping with socially immoral and detrimental industries. In the context of the Islamic banking industry, it can also be highlighted that IFIs are not exempt from CG

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<sup>1</sup> Generally, agents usually possess more or better information about the resources they are managing than the principal, which is referred to as information asymmetry (Akerlof, 1970).

breaches as various banks were closed, chiefly due to factors attributed to poor CG and *Shari'ah* non-compliance.

For instance, The Islamic Bank of South Africa collapsed in 1997, and Nathie (2010) reported that inferior and weak CG practices led to its failure. Also, Faisal Islamic Bank halted its operations in the UK for regulatory reasons (Husna and Abdulrahman, 2012). Moreover, the demise of Ihlas Finance (Ihlas Finans) House in Turkey in 2001 (Ginena, 2014) and the corporate fraud seen in the Dubai Islamic Bank in 2004 (Ausat, 2018) shows that Islamic Banks (IBs) also entail robust CG systems.

For those reasons, IFIs have two major internal structures of CG, the Board of Directors (BOD) and the *Shari'ah* Supervisory Board (SSB). The SSB is an internal governance mechanism that ensures that the operations and activities of IFIs are consistent with the *Shari'ah* rules and principles (Ghayad, 2008; Hamza, 2013; Shahzad et al., 2017; Alam et al., 2020). To govern and organise the unique duties of IFIs, two major global regulatory organisations have been established, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI)<sup>2</sup> and the Islamic Financial Services Board (IFSB)<sup>3</sup>.

Interestingly, the Islamic banking industry has been growing rapidly since its inception in the early sixties. The total assets of the Islamic banking industry grew from USD 1.6 trillion in 2015 to nearly USD 2.8 trillion in 2021, and this is expected to further increase to more than USD 4 trillion in 2026 (see Appendix A). Similar figures have also been reported by the Islamic Financial Services Board, where the global Islamic banking assets surpassed USD 2 trillion in 2021, with the Gulf Cooperation Council dominating as the largest domicile for Islamic banking assets (USD 1,212 billion) followed by the Middle East and South Asia regions (USD 477 billion), South-East Asia (USD 287 billion), and Africa (USD 58 billion) (see Appendix B).

IBs are based on *Shari'ah*, which principally comes from the Holy *Qur'an* and *Sunnah* (Bhatti and Bhatti, 2009). For that reason, IBs, unlike their conventional

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<sup>2</sup> AAOIFI was launched in Bahrain in 1991 for the development of various standards, including accounting, auditing, governance, ethics, and *Shari'ah* standards for IFIs throughout the world.

<sup>3</sup> IFSB was launched in 2002 in Malaysia chiefly to propel the event of a stable transparent and prudent Islamic financial services industry (Ullah et al., 2018).

counterpart, must not deal with *riba* (interest), *gharar* (excessive uncertainty), and *maysir* (gambling). Expressly, interest receiving and payment in transactions, projects bearing excessive risk, and engaging with socially immoral activities such as gambling, alcohol, and acquiring of wealth at others' cost are entirely prohibited by the *Sharī'ah*. Unlike Conventional Banks (CBs), IBs are based on profit and loss (risk) sharing related to business ventures (Saadallah, 2007). They are also expected to redistribute part of their profits to society as a form of Zakat (almsgiving) (Imam and Kpodar, 2016; Zahid and Arshad, 2021).

Islamic banking is generally associated with fairness, justice, equal treatment to all participants, and avoidance of business activities that are harmful to society (Dusuki, 2008; World Bank and Islamic Development Bank Group, 2016; Msellek, 2020). It is worth mentioning that the Islamic banking phenomena not only emerged in Muslim countries but also in Muslim minority countries like the UK, USA, Australia, Belgium, South Africa, Japan, Hong Kong, and Singapore. These countries have propelled changes in regulatory and legal frameworks to cater to Islamic finance as alternative finance in their countries (IFSB, 2015).

Correspondingly, IBs adhere to the *Sharī'ah* rules and principles in all their dealings and operations. Their existence is formulated because compliance with *Sharī'ah* is the primary objective of the establishment of IFIs (Rafay and Farid, 2018). Hence, to regulate these unique attributes, the *Sharī'ah* Governance (hereafter referred to as SG) system of IBs ensures the achievement of full *Sharī'ah* requirements. SG validates that IFIs incorporate the requirements of *Sharī'ah* into their financial operations and activities, including their products and services.

The Global Financial Crisis (GFC) of 2008 has brought attention to the vulnerability of conventional banks (Parashar and Venkatesh, 2010), which has led to the emergence of the Islamic banking system as a viable alternative that emphasizes transparency and avoids undue risks (Hamdan, 2009; Willison, 2009). Parashar and Venkatesh (2010) state that IBs are viewed as safer than CBs because their product structure is essentially asset-backed financing. Mirakhor (2008) asserts that Islamic finance is resilient to shocks because of its inherent stability. Also, banking and finance without *riba* and *maysir* is a better alternative to the mainstream banking system

(Siddiqi, 2008). Iqbal and Llewellyn (2002) emphasize that IBs are characterized by diversified financial products and operations distinguished by distinct risk-sharing features for each type of contract. Notably, some studies concluded the stability and better performance of IBs than the CBs amid the GFC (see, e.g., Hasan and Dridi, 2010; Al-Hares et al., 2013; Kolsi and Zehri, 2014; Farooq and Zaheer, 2015).

Therefore, to observe all these unique qualities In IBs, the *Sharī'ah* Supervisory Board (SSB) is required to advice and supervise Islamic bank activities to ensure that all operations are *Sharī'ah*-compliant (Safieddine, 2009; Kettell, 2011; Nomran and Haron, 2019; Aslam and Haron, 2021). Notably, the scope of CG in IFIs is more comprehensive than that of conventional CG, which operates not only in the interest of shareholders and management but also in the interest of the people having direct or indirect stakes (Hasan, 2008; Sulaiman et al., 2015; Obid and Naysary, 2016; Khan and Zahid, 2020). Figure 1.1<sup>4</sup> presents the various stakeholders of IBs where the IFI has fiduciary duties to them. The involvement of other stakeholders is derived from their ability to influence the firm (Mohammed and Muhammed, 2017a). Although the concept of allowing entities that have stakes in an organisation to participate in the organisation's current and future activities is currently practiced widely and is even increasingly applied in countries like Germany, Sweden, and Japan (Mohammed and Muhammed, 2017a), stakeholders unique to IBs are the SSB and various account holders.

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<sup>4</sup> Adapted from (Beekun and Badawi, 2005; Greuning and Iqbal, 2008; Khandelwal, 2009).

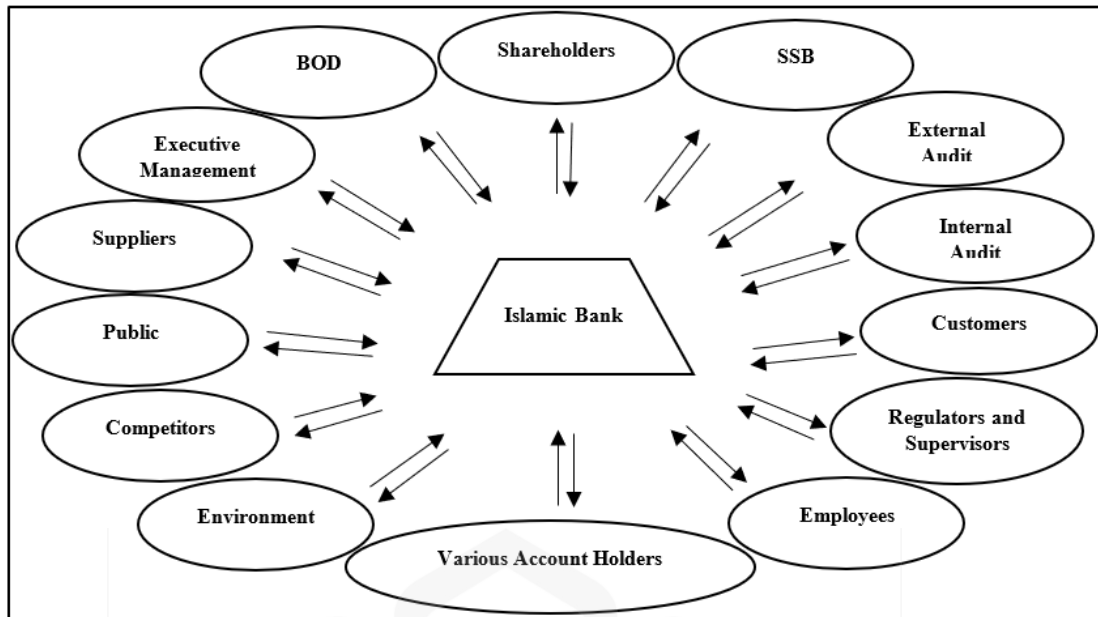


Figure 1.1 Stakeholders of IBs

Bhatti and Bhatti (2009) indicate that while the mainstream CG is based on self-interest, SG's ultimate purpose is to achieve *Maqasid al-Sharī'ah* (Objectives of Islamic law). *Maqasid al-Sharī'ah* is described as a tool to preserve and protect the benefits and interests of society, and *Maqasid al-Sharī'ah* facilitates the needs of human beings and ascertains the circulation of wealth in a fair way (Obid and Naysary, 2016; Nouman et al., 2020). Along these lines, *Maqasid al Sharī'ah* (especially the objective of wealth or *Mal* preservation) necessitates that IBs, aside from maximization of profit, consider society members' justice and welfare (Chapra, 2000). Thus, the SG of IBs guarantees *Sharī'ah*-compliance in financial activities, management, products, instruments, practices, and operations (Hamza, 2013). Moreover, SG is an essential indicator of the health of IFIs, and appropriate controls will maintain consumer and investor confidence in the industry (Thomson Reuters, 2018).

Undoubtedly, CG is the most crucial aspect of corporate development, and it is an even more significant challenge for IBs due to the additional risks compared with conventional banking settings (Hasan, 2009). For instance, IBs face *Sharī'ah* non-

compliance risk<sup>5</sup>, which can damage stakeholders' confidence, consequently disrupting the stability of the IBs (Chapra and Ahmed, 2002; Haqqi, 2014; Ali and Hassan, 2019). Another challenge facing IBs that necessitates good CG revolves around investment accounts<sup>6</sup>. Investment Account Holders (IAHs) lack voting rights and are not allowed to intervene in the management of the funds. Moreover, IAHs have no representatives on the board to influence management decisions and have less information about the bank's overall operations (Magalhaes and Al-Saad, 2013). Therefore, it is indispensable to have good governance and due diligence in place to ensure the interests of IAHs (Adznan, 2018).

As mentioned earlier, IBs, unlike CBs, are governed by dual governance layers consisting of regular BOD and SSB. Shareholders appoint the BOD and the SSB to monitor management (Nomran and Haron, 2019). Figure 1.2<sup>7</sup> explains the CG framework of IBs and the interaction between the banks' various actors (BOD, SSB, management) and shareholders. From the figure, Abdelsalam et al. (2016) assert that while BOD is responsible for legal monitoring, SSB is responsible for moral monitoring. They stress that SSBs play an important role in mitigating agency problems by offering an additional monitoring mechanism. SSB acts as a key internal control mechanism (Haniffa and Hudaib, 2007) that raises the stability of and, thus, the profitability of IBs (Ajili and Bouri, 2018a). SSBs in IBs add great value to these banks as a CG mechanism by overseeing managerial behaviour and mitigating the likelihood of unethical practices (Quttainah and Almutairi, 2017).

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<sup>5</sup> *Sharī'ah* non-compliance risk refers to the risk that arises from an IFI's failure to comply with *Sharī'ah* rules and principles and is a sub-set of operational risks and may in certain circumstances lead to legal, financial, or reputational risks (AAOIFI, 2018).

<sup>6</sup> Investment accounts are profit-sharing and loss-bearing investment accounts between an investor and an Islamic bank. IBs offer investment accounts to their customers either based on a profit-sharing arrangement (*mudarabah*), profit and loss-sharing partnership (*musharakah*), or on the basis of an agency contract (*wakalah*) (Adznan, 2018).

<sup>7</sup> Adapted from (Abdelsalam et al., 2016).

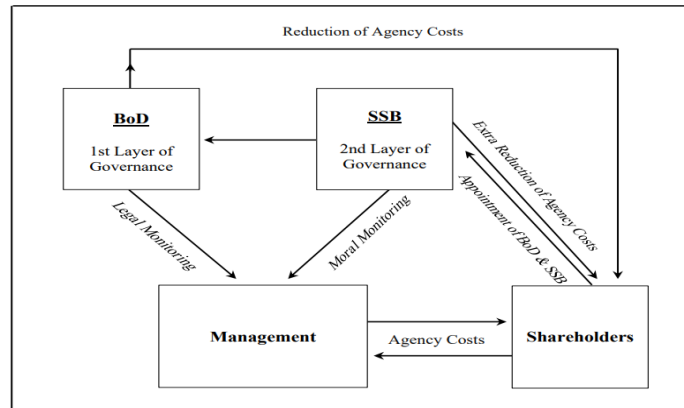


Figure 1.2 Corporate Governance Structure for IBs

The members of SSB, usually consisting of scholars with exceptional skills in Islamic jurisprudence (*uṣūl al-fiqh*), Islamic law of transactions (*fiqh al-mu'amalat*), have fiduciary responsibilities to advise IFIs in matters relating to *Sharī'ah*-compliance in all aspects of operations (Hasan, 2007). More specifically, SSBs are assigned to direct, review, and advise management to ensure that the activities of IBs are confirmatory with *Sharī'ah* rules and principles (Isa and Lee, 2020). Essentially, SSBs are responsible for safeguarding SG, a system conducted to ensure that the activities of IBs are *Sharī'ah*-compliant (Grassa, 2013a).

A sound and effective SSB ensures stakeholders are dealing with and transacting according to *Sharī'ah* guidelines. Thus, SSBs, with functions including *Sharī'ah* review, *Sharī'ah* audit, and enhancing transparency and disclosure, are fundamental for IBs. Although the SG is of utmost importance to IFIs and since it is part of these institutions' CG, empirical studies assessing the impact of CG on the performance of IBs are still limited (Mollah and Zaman, 2015; Aslam and Haron, 2020), suggesting a need for more empirical work. It is worth mentioning that the SG debate on IFIs is still in its early stages and requires much emphasis and further examination.

The general view of CG, including SG, is that it influences and determines firms' performance and safeguards stakeholders' interests. It is found that well-governed firms significantly outperform poorly governed firms (Bauer et al., 2008; Bistrova et al., 2014; Aman et al., 2019). As mentioned earlier, an IFI must guarantee

compliance with the *Shari'ah* rules and principles in every aspect of their businesses and facilitate effective monitoring. Thus, the way IBs perform may be influenced by SSB because of their role as an additional supervisory body of governance besides the BOD.

The interest in SG, especially the role of SSB in IBs' performance research, has been appraised immensely in recent decades. Empirical evidence such as (Mollah and Zaman, 2015; Almutairi and Quttainah, 2017; Nomran et al., 2017; Farag et al., 2018; Nomran et al., 2018; Buallay, 2019; Nomran and Haron, 2019; Nomran and Haron, 2020a; Baklouti, 2022) confirms a positive relationship between some SSB characteristics and IBs performance, and due to their significance to the IBs, the effect of SSB features on IBs' performance is considered in this study.

On the other hand, as shown in Figures 1.1 and 1.2, shareholders are, besides the BOD and SSB, another important body in IBs. Shareholders appoint the dual governance board of IBs to monitor management (Nomran and Haron, 2019). Therefore, it is evident that ownership structure will immensely influence the corporate and *Shari'ah* governance of IBs. The association between ownership structure and firm performance has been an important and ongoing discussion in corporate governance literature (Demsetz and Villalonga, 2001; Iannotta et al., 2007; Ongore, 2011; Aguilera et al., 2012; Arslan, 2021). The ownership structure can reflect on firm performance levels (Ting et al., 2016; Asadi and Pahlevan, 2016; Al-Janadi, 2021). For instance, managerial share-ownership may mitigate managerial incentives of exploiting firm resources, expropriate the shareholder's wealth, and thus may align their interests with that of the shareholders to lower agency costs and increase firm value (Jensen and Meckling, 1976).

Moreover, the blockholder ownership (i.e., the largest shareholder) has the resources, incentives, and means to influence CG (Jensen, 1993). Some researchers contend that block holder's motivations and capacity to monitor managers mitigate agency problems associated with dispersed ownership (i.e., many small shareholders)

(e.g., Davis et al., 1997; Anderson and Reeb, 2003). In terms of institutional ownership<sup>8</sup>, many researchers assert that they are constructive and active corporate monitors because they usually own larger blocks than individual investors and have an incentive to develop specialized expertise in making and monitoring investments (Bainbridge, 2005; Cao and Donnelly, 2010; Al-Janadi, 2021).

Indeed, there has been debate about institutional shareholders' role as effective monitors of firm governance (Jensen, 1993). As mentioned earlier, due to the separation of ownership and control (except for managerial ownership), a conflict of interest emerges between the managers who administer a company and its shareholders because of their divergent goals (Jensen and Meckling, 1976; Fama and Jensen, 1983). These agency conflicts can be mitigated through monitoring (Andres, 2008; Saltaji, 2013). An increasingly crucial internal mechanism influencing governance worldwide is institutional shareholders' emergence as equity owners in most countries (Gillan and Starks, 2003; Solomon, 2007; Bebchuk et al., 2017).

Institutional shareholders possess considerable influence over the firms they hold shares in owing to their sizable ownership (Maug, 1998; Gallagher et al., 2007; Schnatterly and Jennings, 2008; Kustono et al., 2021). Moreover, such investors are often regarded as "sophisticated investors" more than retail (individual) investors because of their professional knowledge in acquiring and processing financial information and industry and investment experience (see, e.g., Hand, 1990; Hribar et al., 2004; Menkhoff et al., 2010; Kang et al., 2018). Consequently, numerous studies in the literature characterize institutional shareholders as effective corporate monitors. Shleifer and Vishny (1986) and Shleifer and Vishny (1997) assert that institutional shareholders, because of their significant shareholding, have the incentive to gather information and monitor managerial actions due to the greater benefits they reap than smaller shareholders from monitoring the firm.

Moreover, Kang et al. (2018) outline that information advantages and governance experience obtained from multiple blockholding are important channels

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<sup>8</sup> Institutional owners/shareholders/investors are shareholder groups or institutions (e.g., banks, public and private pension funds, mutual funds, insurance companies, endowment funds, sovereign wealth funds, etc.).

through which institutional shareholders perform effective monitoring. The authors highlight that such shareholders facilitate effective monitoring and increase firm value thanks to their large ownership, industry expertise/knowledge, and past activism/governance experience accumulated from their portfolio holdings. Therefore, it is expected that with their large equity holdings, access to superior resources, and the power inherent in voting rights, institutional owners would be able to have a significant impact on CG (David and Kochhar, 1996). Notably, previous research has shown that institutional shareholders' presence improves firm performance (see, e.g., Cornett et al., 2007; Yuan et al., 2008; Elyasiani and Jia, 2010; Khamis et al., 2015a; Khamis et al., 2015b; Rashid, 2020).

Hence, a question arises as to whether and how institutional shareholding influences the role of SSB in assuring sound and effective SG in IBs. Although very few studies investigated the influence of ownership structure (e.g., Zouari and Taktak, 2014; Bourkhis and Omri, 2016), including institutional ownership (Zouari and Taktak, 2014; Djeutcheu, 2019; Alsartawi, 2019), on the performance of IBs, no previous research assessed how institutional owners could influence and moderate the relationship between SSBs and IBs' performance. Therefore, this study aims to fill this gap.

To sum up, this study attempts to assess the impact of SSB characteristics on performance in a sample of IBs scattered in the Gulf Cooperation Council (GCC) and Southeast Asia (SEA) countries. Crucially, the current study contributes to understanding the role of SSB in IBs' performance and complements the existing literature. Moreover, the moderating effect of institutional shareholding on the relationship between SSB and IBs' performance is also explored in this research. As argued above, a common assertion is that given their professional knowledge and experience (also called sophistication), institutional investors typically observe and explore the operations involved with their investee firms, which may significantly influence their corporate management and, subsequently, performance.

## 1.2 PROBLEM STATEMENT

Banks are vastly crucial to the financial system and economy of any country. Banks channel funds and act as intermediaries between borrowers and lenders, provide capital for business entrepreneurship, provide services such as foreign exchange transactions, financing projects, lending loans, and contribute to societies' economic well-being. Hence, any disruption in the banking functions can have an adverse effect on both the individual and the national levels. The importance of the banking sector was particularly highlighted by the 2008-2009 contagious GFC that had shaken world economies' stability and dislocated financial markets' confidence. Thus, good CG enhances the stability of the financial system and contributes to the community's welfare.

While Conventional Banks (CBs) embrace a single-layer governance framework, IBs have an extra layer of governance in the form of SSB that thoroughly guides IBs towards *Sharī'ah*-compliant practices (Graiss and Pellegrini, 2006a; Mollah and Zaman, 2015; Nomran and Haron, 2020a). This multi-layer of governance ensures that IBs are not involved with interest and speculation in their lending and investment activities, which may influence performance (Nawaz et al., 2020). IBs also, besides regular risks, bear more risks than CBs, including *Sharī'ah* non-compliance risk because of the need for conformity to *Sharī'ah* principles (Rahman and Bukair, 2013; Ahmed and Khatun, 2013; Hasan et al., 2020). AAOIFI (2018) notes that *Sharī'ah* non-compliance risk is a part of operational risks and may, in certain circumstances, lead to legal, financial, or reputational risks.

Indeed, IBs are typically faced with *Sharī'ah*-compliance challenges due to the various and complex Islamic banking products and services that necessitate well informed *Sharī'ah* scholars and efficient SSBs. A direct consequence of non-compliance can be fund withdrawals and the nullification of investment contracts, which can cause a downturn in performance and profits and increase the risk of IBs (Hamza, 2013; Basiruddin and Ahmed, 2019). Such outcomes can damage the reputation of IBs and reduce the confidence of depositors, investors, customers, and other stakeholders, which, in turn, affect their performance (Nawaz et al., 2020). Higher costs, financial losses, liquidity difficulties, bank runs, bank failure, industry smearing, and financial instability are other possible consequences of *Sharī'ah* non-compliance

(Ginena, 2014). Furthermore, additional risks are linked with IBs, which are moderately related to profit-sharing investment accounts (Alexakis and Tsikouras, 2009).

Therefore, non-compliance with *Sharī'ah* can bring reputational risk and harm the industry's stability as a whole (Ali and Hassan, 2019; Nomran and Haron, 2020a). In this regard, to lessen these risks, IBs should have a SSB governance layer besides the regular BODs to ascertain that the stated principles and enhanced performance are achieved. It is asserted that SSB characteristics could influence the performance of IBs. Since SSB decides which product is *Sharī'ah*-compliant and which is not, the nature of their decision may affect the acceptance of one banking product over another, and thus, may increase or decrease the volume of their businesses (Mohammed and Muhammed, 2017a). The funds and deposits of IBs are invested with SSB's consent, and in the case of *Sharī'ah* non-compliance occurrence of any transaction, the returns of such transactions are declared as void and credited to the charity accounts of the banks, not to their Profit and Loss sharing Accounts (Ayub et al., 2019). As this *Sharī'ah* non-compliant income is excluded from the bank's books, it results in net losses on these transactions for the Islamic bank (Basiruddin and Ahmed, 2019).

Ullah and Khanam (2018) also indicate that since the SSB oversees the banks' investments, the IB cannot invest beyond the SSB-approved investments regardless of whether they can earn a higher return rate. Besides, IBs cannot launch new products without prior approval and validation from the SSB (Iqbal et al., 1998; Ahmed, 2014; Haridan et al., 2018). Thus, there is no suspicion that SSB could affect the bank's performance by mandating the non-permissibility of a specific transaction, service, or product if the board deemed it as such.

Moreover, SSB could greatly influence how IBs perform through their supervision and continuous inspection of the bank's activities. Mollah and Zaman (2015) and Nomran and Haron (2020a) outline that because of SSB's role in the IBs decisions, products are likely to be *Sharī'ah*-compliant and less risky, it improves the adverse effects of excessive risk-taking, therefore enhancing the performance of IBs. Hence, effective SSBs are essential and of great importance to the performance of IBs and to the various stakeholders who rely on them for *Sharī'ah*-compliance assurance.

Nomran and Haron (2020b) critically reviewed the existing literature on the relationship between SSB characteristics and the performance of IBs, and they identified research gaps and have implicated future studies to carry out further examinations on the relationship between SSB characteristics and the performance of IBs. The authors identified some gaps in the SG area of research, including how SSB independence, along with SSB remuneration, can affect the performance of IBs (Nomran and Haron, 2020b).

The influence of BOD independence, remuneration, and busyness has been investigated in much research; however, less attention has been given to SSB independence, remuneration, and busyness. Therefore, this study mainly endeavours to examine, besides the other existing SSB characteristics in the previous literature, the effect of SSB independence, remuneration, and busyness on IBs' performance. It also assesses the moderating effect of SG models (i.e., *Shari'ah* supervision models) on the relationship between SSB effectiveness and the performance of IBs. Furthermore, the present study assesses whether effective SSBs influence the performance of IBs differently in crisis periods. Lastly, the moderating effect of institutional shareholding on the relationship between SSB effectiveness and IBs' performance is also examined.

First, the independence of corporate boards is one of the significant aspects of CG. Fama and Jensen (1983) outline that directors in corporate boards act as an essential mechanism in reducing agency conflicts and safeguarding shareholders' interests. Nevertheless, their degree of monitoring relies on the extent to which they are independent of any inside influence and can ratify management decisions. Accordingly, independent directors improve and enhance firm performance by offering monitoring functions without bias and guiding their expertise to the firm's and shareholder's interests (Fama and Jensen, 1983). Therefore, highly independent BODs are believed to have a greater monitoring power (Grose et al., 2021).

Similarly, SSB independence is perhaps the most important attribute influencing SG and SSB efficiency. SSBs must be highly independent to carry out their responsibilities and duties in an independent manner. Because of the various stakeholders associated with the IBs, such as IAHs, depositors, community, regulators, shareholders, and other stakeholders, Grassa and Matoussi (2014a), Gebba and

Aboelmaged (2016), and Karbhari et al. (2020) outline that the governance system of IBs should be different from their conventional counterpart banks. Ensuring SSB independence in performing their fiduciary obligations is expected to discharge such duties effectively and freely (Sori et al., 2015; Abidin et al., 2021).

Because sometimes IFI's management observes issues from a profit and business perspective, independent SSBs must exist because they can raise any issues or matters regarding IFIs' policies and operations with confidence without the fear of dismissal, thus ensuring SSB members' independence in performing their obligations is expected for them to present objective and informed decisions without any 'fear' or 'favour' and influence from the management (Sori et al., 2015). Garas and Pierce (2010) and Kasim et al. (2013) state that SSB's independence in IBs is essential to foster stakeholders' confidence in compliance with *Sharī'ah* rules and principles. Therefore, the major standard-setting for IFIs such as (AAOIFI, IFSB, and Bank Negara Malaysia (BNM)) express that SSBs should be acknowledged as independent, especially from the management, whereby they have the freedom in exercising their duties to make suitable and independent decisions (IFSB, 2009; BNM, 2010; AAOIFI, 2015).

In this manner, AAOIFI's Governance Standard No. 1 affirms that shareholders have the mandate to appoint the SSB members during the annual general meeting. This ensures their independence from management, as managers do not have the authority to appoint or dismiss them (see, AAOIFI, 2015). In addition, Alsartawi (2019) reports that the SSB is not only independent from the BOD, but the SSB can also attend the meetings of the BOD to scrutinise the religious aspects of their decisions. Notably, a lack of SSB independence can have severe consequences on the performance of IBs. Due to a lack of independence, the managers of IBs may pressure the SSB to certify and legitimate certain investments, services, and prior decisions to meet their earnings target (Alam and Miah, 2021), increasing *Sharī'ah* non-compliance risk. The inferiority of SSB independence can result in poor governance that might affect firms' performance and profitability, the possibility of market failure, and tarnishing the image of IBs (Alam and Miah, 2021); therefore, the importance of independent SSBs.

Alsartawi (2019) outlined that the separation between SSB and management may restrain managers from undertaking self-centric activities that solely benefit them

and cause shareholders to bear the costs of their actions. Therefore, an independent SSB mitigates the agency problem, lessens financing costs, and enhances the performance of IBs (Alsartawi, 2019). Alsartawi (2019) is the only study that assessed the impact of SSB independence and the performance of IBs in the GCC. The study found that a negative relationship between SSB's independence and performance. The study prescribes this result because *Sharī'ah* scholars in the GCC region have an advising role rather than a supervisory role, letting managers supersede their decisions.

Hence, it is evident that this result cannot be generalised to IBs outside of GCC, such as IBs in SEA region, Africa, and other parts of the world. Moreover, Nomran and Haron (2020b) argue that the SSB independence measurement used in this study is not enough to measure SSB independence. Therefore, this study uses a different measure to capture SSB independence. Moreover, the current study aims to include other IBs in different regions and extended study periods.

Second, the influence of the remuneration of SSBs on the performance of IBs is also examined in this research. The remuneration of corporate boards has been one of the most debated CG literature issues. Remuneration has been perceived as a partial remedy to the agency problem (Bebchuk and Fried, 2003). Fama and Jensen (1983) argue that incentives offered to executives tend to mitigate agency problems and improve firm performance. According to agency theory, compensation contracts aim to reward agents for maximizing the firm's performance and shareholder's wealth (Doucouliagos et al., 2007).

It was found that directors' remuneration positively influences firm performance (see, e.g., Conyon and Peck, 1998; Merhebi et al., 2006; Lee and Isa, 2015; Lemma et al., 2020). However, this debate does not seem to be well extended to the SSBs in Islamic banking settings. SSBs are an integral part of IFIs, and their members are eligible to be appropriately remunerated for their work (Al Qari, 2002; Muhammad et al., 2021). Bakr (2001) and Nashmi (2002) recommend that shareholders approve the remuneration based on the BOD suggestions. The study of Nomran and Haron (2020b) recommends future studies to carry out further research on how SSB remuneration could affect the performance of IBs. To the best of the researcher's knowledge, only one study (i.e., Haron et al., 2021a) investigated the impact of SSB remuneration on the

performance of IBs in Malaysia. However, this study is limited to Malaysia, and further research is required. Therefore, this research will consider addressing such a gap.

Third, the effect of SSB busyness on the performance of IBs is examined in this research. Cross-memberships or multiple directorships of directors have been one of the most discussed topics in the CG literature and have been analysed from two different points of view. It has long been contended that directors serving multiple boards (i.e., busy directors) across many firms have networking and reputational advantages contributing to corporate performance and risk control (Jiraporn et al., 2009; Brennan et al., 2016). Directors with multiple appointments can bring external resources to the firm, allowing them to acquire new skills, education, and experiences obtained from these different appointments (Hundal, 2017). However, Directors who are 'over-boarded' may not be able to fulfil their monitoring roles effectively, having limited time to closely inspect a bank's operations and strategic decisions (Trinh et al., 2020). The disadvantage of board busyness may be severe for large and complex financial firms (Kress, 2018). Falato et al. (2014) find busyness is detrimental to the effectiveness of board monitoring and thus reduces firm performance and shareholder value.

Similarly, *Shari'ah* scholars serving multiple SSBs have been scrutinised from two perspectives. First, reputable SSB members that serve on the SSB of IFIs may be perceived as beneficial as they bring resources, networks, and experience, and are exposed to more *Shari'ah* discussions on IBs' practices, therefore increasing their expertise in *Shari'ah* compliance assurance. On the contrary, however, busy SSBs may lack the necessary time and commitment to fulfil their duties effectively, which could adversely affect the bank and put stakeholders' interests at risk (Razak, 2020a). The role of the SSB surpasses that of a principal supervisor of an Islamic bank's activities, as various stakeholders such as IAHs rely on the SSB to ensure their interests are safeguarded. Therefore, it is undeniably crucial that SSBs have the time and effort to serve IBs' needs to conform to *Shari'ah* guidelines.

Although BOD busyness has been studied widely in the CG debate in conventional board rooms, SSB busyness has rarely been explored. To the best of the researcher's knowledge, only one study (i.e., Trinh et al., 2020) has examined the link between SSB busyness and the performance of IBs. Nonetheless, the study has several

limitations. First, the authors used only the traditional performance measurement (i.e., ROE and operational efficiency) to study the relationship. Second, their study period is only five years (i.e., 2010-2015). Thus, this study fills the gap by employing different performance measurements (i.e., accounting and social), adding more SSB variables, and extending the study period.

Fourth, the influence of the overall effect of SSB is examined in this research. Most previous studies employed individual SSB characteristics to estimate their effect on bank performance, while very few studies employed a composite measurement to capture the overall impact of the SSB. Many researchers contend that using only one governance indicator may not reflect the total effect of CG (see, e.g., Brown et al., 2011). According to Srinidhi et al. (2014), employing a composite measure for governance mechanisms can reduce errors caused by using a single structural measurement. Therefore, it is rational to investigate them to capture the overall effect of CG attributes. To address this issue in the context of SSBs, several studies, including Abdullah et al. (2014), Ajili and Bouri (2018a), Ajili and Bouri (2018b), Farook and Lanis (2007), Farook et al. (2011), Rahman and Bukair (2013), and Nomran and Haron (2019).

Abdullah et al. (2014) measured the SSB score by combining three SSB characteristics (size, expertise, and cross-memberships). Mollah and Zaman (2015) and Farag et al. (2018) used the SSB size to capture the SSB effectiveness, and Musibah and Alfattani (2014) used the educational level. Ajili and Bouri (2018a) and Ajili and Bouri (2018b) employed a SSB score consisting of three SSB attributes (size, education level, and expertise) besides the existence of SSB. However, these studies suffer from limitations by either using a single proxy or triad characteristics, neglecting other important factors. Notably, in contrast to these studies, Farook and Lanis (2007) and Farook et al. (2011) employ a more inclusive SSB score consisting of five important characteristics, namely SSB existence, size, cross-membership, doctoral qualification, and reputation, while Rahman and Bukair (2013) replaced the existences of SSB by the expertise of SSB. Similar to Rahman and Bukair (2013), Nomran and Haron (2019) recently used a SSB score consisting of important SSB characteristics, namely size, cross-membership, educational qualification, reputation, and financial expertise.

To complement these studies, the current study adds one additional SSB variable (i.e., meetings) to construct a SSB score to capture SSB effectiveness. Specifically, this study extends the SSB score used by Rahman and Bukair (2013) and Nomran and Haron (2019), which sums the value of five dichotomous SSB characteristics (i.e., size, cross-memberships, doctoral qualification, reputation, and financial expertise) by adding a sixth variable (i.e., SSB meetings) onto the construction of the SSB score.

There are several reasons for adding SSB meetings to the SSB score employed by Rahman and Bukair (2013) and Nomran and Haron (2019). It has been argued that the intensity of board activities is measured by the frequency of their meetings and the quality or effectiveness of its monitoring (see, e.g., Conger et al., 1998; Vafeas, 1999). Board meetings are a component of the board process and are regarded as a sign of the board's diligence (Carcello et al., 2002). Moreover, a higher frequency of board meetings can lead to a higher quality of managerial monitoring, thereby positively influencing firm performance (Vafeas, 1999; Ntim, 2009). Similarly, the extent to which the SSB effectively performs their duties and tasks can depend on the number of meetings they convene. Hence, this study argues that a higher number of meetings by SSBs contributes to their effectiveness, which can lead to improved managerial monitoring and, consequently, enhanced performance of IBs. Hence, besides examining the effect of SSB score on the performance of IBs, the current study also tests the effect of individual SSB score characteristics on the said relationship to compare the differences of using individual versus composite measurement. As argued above, CG characteristics can be complementary. Likewise, utilising a SSB composite score may allow SSB characteristics to complement each other and, hence, may have a different influence on the performance of IBs compared to the influence of individual SSB characteristics. That being said, this study investigates the effect of SSB score to capture the overall effectiveness and its individual characteristics on the performance of IBs.

Fifth, since the 2008 financial crisis has been and remains the center of the CG debate, it would be rational to examine different periods, such as crisis and non-crisis. Although problems in subprime mortgage markets initiated the GFC, many researchers contend that inadequacies in the wider corporate sector were a possible cause of the crisis. More recently, the global COVID-19 pandemic crisis that emerged in December 2019 has adversely affected world financial systems and economies. Therefore, this

study considers the effect of SSBs on IBs' performance in crises (i.e., the 2008 GFC and the COVID-19 Pandemic) and non-crisis periods. To the best of the researcher's knowledge, only two studies (i.e., Mollah and Zaman, 2015; Wahyuni and Aidah, 2022) considered the influence of effective SSBs in crisis and non-crisis periods. The former study considered the impact of SSB on performance in the 2008 GFC, while the latter considered the effect of SSB on the recent COVID-19 pandemic crisis. However, these studies have various limitations. First, they used only one SSB characteristic (i.e., SSB size) to assess the influence of SSB on the performance of IBs in crisis and non-crisis periods. Second, they use the conventional performance measurements. Therefore, this study differs by using an overall SSB score comprising six important attributes and employing Islamic social performance measurement (i.e., Zakat payments).

Chapra (2008) and Siddiqi (2008) argue that non-interest banks exercised more market discipline and were not entirely destabilized during the GFC shock. In addition, the findings of Hasan and Dridi (2010) and Bourkhis and Nabi (2013) suggest that the business models of IBs supported mitigating the impact of the crisis on their profitability. However, it is vital to examine how the SSB affects the performance of IBs amid a crisis. The role of SSB means that the products of IBs are likely to be less risky because of *Shari'ah*-compliance (Mollah and Zaman, 2015); therefore, SSB may be helpful to IBs to maintain their performance in a crisis period. Studying the impact of SG as represented by the SSB on the performance of IBs in a crisis (e.g., GFC and Covid-19 pandemic crisis) and non-crisis period would help IBs adopt an appropriate SSB structure that will enhance their performance (Nomran and Haron, 2020b). Therefore, this study examines the effect of SSB's effectiveness on the performance of IBs in crisis (GFC and COVID-19) and non-crisis periods.

Sixth, apart from these SSB characteristics, this study also aims to look at the differences between SG models across jurisdictions that operate under the Centralised SG Model (CSGM) and Decentralised SG Model (DSGM). Previous literature has commonly classified *Shari'ah* governance/supervision into CSGM and DSGM (see, e.g., Grais and Pellegrini, 2006a; Grais and Pellegrini, 2006b; Alman, 2012; Hamza, 2013; Alam, 2021). For example, the CSGM found in Malaysia, Indonesia, Oman, Sudan, and Pakistan represents SG at both the bank and national levels, where each IB establishes its own SSB besides having a national SSB at the central authorities' level

(Grassa, 2015a; Hakimi et al., 2018). In contrast, the DSGM suggests that SG is at the Islamic bank-level and is found in countries such as Saudi Arabia, Qatar, Jordan, and Yemen. Under the latter model, the SSB at the IB level has the authority to decide the permissibility of contracts and *Sharī'ah*-compliance of products, while under the CSGM, there is as well a central *Sharī'ah* supervisory, and IBs must comply with the rules set by the central authority (Hamza, 2013; Kantakji et al., 2018).

Thus, the influence of SSB on IBs could vary between jurisdictions following either the CSGM or DSGM. Each model is said to have advantages and disadvantages. The CSGM allows the harmonization of *Sharī'ah* rulings (*fatwas*) and strengthens the credibility of IBs (Hamza, 2013). According to the author, the diversity of *fatwas* among the *Sharī'ah* scholars may prevent harmonizing products and financial procedures, which could be a significant challenge and is found under the DSGM. In this manner, CSGM provides more standardisation and uniformity and enhances SSB independence by terminating potential conflicts of interest between SSB and the management of IBs (Grais and Pellegrini, 2006a; Grais and Pellegrini, 2006b). On the other hand, some researchers believe that the DSGM is better than the CSGM because it provides the opportunity for innovation (see, e.g., Grais and Pellegrini, 2006a; Alman, 2012). In addition, Quttainah et al. (2013) assert that the waiting time until IBs receive a *fatwa* from a central *Sharī'ah* authority may result in a loss of opportunity for the banks and negatively influence their performance; hence, in this context, DSGM may be better than the CSGM.

Despite this, there is a scarcity of empirical studies assessing how the differences in SG models could affect the relationship between SSB effectiveness and the performance of IBs. However, a few studies, such as Mezzi (2018), Alam et al. (2019), and Nomran and Haron (2020c), have examined the relationship between SG models and the performance and efficiency of IBs. Using dummy variables, Mezzi (2018) documents a positive and significant association between CSGM and the efficiency of IBs, while Alam et al. (2019) found the same result between CSGM and the performance of IBs. Moreover, the findings of the descriptive analysis study of Nomran and Haron (2020c) demonstrate that, on average, IBs operating under the CSGM showed higher financial performance. The current study differs from these studies. First, unlike Mezzi (2018) and Alam et al. (2019), the current study divided the

sample IBs into two sub-samples consisting of those who adopt the CSGM versus those who adopt the DSGM to compare the effect of SSB effectiveness on the performance of IBs adopting the CSGM versus the DSGM. Second, although Nomran and Haron (2020c) divided IBs into two groups based on which SG models they adopt, the authors only compared the financial performance of countries that adhere to the CSGM versus those that embrace the DSGM. Therefore, this study compares the financial performance of the two sub-samples and considers the effect of SSB effectiveness. Lastly, the current study includes different performance indicators and extended study periods, thus contributing further to the impact of SG models on SSB effectiveness and performance of IBs.

Seventh, this research will also examine the moderating effect of institutional shareholding on the relationship between SG represented by the SSB and IBs' performance. No previous study has investigated the influence of institutional shareholding on the CG of IBs. The agency theory suggests that the separation of ownership and control roles leads to agency problems between managers and shareholders because of their distinct goals (Jensen and Meckling, 1976). Since shareholders ultimately bear the costs of agency problems and managers' operations inefficiencies, it is a vital issue for shareholders and ways to mitigate it (Nagel et al., 2015).

In this regard, Pound (1988) contends that institutional shareholders with large shareholding have the professional knowledge and mechanisms to monitor managers and are better positioned to reduce costs. Moreover, institutional shareholders are often regarded as "sophisticated investors" more than individual investors because of their professional knowledge in acquiring and processing financial information and industry and investment experience (see, e.g., Hand, 1990; Hribar et al., 2004; Menkhoff et al., 2010; Kang et al., 2018). Hence, combining large block holding with sophistication may imply that institutional shareholders are better positioned to monitor corporate management, reducing agency problems, and enhancing performance.

Institutional shareholders are documented to serve an effective role as corporate monitors (see, e.g., Hartzell and Starks, 2003; Almazan et al., 2005; Fich et al., 2015; Sakawa and Watanabel, 2020). Institutional shareholders have considerable influence

over the firms they hold shares in due to their large ownership (Maug, 1998; Gallagher et al., 2007; Schnatterly and Jennings, 2008; Kustono et al., 2021). Such shareholders can provide active monitoring that is difficult for smaller, more passive, or less-informed investors (Black, 1991; Kahn and Winton, 1998; Noe, 2002; Cremers and Nair, 2005). Because of such institutional shareholders' strong incentives and fiduciary responsibilities, they usually obtain and gather company information for investment purposes (El-Gazzar, 1998), allowing them to access private pieces of information not readily available to individual investors (Michaely and Shaw, 1994). Furthermore, it has been argued that the shareholders with a larger stake of investments in the firm have stronger motivation to handle monitoring and other costly activities (Shleifer and Vishny, 1986; Gillan and Starks, 2000). Institutional shareholders are entitled to voting rights at the annual general meeting, and as such, they can engage in CG actively (Mizuno, 2014).

Regarding IBs, institutional shareholders can play an active monitoring role. As mentioned earlier, institutional shareholders usually own larger blocks and are considered sophisticated investors; hence, they can provide constructive monitoring, reduce potential opportunistic behaviours, and help minimize agency costs. Notably, IBs have another type of agency problem because of the nature of their business. In addition to the agency problems that ordinarily take place in conventional banks when managers seek to maximize their interests as opposed to shareholders' wealth, IBs are also likely to face another type of agency problem in case managers deviate from their duty to ensure that all funds are invested in *Shari'ah*-compliant assets (Zainuldin et al., 2018).

Garas (2012) highlights that SSB members are appointed by the shareholders or after the BOD recommends to the shareholders, directly by the BOD, or by the management. The management proposes their remuneration and is approved by the BOD (Grais and Pellegrini, 2006a). Thus, the SSB may not be fully independent, raising issues such as deviation from *Shari'ah*-compliance or a conflict of interest between the SSB and management. In addition, another conflict may arise between SSB and BOD due to the subordination of the SSB's role in IBs. Razak (2018) states that due to the lack of SSB independence and the absence of strong legislation in some countries, the BOD may refuse the decisions made by SSB deemed as counter-productive to the

bank's profit-oriented objectives, and in some cases, BOD may alter SSB decisions to accommodate its interests. This may not be a surprise because, in some jurisdictions, the BOD appoints the SSB (Razak, 2018).

Another issue found in IBs is the concept of "*fatwa shopping*," which is a concept of managers searching for flexible and lenient opinions from SSB members (Oseni, 2017). Moreover, due to a lack of independence, the managers of IBs may pressure the SSB to certify and legitimate certain investments, services, and prior decisions to meet their earnings target (Alam and Miah, 2021). These issues, in turn, increase *Sharī'ah* non-compliance risk, which is a part of operational risks that can lead to legal, financial, and reputation risks (AAOIFI, 2018). Unlike CBs, *Sharī'ah* non-compliance can negatively influence the performance of IBs, increase their risk, and even endanger their existence. *Sharī'ah* non-compliance is an apparent risk to the shareholders, especially those who hold significant shares. Hence, all these factors can harm SG and *Sharī'ah*-compliance supervision role by the SSBs and may negatively influence the IBs' performance.

Therefore, large Institutional shareholders, combined with the sophisticated knowledge, information they gather, and their direct access to management, can thus monitor the management of IBs to ensure the absence of any unethical activities and the survival of IBs. More importantly, since the SSB is responsible for safeguarding SG, such shareholders can ensure and enable the SSB to perform their tasks and duties freely and independently.

To sum up, institutional shareholders, according to the "active monitoring" view, constructively monitor firms, minimize agency problems, and enhance firm performance in two ways (Shleifer and Vishny, 1986; Shleifer and Vishny, 1997). From a one-point view, institutional shareholders deploy their well-developed managerial skills, professional knowledge, and voting rights to pressure management to improve firm efficiency and corporate governance and assist them in making business decisions. On the other, institutional shareholders can either provide funding when firms need funding to expand or use their connections to help the firm source financing.

Thus, this study aims to examine if institutional shareholders are indeed “active monitors” by exploring how their existence moderates the relationship between SSB effectiveness and the performance of IBs. As shown in Figure 1.1, large shareholders are among the stakeholders that influence the performance of IBs. Assessing the role of large institutional shareholders on the relationship between SSB effectiveness and performance would help understand whether they support SSB in controlling the opportunistic behaviour of management and, therefore, mitigating the conflict of interest that can result from the subordination of SSB’s role.

Last but not least, it is also essential to employ an Islamic performance approach when measuring the performance of IBs. Ghayad (2008) contends that the performance of IBs and CBs should not be measured in the same way because of the divergence of their objectives. The purpose of IBs to pay Zakat is to enhance justice and wealth in society and reduce poverty (Mohammed and Muhammed, 2017b). To address this concern, Zakat has been suggested by several researchers as an alternative method (see, e.g., Ibrahim et al., 2004; Mohammed and Muhammed, 2017b; Nomran and Haron, 2019). Most previous studies in the CG-performance literature of IBs have failed to use a performance approach that reflects IBs being *Shari’ah*-compliant because of their distinctiveness over CBs. Instead, most previous studies use traditional accounting performance measures such as ROA and ROE and the market-based approach (i.e., Tobin’s-Q). Nevertheless, few studies, such as Nomran and Haron (2019) and Haron et al. (2021a), have used and emphasized the importance of using Zakat as an appropriate performance measurement to explain the social performance of IBs. Hence, this study contributes further to the SG literature by employing Zakat to measure the Islamic social performance of IBs, in addition to traditional measures.

Overall, this study addresses some gaps in the SSB-performance literature, including the effect of independence, remuneration, and busyness on IBs’ performance. Moreover, as argued earlier, because institutional shareholders are viewed as effective monitors, it is vital to understand how they affect the association between SSB effectiveness and the performance of IBs.

To sum up, the problem statement explained in this section is subsequently summarised in numbering as follows:

1. There is a crucial need to examine how SSB independence, remuneration, and busyness influence the performance of IBs.
2. There is a need to complement the measurement of the overall effect of SSB on IBs' performance by employing an enhanced SSB score to capture their overall effect.
3. There is a need to assess the role that effective SSBs play in crisis and non-crisis periods.
4. There are insufficient studies examining how the SG models (i.e., CSGM vs. DSGM) affect the relationship between SSB effectiveness and the performance of IBs.
5. There are no studies examining the moderating effect of institutional shareholding on the relationship between SSB effectiveness and the performance of IBs.

### **1.3 RESEARCH OBJECTIVES**

This study has six objectives, and they are:

1. To investigate the influences of SSB independence, remuneration, and busyness on the performance of IBs.
2. To examine the impact of SSB effectiveness<sup>9</sup> on the performance of IBs.
3. To assess whether individual SSB score characteristics (size, cross-membership, financial expertise, reputation, educational qualification, and meetings) affect the performance of IBs.

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<sup>9</sup> SSB effectiveness is measured by a SSB score following literature.

4. To test whether effective SSB influences the performance of IBs differently in crisis periods.
5. To determine whether SG models (i.e., CSGM and DSGM) moderate the relationship between SSB effectiveness and performance of IBs.
6. To determine whether institutional shareholding moderates the relationship between SSB effectiveness and the performance of IBs.

#### **1.4 RESEARCH QUESTIONS**

To fulfil the objectives of the study, the following questions are stated:

1. What are the effects of SSB independence, remuneration, and busyness on the performance of IBs?
2. What is the impact of SSB effectiveness on the performance of IBs?
3. Do individual SSB score characteristics (size, cross-membership, financial expertise, reputation, educational qualification, and meetings) affect the performance of IBs?
4. Do effective SSBs influence the performance of IBs differently in crisis periods?
5. Do SG models (i.e., CSGM and DSGM) moderate the relationship between SSB effectiveness and the performance of IBs?
6. Does institutional shareholding moderate the relationship between SSB effectiveness and the performance of IBs?

## 1.5 MOTIVATION OF THE STUDY

The uniqueness of IBs originates from the principle of *Shari'ah* compliance. To cater to the need of IBs to comply with such a principle, a SSB should be established by IBs. The SSB's primary function is to assure the stakeholders that IBs' products and services comply with *Shari'ah* rules and principles. Failing to comply with *Shari'ah* can lead to numerous consequences, including higher risks that can affect the reputation and trustworthiness of IBs (Hamza, 2013), which could have an adverse effect on their performance. According to Alman (2012), IBs are mainly funded by deposits, current and investment accounts as their main financing source. Therefore, non-compliance with *Shari'ah* can lead the customers of IBs to withdraw their funds in case such banks breach *Shari'ah* rules and principles as shown by many studies (see, e.g., Abduh, 2011; Lee and Ullah, 2011). SSBs are also responsible for protecting the interests of IAHs. Although IAHs share risks with IBs, they have no monitoring and voting rights (Alman, 2012). The SSB is expected to protect IAHs' rights from banks' excessive risk-taking behaviour (Mollah and Zaman, 2015). Therefore, it is evident that SSBs are an essential part of IBs to safeguard the attributes mentioned above.

There are several motivations behind this study. First, although numerous studies explored the influence of SSB on the performance of IBs, there is still a need to examine some prominent SSB characteristics such as independence and remuneration (Nomran and Haron, 2020b) and busyness. This has encouraged this study to undertake an assessment of these SSB characteristics. Second, much emphasis has recently been placed on SG models across jurisdictions. This is because different SG mechanisms in different countries have implications for the performance of IBs. Nomran and Haron (2020c) contend that variations in the SG practices across countries can influence bank performance through variations in the regulatory models that regulate the characteristics, roles, and duties of SSBs, which in turn may affect the SSB's effectiveness in carrying out its roles. Therefore, it would be rational to examine the influence of SG models (i.e., centralised versus decentralised) on the performance of IBs across different jurisdictions that adopt different models.

Third, although the role of institutional shareholding in firms has been widely discussed in the conventional banking context, this debate seems not to have been well

extended to the Islamic banking context. Institutional shareholders are considered active corporate monitors owing to their professional knowledge and experience coupled with their usual significant shareholdings. Therefore, it would be useful to investigate how these shareholders influence the SG of IBs. More specifically, as a conflict of interest could arise between SSB and the management of IBs, institutional shareholders could help monitor any managerial opportunistic behaviours. No previous study has investigated the effect of institutional shareholding on the SSB of IBs.

Lastly, most previous studies in the SG literature have failed to employ a performance measurement unique to IBs. Most previous studies use traditional accounting performance measures such as ROA and ROE and the market-based approach (i.e., Tobin's-Q) to assess the performance of IBs. However, it is vital to use an approach that is distinctive to IBs to measure the performance of IBs because of their distinctiveness over CBs. To address this issue, some recent studies used Zakat payment to explain the social performance of IBs (see, e.g., Mohammed and Muhammed, 2017b; Nomran and Haron, 2019; Haron et al., 2021a; Haron et al., 2021b). Therefore, the current study employs Zakat payments in addition to the ROA and ROE.

## **1.6 CONTRIBUTION OF THE STUDY**

This study will immensely contribute to and enrich the existing literature on the role of SSBs in IBs. More precisely, this study will contribute to the influence of some prominent SSB variables (i.e., independence, remuneration, busyness) on the performance of IBs. Second, this study will benefit the IBs by figuring out the extent to which the SG models can affect their performance. Third, this study will also contribute to the ongoing debate on governance issues in IFIs and complement the Islamic finance literature on CG. Fourth, the study adds to the Islamic corporate governance literature on the role of institutional shareholders in IBs. Finally, the findings of this study are expected to be beneficial to the regulators and policymakers as the study furnishes insights about SG practices across jurisdictions, permitting them to implement guidelines and regulations to enhance the SG of IBs.

## **1.7 STRUCTURE OF THE THESIS**

This thesis is organised and structured into six chapters. Chapter one introduces the study and provides a background of the topic, research problem, objectives, research questions, motivation, the contribution of the research, and the dissertation structure. Chapter two provides a literature review on CG and SG. First, the CG concept is introduced in general, and then the Islamic perspective of CG and SG is discussed. Second, after analysing previous literature, the limitations and gaps that need to be addressed are revealed.

Chapter three explains the theoretical foundations used in this study, and then the hypotheses are developed. In the fourth chapter, the methodology of the study is described. It includes descriptions and measurements of the model's variables, data collection methods, and statistical analyses to analyse the data to achieve this study's objectives. Next, the results of the statistical analysis of the data are discussed in chapter five. This chapter further presents empirical evidence to accept or reject the hypotheses. Finally, the last chapter concludes the research and provides the implications of the results and suggestions for future research.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 INTRODUCTION**

This chapter presents the general framework of the CG of financial institutions. Firstly, the definition of CG in banking systems and their importance to banks and IBs are discussed. Second, the SG mechanism of IBs is introduced. Then, the SSB-related practices, functions, importance, and issues are scrutinised. Afterward, SG governance models are explained, followed by the prior empirical literature on the SSB-performance relationship of IBs. After a thorough review of previous literature, the gaps are presented. Finally, the role of institutional shareholders in IBs is assessed, and their moderating effect on SSB effectiveness is presented.

#### **2.2 CORPORATE GOVERNANCE**

The importance of CG in a firm mainly emerges because of the separation between owning and controlling bodies. Agency theory assumes that managers in firms are typically self-centric, pursue their interests rather than shareholders, and are resourceful (McCullers and Schroeder, 1982). As such, information asymmetry eventuates within the company because managers have the competitive advantage of information over the owners (Abidin, 2009; Lata, 2020). Hence, the CG mechanism mitigates these conflicts, monitors management, and ensures the alignment of management goals with shareholders' interests.

The global financial and economic crisis that included financial institutions' failure, such as Lehman Brothers, made the CG topic a principal concern for governments, academics, and regulators (Ginena, 2014). In Asia, CG has gained a significant distinction since the Asian financial crisis in 1997. Other factors that have also contributed to the growing concern in CG include the growth of institutional shareholders and their role in developed economies, suboptimal economic and social

development in developed countries, globalization of financial markets, global trend of deregulation of financial sectors, and liberalization of institutional shareholders' activities (Iqbal and Mirakhor, 2004). Besides, the shift from the traditional 'shareholder value-focused' view on CG for a CG structure incorporating a wide circle of stakeholders (Iqbal and Mirakhor, 2004; Jizi et al., 2014).

Global investors are regularly doubtful when companies show excellent performance due to their concern about the financial reports' consistency and accuracy (Sayari and Marcum, 2018). Their doubt, however, can be logical when looking at corporate scandals such as Enron, Lehman Brothers, and WorldCom, which weak CG and lack of prudential control initiated. Studies such as Kaplan and Minton (1994), Iskander and Chamlou (2000), and Claessens et al. (2000) assert that better governance may result from enhanced internal CG mechanisms and improved accounting, disclosure, and auditing standards. Hence, a sound CG mechanism is essential in any corporation to furnish confidence and attract investors. Goel (2018) outlines that CG is crucial for investors as it increases confidence in the company for a better return on investment.

Hence, the essence of CG lies in transparency and fairness in activities and enhanced disclosures to ensure stakeholders' interest (Arora and Bodhanwala, 2018). The CG regulations are required to enable the firm to perform better through quality decision-making (Shivani et al., 2017) and promote effective monitoring and proficient control of the business.

### **2.2.1 Definition of Corporate Governance**

Larcker et al. (2007, p. 964) define CG as "the set of mechanisms that influence the decisions made by managers when there is a separation of ownership and control." Similarly, The Organization for Economic Co-operation and Development (OECD (2004, p.11)) defines CG as "a set of relationships between a company's management, its board, its shareholders and other stakeholders."

More broadly, the Basel Committee for Banking Supervision (BCBS (1999; p.4) defines CG from the banking industry perspective as “CG involves the manner in which the business and affairs of banks are governed by their boards of directors and senior management, which affect how they: set corporate objectives; operate the bank’s business on a day-to-day basis; meet the obligation of accountability to their shareholders and take into account the interests of other recognized stakeholders; align corporate activities and behaviour with the expectation that banks will operate in a safe and sound manner, and in compliance with applicable laws and regulations, and protect the interests of depositors.” Notably, the BCBS widened the term ‘stakeholders’ to comprise supervisors, governments, depositors, employees, suppliers, and the community.

BCBS (1999; p.19) further adds that “A bank’s board of directors and senior management are primarily responsible and accountable for the performance of the bank.” Likewise, shareholders should hold the board accountable for governing the bank effectively.” Another definition by Turnbull (1997; p. 181) states that “CG describes all the influences affecting the institutional processes, including those for appointing the controllers and/or regulators, involved in organizing the production and sale of goods and services.”

CG deals with how suppliers of finance to corporations assure themselves of getting a return on their investment, as expressed by Shleifer and Vishny (1997). To counteract agency problems, Kidd and Richter (2003) contend that CG is an indirect mechanism in mitigating agency and transaction costs of self-interest-motivated managers at companies’ and shareholders’ expense. Yilmaz (2018) demonstrates that CG is particularly crucial for publicly held companies with enormous shareholders who are not engaged in day-to-day activities and have no immediate access to inside information. Furthermore, Bushman and Smith (2003) emphasize that CG structures serve to guarantee that minority shareholders obtain reliable information concerning the firm’s value and that management and large shareholders cheat them out of their investments’ value. Additionally, it encourages managers to maximize firm value instead of pursuing personal interests.

Although there is no consensus on the definition of CG, it is perceivable from the above definitions that the essence of CG is to safeguard not only the interests of shareholders but also an extended larger group of stakeholders such as customers, suppliers, shareholders, government, employees, and community.

### **2.2.2 Significance of Corporate Governance to the Banking Sector**

CG practices have become more popular because of its importance to firms' performance and rising corporate fraud concerns worldwide. The banking sector's contribution might become more apparent after the massive collapse in this sector following the global 2008-09 financial meltdown. Banks are entrusted with people's funds, and their distinctiveness as financial entities with omnipresent impact requires higher regulation standards by governments to restrain the possibility of their failure and the severe consequences that can result from that (Levine, 2004). Accepting deposits, financial intermediation, liquidity production, reserve requirements, and loaning are some features that make banks different from non-financial organisations (e.g., industrial firms).

Moreover, Small and Medium Enterprises (SMEs) are effectively dependent on banks for external finance and are a wide margin, the most critical source of external finance for SMEs (Mullineux, 2006; Ayuba and Zubairu, 2015; Veiga and McCahery, 2019). The SME sector represents over half the output or employment in non-centrally planned economies (Mullineux, 2006; Wandiba, 2012). In addition, banks are predominant in countries with the least developed capital markets, and firms and households primarily depend on banks for payment services.

Because of these inherent differences, banks are subject to stringent prudential regulation of their capital and risk (Mulbert, 2009). In addition to that, these differences are reflected in banks' CG practices and the theoretical literature on the "good CG of banks." It is worth mentioning that banks, unlike non-financial firms, take deposits from customers, and they must ensure the interests of these customers and avoid undue hazards. For that reason, good CG is essential in addressing agency problems and

providing investors with extra insurance against any expropriation of their wealth (ElKelish, 2018).

Good governance of banks tends to result in competent capital allocation by managers, allowing them to observe the companies they finance prudently (Ginena, 2014). Moreover, because banks are affiliated with larger stakeholders, such as shareholders, investors, depositors, and regulators (Yamak and Suer, 2005), banks' CG systems should ensure transparency and accountability to safeguard these stakeholders' interests. Further, Claessens (2003) highlights that better CG in the financial service sector facilitates increased external financing, lower cost of capital, enhances operational performance through better allocation of resources and better management, reduces the risk of a financial crisis, and attains a better relationship with all stakeholders.

The distinctive features of CG in the banking sector are, for the most part, concentrated on achieving policies, a set of legal rules, and managerial behaviours amongst the shareholders, the BOD, the managers, and depositors, as well as the other various stakeholders. Therefore, the Principles and codes of CG and the extent of their implementation are imperative for the banking sector to ensure effective CG practices. Consequently, the weak enforcement of proper CG practices can fail to attract investors, resolve agency conflicts, and negatively influence banks' performance.

### **2.2.3 Importance of Corporate Governance to Islamic Banks**

The unique and primary distinction that differentiates IBs from CBs is the concept of *Sharī'ah*-compliance. Matoussi and Grassa (2012) underline that non-compliance with *Sharī'ah* principles can result in the financial turmoil of IBs. Non-compliance can also shake customers' confidence and the community since most customers use IBs because of their religious beliefs (Basiruddin and Ahmed, 2019).

Further, unlike CBs, IBs are featured by the arrangement of *Sharī'ah*-compliant investment contracts, which pose different types of agency problems (Safieddine, 2009). These contracts are principally designed based on the concepts of equity

participation, i.e., profit-sharing (*Mudaraba*) and profit-and-loss sharing (*Musharaka*) (Farag, 2016). The riskiest type is the *Mudaraba* contract, which comes in two structures: restricted and unrestricted (Archer et al., 1998; Karim, 2001).

Unrestricted contracts permit managers of IBs to make investment decisions at their discretion. In contrast, restricted contracts ordinarily allow the capital providers (i.e., the principal or IAHs) to have a say in how banks, i.e., the agent or *Mudarib*, utilise the capital they provide. However, in both arrangements, IAHs reserve no right to intervene in fund management and are at risk of financial losses (Safieddine, 2009; Farag, 2016) because, in the *Mudaraba* contract, profits are shared, but the losses are born by the IAHs (Farag et al., 2018). Therein exists the risk of opportunism from managers of IBs to pursue personal welfares at the expense of IAHs' interests (Karim and Archer, 2006). In fact, the empirical findings of Farag et al. (2018) demonstrate that the greater the size of the unrestricted contracts, the higher the IBs' agency costs, suggesting that such contracts are one of the primary sources of agency conflicts in IBs. Therefore, to cope with this problem, a robust and prudential CG is essential to reduce agency problems and IAHs-managers information asymmetry.

It is also worth mentioning that several IBs worldwide have been closed for regulatory and *Sharī'ah* non-compliance-related causes. For instance, The Islamic Investment Companies of Egypt was closed in 1988 due to weak CG, irresponsible management, improper regulatory mechanisms, and participation in *Sharī'ah* non-compliant activities (Zubaida, 1990). Also, the demise of the Islamic Bank of South Africa in 1997 was reported to be caused by inferior CG and SG (Nathie, 2010). Similarly, the demise of Ihlas Finance House in Turkey in 2001 and various fraud cases, which led to losses at the Dubai Islamic Bank between 2004 and 2007, manifest the vitality of CG for IBs (Ginena, 2014). Moreover, Faisal Islamic Bank in the UK ceased its operations for regulatory reasons (Husna and Abdulrahman, 2012). Hence, IBs should uphold Islamic rules and principles in their operations and dealings since shareholders' and stakeholders' objectives are to invest and transact as per the *Sharī'ah* requirements.

For that reason, since IBs have a different governance structure than CBs, various regulatory bodies for IFIs have initiated and improved the regulatory and

supervisory system for advancing CG standards and guidelines of IFIs. AAOIFI, IFSB, and BNM are some of the leading issuers of CG standards and guidelines for IFIs. For instance, AAOIFI<sup>1</sup> has issued nine governance standards for IFIs so far, including (1): *Sharī'ah* Supervisory Board Appointment, Composition, and Report; (2): *Sharī'ah* Review; (3): Internal *Sharī'ah* Review; (4): Audit and Governance Committee for IFIs; (5): Independence of *Sharī'ah* Supervisory Board; (6): Statement on Governance Principles for Islamic Financial Institutions; (7): Corporate Social Responsibility (CSR) conduct and disclosure for IFIs; (8) central *Sharī'ah* boards; and (9) *Sharī'ah* compliance function.

Likewise, IFSB-10 in 2009 also issued the *Sharī'ah* governance standards in five guiding principles as Part I: General approach to *Sharī'ah* governance system; Part II: Competence; III: Independence; Part IV: Confidentiality; and lastly Part V: Consistency (IFSB, 2009; p.5). Also, BNM issued the “Guidelines on *Sharī'ah* Governance Framework for IFIs” in 2010, aiming to guide IFIs towards best SG practices (BNM, 2010).

In general, the CG of IBs is unique, and it requires another governance layer known as SSB beside the BOD. To ensure good CG, IBs must have a SSB to ascertain that all products and services accommodated by IBs comply with *Sharī'ah* rules (IFSB, 2005). Thus, it is evident that the CG mechanism of IBs differs from that of CBs. CG in IBs aims to safeguard stakeholders’ interests. IBs observe morality and ethics in their activities, including their governance system, to promote prudential Islamic banking institutions. For example, IBs do not invest in businesses that are detrimental to society, such as alcohol, pornography, and gambling (Ma’ruf et al., 2021), to name a few. The CG of IBs must incorporate moral accountability, responsibility, transparency, and fairness to achieve *Sharī'ah*-compliance and guarantee stakeholders’ rights.

### **2.3 DEFINING CORPORATE GOVERNANCE IN THE ISLAMIC BANKING CONTEXT**

Islamic CG model in Islam has remarkable features and presents distinctive characteristics compared with the Western concept of Anglo-Saxon and European

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<sup>1</sup> See (<https://aaoifi.com/?lang=en>) for AAOIFI’s issued governance standards.

models (Hasan, 2009). While the Anglo-Saxon fosters a shareholder value system and the European model upholds the stakeholder value orientation, an Islamic CG model incorporates the element of *Tawhīd* (Oneness of God), *Shūrā* (Consultation), *Sharī'ah* rules and maintains the private goal without disregarding the obligation of social welfare (Hasan, 2009). In general, the structure of CG in IFIs permits the assurance of commitment to Islamic principles to guarantee fairness to all stakeholders (Elgattani and Hussainey, 2020).

Various entities have presented the definition of CG from an Islamic perspective or CG of IFIs. The definition of IFSB-3 lays out a patent explanation of the genuine meaning and structure of CG in IFIS. IFSB-3 defines CG as a “set of relationships between a company’s management, its Board of Directors, its shareholders and other stakeholders which provides the structure through which: (i) the objectives of the company are set; and (ii) the means of attaining those objectives and monitoring performance are determined.”

It additionally explains CG of Institutions offering only Islamic Financial Services (IIFS) to incorporate “ (i) a set of organizational arrangements whereby the actions of the management of IIFS are aligned, as far as possible, with the interests of its stakeholders; (ii) provision of proper incentives for the organs of governance such as the Board of Directors, SSB, and management to pursue objectives that are in the interests of the stakeholders and facilitate effective monitoring, thereby encouraging IIFS to use resources more efficiently; and (iii) compliance with Islamic *Sharī'ah* rules and principles (IFSB, 2006; p. 33).”

Apparently, there are some similarities between CG’s definition from an Islamic perspective and a conventional point of view, such as ensuring the interests of shareholders and stakeholders and meeting the corporation’s objectives. Although the definition of IFSB-3 comprises all components of the CG framework and is similar to the common concept of CG in any other sort of financial institution, it demonstrates that an exclusive feature for IFIs is compliance with Islamic *Sharī'ah* rules and principles (see, IFSB, 2006). Hence, to realize this distinctive feature of IFIs, an effective SG mechanism must exist in the governing structure of IFIs. This SG mechanism in IFIs is needed to safeguard *Sharī'ah*-compliance and the rights of associated stakeholders.

### 2.3.1 *Sharī`ah* Governance Definition

Although SG is relatively new, its implementation can be traced back to early Muslim societies, where it was known as the institution of *Hisbah* (Hakimi et al., 2018). The IFSB has published an elaborate definition of SG. The IFSB-10 defines SG as: “*Sharī`ah* Governance System” refers to the set of institutional and organizational arrangements through which an IIFS ensures that there is effective independent oversight of *Sharī`ah* compliance over each of the following structures and processes: a: Issuance of relevant *Sharī`ah* pronouncements/ resolutions; b: Dissemination of information [.....] c: An internal *Sharī`ah* compliance review/audit for verifying that *Sharī`ah* compliance has been satisfied [.....]; d: An annual *Sharī`ah* compliance review/audit [.....] (IFSB, 2009; p. 2-3).”

IFSB-10 further explains the first point as “*Sharī`ah* pronouncements/ resolutions” refers to a juristic assessment on any issue relating to *Sharī`ah* issues in Islamic finance, given by the properly mandated *Sharī`ah* board. Once it is concluded that a *Sharī`ah* pronouncements/resolutions should be executed, it turns into a *hukm al-Shar`ī* (*Sharī`ah* ruling) with the full legal effect that binds these institutions. The second point manifests the spreading of *Sharī`ah* pronouncements/resolutions to the operative team of the IIFS, who monitor the daily compliance with the *Sharī`ah* pronouncements/resolutions regarding each level of transactions and operations. Such a task would typically be conducted by an assigned “Internal *Sharī`ah* Compliance Unit/Department (ISCU).”

The third point in the IFSB-10 definition describes that a trained and competent Internal *Sharī`ah* Compliance Review/Audit Unit (ISRU) confirms *Sharī`ah* compliance, and in the case of *Sharī`ah* non-compliance, the incidence will be recorded and reported. While the ISCU is a segment for the IIFS’s compliance team, ISRU might be set up to function similarly to the IIFS’s internal audit team. The primary distinction is that while the internal audit will generally report to the Audit Committee, the ISRU will answer to the *Sharī`ah* board. Therefore, The ISRU of IFIs must be independent to perform their duties efficiently. Moreover, where suitable, the ISRU reports will require

or suggest the IIFS management to address and rectify any issues of *Sharī'ah* compliance.

Fourthly, an annual *Sharī'ah* compliance and review/audit ensures that the *Sharī'ah* compliance and review/audit have been pertinently completed and the *Sharī'ah* board has precisely noted its findings. Alternatively, this task may be assigned to an appropriately competent external auditor or external *Sharī'ah* firm. The *Sharī'ah* board, which issued the *Sharī'ah* pronouncements/resolutions, can assume responsibility for this process, having received feedback and report from the ISRU. The *Sharī'ah* board or *Sharī'ah* advisory firm that executes the *Sharī'ah* compliance, review/audit will generate reports showing whether the IIFS has complied with *Sharī'ah* requirements throughout the financial year.

The definition of IFSB-10 illustrates how the SG mechanism supplements the current governance, control, and compliance function of IFIs compared to the scenario in a conventional financial context. Table 2.1 demonstrates some primary features of the SG framework and critical functions that are responsible for guaranteeing SG in IFIs. The table provides an understanding of the governance system in IFIs. While IFIs have the governance mechanism found in any other financial institution, another governance system is imposed on the IFIs known as the SG system, including but not limited to independent *Sharī'ah* boards (otherwise known as *Sharī'ah* supervisory/advisory boards), internal and external *Sharī'ah* review, and internal *Sharī'ah* compliance unit/department.

Table 2.1 *Sharī'ah* Governance System in IFIs

<b>Key functions</b>	<b>Typical Financial Institution</b>	<b>Exclusive to IFIs</b>
Governance	Board of directors	<i>Sharī'ah</i> Supervisory Board
Control	Internal auditor External auditor	Internal <i>Sharī'ah</i> Review Unit/Department (ISRU) External <i>Sharī'ah</i> review
Compliance	Regulatory and financial compliance officers, unit, or department	Internal <i>Sharī'ah</i> Compliance Unit/Department (ISCU)

Source: Adapted from IFSB-10 (2009; p. 4).

To sum up, SG is a governance mechanism that guarantees all activities and business dealings of IFIs are free from non-permissible elements such as *riba*, *gharar*, *maisir*, and other similar sorts, as defined by Bahari and Baharudin (2016). More precisely, SG refers to a mechanism led by *Sharī'ah* principles and controlled by a religious board to validate that the activities of IFIs are confirming with the *Sharī'ah* conducts and principles (Grassa, 2013a). Thus, the essence of SG is to guide IFIs toward the best *Sharī'ah*-compliance practices and incorporate Islamic moral principles and ethical standards into their operations, management, and products. It is worth mentioning that the SSBs in IBs are entrusted and primarily responsible for ensuring a sound and effective SG system (IFSB, 2009). Because of this role, which entails guaranteeing a good, sound, and effective SG, the current study attempts to assess their role in influencing the performance of IBs.

### **2.3.2 The Role of the *Sharī'ah* Supervisory Board in Islamic Banks**

As shown in Table 2.1, an important feature unique to IFIs is the *Sharī'ah* Supervisory Board (SSB). The AAOIFI Governance Standard No.1 defines *Sharī'ah* boards as “A *Shari'a* supervisory board is an independent body of specialized jurists in *fiqh Al-mua'malat* (Islamic commercial jurisprudence). [...] The *Shari'a* supervisory board is entrusted with the duty of directing, reviewing, and supervising the activities of the Islamic financial institution in order to ensure that they are in compliance with *Shari'a* rules and principles.” (AAOIFI, 2015). Moreover, AAOIFI (2015) states that the *fatwas* (rulings) of the *Sharī'ah* supervisory board shall be binding on the Islamic financial institution. According to IFSB (2009), the SSBs in IBs are expected to play a leading role in ensuring sound *Sharī'ah* governance (SG).

IBs are governed by dual governance layers (i.e., BOD and SSB). A vital component of the SG system is SSB, comprising a number of *Sharī'ah* scholars who review and approve all the products offered by the IFIs (Al Mannai and Ahmed, 2019). Grassa (2013a) emphasizes that SSB is a SG element to ensure *Sharī'ah*-compliance in the banks' day-to-day activities and operations. IFSB-3 mentions that because the foundation of IFIs is the offering of financial services that must fulfil *Sharī'ah*

requirements, it would not be acceptable that the IFI does not function without *Sharī'ah* supervision of any sort (IFSB, 2006; 23).

IBs without SSBs will not be able to attract investors and entrepreneurs who wish to invest their funds as per *Sharī'ah* rules and principles, thus the importance of SSBs for IBs. In some Muslim-majority countries like Indonesia, the appointment of *Sharī'ah* scholars in IBs is mandatory before introducing Islamic financial products (Ahmed and Mohamad, 2019). Moreover, IFSB-3 outlines that SSB's role is to ensure that IBs have suitable pre-and-post-*Sharī'ah*-compliance monitoring systems in place (IFSB, 2006).

SSB members should be appointed the shareholders as displayed by the AAOIFI governance standard No.1 to ensure that the SSB is independent of the management and BOD to provide a supervisory and advisory role without fear or favour. The SSB should consist of three members, not including directors or significant shareholders of the IFI, and should not be involved with the IFI's management (AAOIFI, 2010). Additionally, SSB members and their family members should not be employed as senior executive officers (AAOIFI, 2010; AAOIFI, 2015).

In general, SSB has fiduciary duties to all its stakeholders. The role of SSB in IBs is chiefly two-fold: namely, advisory and supervisory functions. IFSB-3 (2006; 23) states that the SG system is responsible for *ex-ante*<sup>2</sup> and *ex-post*<sup>3</sup> processes as an integral part of good CG practices. The applicable *ex-ante* tasks (advisory function) incorporate issuing *Sharī'ah* resolutions and compliance checks before offering the product to Islamic bank customers. After the *ex-ante* process is concluded and the product has been offered, IFIs would execute the *ex-post* measures (supervisory function), namely, internal *Sharī'ah* review and *Sharī'ah* governance reporting to inspect and monitor the compatibility of its *Sharī'ah* compliance and effectively oversee any *Sharī'ah* non-compliance risk that may emerge over time (IFSB, 2009).

The SSB in IBs is to review and decide if the investments undertaken are and continue to be *Sharī'ah*-compliant throughout the investment period and generate an

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<sup>2</sup> *Ex-ante* responsibilities involve advising IFIs before the initial offering of products (see IFSB, 2009).

<sup>3</sup> *Ex-post* functions involve undertaking post-offering tasks, including reviewing the product after offering to ensure the compatibility of its *Sharī'ah*-compliance status (see IFSB, 2009).

annual *Sharī'ah*-compliance report (Al Mannai and Ahmed, 2019). Hence, SSB's decisions and rulings could influence the volume of the Islamic bank's business, as they can reject any product or service that is not in line with the *Sharī'ah* requirements (Mohammed and Muhammed, 2017a). Also, the SSB may overrule any business transactions or financial products deemed *Sharī'ah* non-compliant, albeit those transactions bring the greatest economic benefits in the shareholders' best interests (Frag et al., 2018). Notably, on the occasion that a performed transaction is later discovered to be *Sharī'ah* non-compliant, the SSB has the authority to declare the returns of such undertaking to be non-permissible and should be taken out of the bank's income accounts and transferred to a charity account (Rammal, 2006; Ayub et al., 2019). It is worth mentioning that the SSB rulings are binding on the IFI's BOD (Muneeza and Hassan, 2014). Thus, the SSB is mainly accountable for monitoring and overseeing the activities of IBs and operates as a control system to guarantee the *Sharī'ah*-compliance of the banks in their services and management (Masruki et al., 2020).

SSB in IBs also have duties to ensure the interest of IAHs because IAHs' control over the investment decisions is transferred from IAHs (the capital providers) to the Islamic bank's management (*Mudarib*) (Sulaiman et al., 2015). IAHs are not represented on boards in IBs and may reduce the IAH's access to the company's information (Saffieddine, 2009). Also, IAHs have no voting rights in the shareholders' meetings and are exposed to higher risks and conflicts of interest between them and the bank's management (Zainuddin et al., 2018). Notably, the profit-sharing investment accounts held by IAHs constitute an essential source of the IBs' funding (Archer and Karim, 2009). Although IAHs share risks with IBs, they have no monitoring and voting rights (Alman, 2012; Adznan, 2018). Thus, it is the responsibility of the SSB to restrain the management and the board from excessive risk-taking (Mollah and Zaman, 2015), safeguard IAHs' rights, and ensure that management trustily manages their funds in line with *Sharī'ah* rules and principles.

SSB in IBs also have functions to mitigate *Sharī'ah* non-compliance risks that may lead to funds withdrawals. This can be done by adhering to prudential advisory and supervisory efforts from the SSB by following the guidelines of the *Sharī'ah* and not tolerating highly speculative activities that may damage the bank's reputation. Because

*Sharī'ah* non-compliance could damage the reputation of IBs, Iqbal (2002) points out that SSB plays a crucial role in guaranteeing and improving the credibility of IFIs. Moreover, Grais and Pellegrini (2006a) outline the *Sharī'ah* board's functions into five main areas: *ex-ante* audit, *ex-post* audit, calculation, distribution of Zakat, and disposing of *Sharī'ah* non-compliant earnings and advising on the distribution of income and expenses.

To sum up, SSBs are responsible for monitoring the ethical and moral aspects of corporate management behaviour. Islamic moral codes will prevent individuals from behaving against ethics and, therefore, are accountable for guiding top management in applying Islamic rules in daily transactions (Zainuldin et al., 2018). Undeniably, SSB is the most effective CG tool to ensure that IBs are committed to *Sharī'ah* (Albarrak and El-Halaby, 2019). Ultimately, SSB's ideal function in IBs can be concluded as monitoring *ex-ante* and *ex-post* perspectives, namely in activities and operations of IBs to ensure *Sharī'ah*-compliance. Their tasks revolve around advising, supervising, reviewing, and approving. Therefore, it is evident that the existence of SSB can highly influence the way IBs perform.

### **2.3.3 Issues in *Sharī'ah* Governance**

The literature documents five SG issues that may result from the functions of SSB as well as may have an impact on SSB efficiency, namely independence, confidentiality, competency, consistency, and disclosure (see, e.g., Grais and Pellegrini, 2006a; Greuning and Iqbal, 2008; IFSB, 2009; Grassa, 2013b; Bouheni and Ammi, 2015). The following part discusses these issues.

#### **2.3.3.1 Independence of the *Sharī'ah* Supervisory Board**

In principle, SSBs are required to provide unbiased opinions on the *Sharī'ah*-compliance of IB's activities. Nevertheless, their employment status generates an economic stake in the bank, which may compromise their independence (Greuning and Iqbal, 2008). The lack of SSB independence is a concern because SSB members may

approve suspicious operations to ensure their position on the board (Grassa, 2013b). Therefore, to ensure the independence of SSBs, the major standard-setting organisation (i.e., AAOIFI, IFSB, and BNM) for IFIs expresses that SSBs should be acknowledged as independent from the management, whereby they have the freedom in exercising their duties to make informed and independent decisions (see, IFSB, 2009; BNM, 2010; AAOIFI, 2015). According to these organisations, SSB members should not be employees of the bank, should not be involved in the bank's operational responsibilities, and should make objective judgments on matters related to *Sharī'ah* without influence from management or inappropriate outside interest.

AAOIFI's Governance Standard No. 1 states that shareholders appoint the SSB in the annual general meetings. This ensures their independence from management, as managers do not have the authority to appoint or dismiss them (see, AAOIFI, 2015). Accordingly, the SSB should be independent and not have a business, monetary benefits, or any other association with the bank. Thus, a lack of SSB independence may cause several problems, including “*fatwa shopping*”<sup>4</sup> and an increased risk of *Sharī'ah* non-compliance, which can lead to legal, financial, and reputation risks (AAOIFI, 2015), and subsequently can harm bank performance.

### **2.3.3.2 Confidentiality of the *Sharī'ah* Supervisory Board**

It is a common practice for *Sharī'ah* scholars to serve on the SSBs of multiple IFIs simultaneously. This issue raises concerns related to confidentiality (Grais and Pellegrini, 2006a; IFSB, 2009; Bouheni and Ammi, 2015). In performing their duties, SSB members may have access to files, records, draft materials, and conversations that are deemed confidential under the IFI's internal procedures and by market practice<sup>5</sup> (IFSB, 2009). Consequently, a member of a SSB with confidential information about a bank may decide to disclose it to the competitors, negatively affecting the bank's performance (Baklouti, 2022). Therefore, it is a core concern of professional ethics that

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<sup>4</sup> Salisu et al. (2020) describe *fatwa shopping* (or opinion shopping) as “*fatwa shopping attitude is a process of searching Sharī'ah opinions from different Sharī'ah scholars for suitable and convenient fatwa to suit the need of bank managers even at the minimum level of Sharī'ah compliance*”. “*Fatwa shopping*” increments the inconsistency between Islamic financial products, prompting consumers and investors to be uncertain about the *Sharī'ah*-compliance of the offered products and gradually driving them to lose faith in Islamic finance completely (Malik et al., 2011).

<sup>5</sup> Confidential information refers to information obtained by SSB members in the course of their duties that is not public and is not authorized to be made public (IFSB, 2009, p.18).

confidential or sensitive information obtained by SSB members while serving IFIs should not be utilised in ways that can harm these institutions, particularly in ways that might give a competitive advantage to their competitors (IFSB, 2009).

#### ***2.3.3.3 Competence of the Sharī'ah Supervisory Board***

The SSB members should possess the appropriate knowledge and skills to adequately perform their duties and responsibilities (IFSB, 2009). SSB members must have sufficient knowledge of Islamic commercial laws (*fiqh al-mu'amalat*) as well as in financial and accounting fields (Grais and Pellegrini, 2006a; Grassa, 2013b). However, few scholars are well-versed in all these disciplines (Greuning and Iqbal, 2008; Grassa, 2013b). Moreover, it is contended that SSB members with doctoral degrees in a relevant field are better versed in Islamic finance and banking fields (Farook et al., 2011; Rahman and Bukair, 2013; Nomran et al., 2018). Nonetheless, there are *Sharī'ah* scholars even without any academic degree or qualification in *Sharī'ah* related studies (Bakar, 2016).

#### ***2.3.3.4 Consistency of the Sharī'ah Supervisory Board's Fatwa***

This issue concerns the uniformity of *fatwas* issued by SSB scholars across IBs over time and jurisdictions (Grais and Pellegrini, 2006a; Bouheni and Ammi, 2015). *Fatwas* issued can change under different circumstances and over time, resulting in a conflict of opinion among scholars about financial instruments and transactions (Grassa, 2013b). As the Islamic financial industry expands, the number of conflicting *fatwas* is anticipated to increase, which may undermine customer confidence in the industry (Greuning and Iqbal, 2008; Grassa, 2013b). Accordingly, it is advised that SSB members should, as far as possible, seek to reach a consensus in arriving at decisions, and only when consensus cannot be reached within a reasonable time should any decision be taken based on a simple majority (IFSB, 2009). Thus, SSB members should be consistent in the *fatwas* they provide to the different IFIs they serve (IFSB, 2009).

### **2.3.3.5 Disclosure of the *Sharī'ah* Supervisory Board**

This last issue is the disclosure of all information related to the SSB. Transparent IFIs should disclose all matters related to the SSB, including duties, decision-making process, *fatwas* issued, *Sharī'ah* reports, competence, and composition, which could enhance stakeholders' confidence in the credibility and commitment of IFIs to the *Sharī'ah* principles (see, Grais and Pellegrini, 2006a; Grassa, 2013b).

### **2.3.4 *Sharī'ah* Governance Models**

Different jurisdictions have different approaches and models of the SG mechanism; some opt for a more prominent involvement with the regulatory authorities and implement a regulatory framework governing *Sharī'ah* supervision at the national and institutional levels (Grassa, 2013a). In contrast, others favour less intervention to the regulatory authorities and have adopted a SG system only at the institutional level. As a result, two types of SG models (i.e., centralised and decentralised *Sharī'ah* governance models) (see Table 2.2 for countries that adopt both models) are mainly found across jurisdictions (see, e.g., Grais and Pellegrini, 2006a; Grais and Pellegrini, 2006b; Alman, 2012; Hamza, 2013). The CSGM is based on *Sharī'ah* supervision at both the institutional level (i.e., Islamic financial institution's SSB) and the national level (e.g., SSB at the central bank). In contrast, the DSGM implies *Sharī'ah* supervision at the institutional level only. Figure 2.1<sup>6</sup> shows the difference between SG models (i.e., CSGM and DSGM).

Hamza (2013) emphasizes that CSGM aims to ensure the harmonization of *Sharī'ah* rulings and strengthen the credibility of IBs. According to him, the diversity of opinions (*fatwas*) among the *Sharī'ah* scholars may prevent harmonizing products and financial procedures, which could be a significant challenge. Additionally, the author argues that the absence of centralization and *Sharī'ah* supervision can prompt a lack of standardisation of *fatwas* and consistency in Islamic banking products. Consequently, CSGM is said to provide more standardisation and uniformity and

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<sup>6</sup> Source: Adapted from Nomran and Haron (2020c).

enhance SSB independence by terminating potential conflicts of interest between SSB and the management of IBs (Grais and Pellegrini, 2006a; Grais and Pellegrini, 2006b) and reduce the “*fatwa shopping*” problem (Oseni et al., 2016).

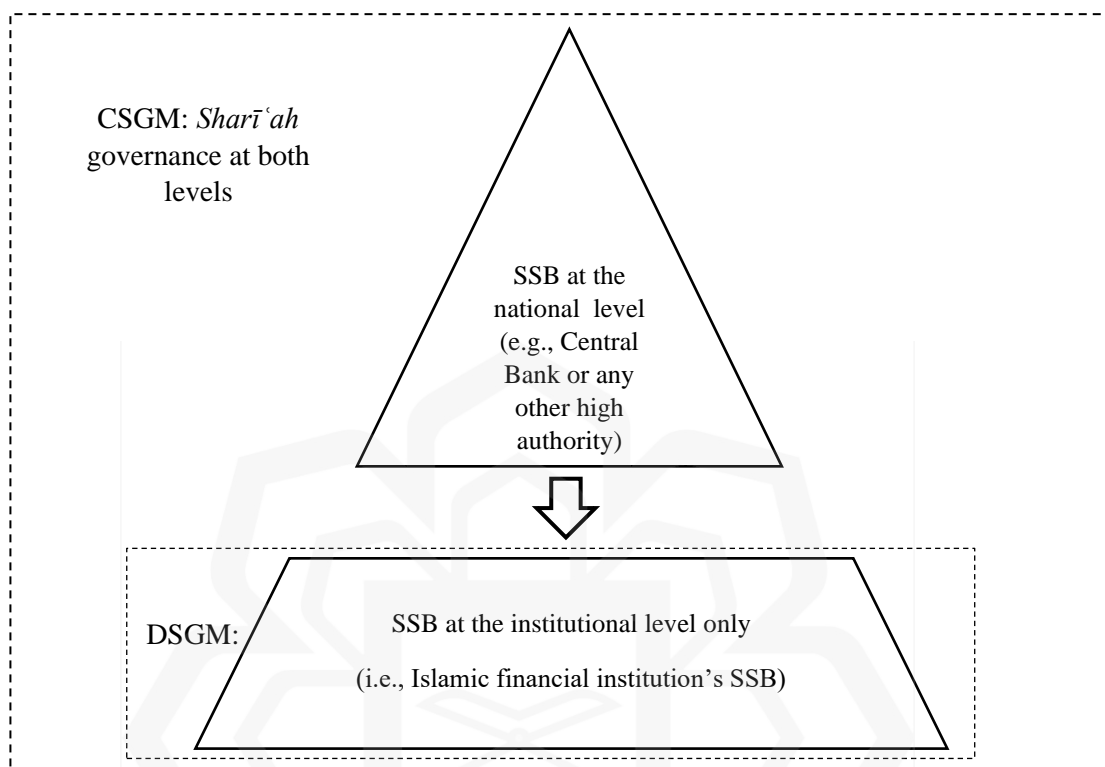


Figure 2.1 *Sharī'ah* Governance Models Based on Supervision Structure (CSGM & DSGM)

“*Fatwa shopping*” is more likely in jurisdictions with no central *Sharī'ah* governance regulations (Ullah et al., 2018). For this reason, some authors believe that CSGM is better than DSGM (see, e.g., Hamza, 2013; Oseni et al., 2016). In summary, some disadvantages linked to the DSGM include “*fatwa shopping*,” lack of binding SSB opinions, SSB’s opinions inconsistency, jeopardized SSB independence, the decisions of SSB not being respected by the BOD, and exposure to *Sharī'ah* non-compliance risks (See, Razak, 2018). Notably, countries like Malaysia, Indonesia, Brunei Darussalam, Bahrain, UAE, and Oman are examples of countries that embrace the CSGM.

Indeed, varying opinions may arise under the DSGM, as the different scholars may suggest many different *fatwas* on the same issue (Grais and Pellegrini, 2006a; Grais and Pellegrini, 2006b; Al-Amine, 2011). For instance, Al-Amine (2011) cites the Japan Bank for International Co-operation case when it decided to issue a sovereign *Sukuk*

and selected Citibank from the UAE and CIMB from Malaysia to organise the deal. However, the SSB of the respective banks could not agree on whether the *Sukuk* is compliant with the *Sharī'ah*, and the deal needed to be reshaped, which frustrated the issuer because of the additional costs and time. Similarly, Zada and Muhammad (2018) discuss the case of Dana Gas *Mudarabah* based *Sukuk* when the company in 2017 announced that its *Mudarabah*-based *Sukuk* instrument is no longer *Sharī'ah*-complaint due to changes in *Sharī'ah* interpretation; thus, it will not fulfil its payment obligation under the *Sukuk* and instead will sort to restructuring, and consequently, a legal dispute between the *Sukuk* holders and the company.

On the other hand, several researchers, such as Grais and Pellegrini (2006a) and Alman (2012), believe that the DSGM is more constructive than the CSGM. The authors view that the DSGM provides more opportunities for innovation than the CSGM. Moreover, Quttainah et al. (2013) highlight that the waiting time until IBs receive a *fatwa* from a central *Sharī'ah* authority may result in a loss of opportunity for the banks and negatively influence their performance. Countries like Saudi Arabia, Qatar, Kuwait, Thailand, and the Philippines are examples of countries that adopt the DSGM.

However, it is worth mentioning that no specific SG model is preferred by jurisdictions (Oseni et al., 2016). In fact, In the CSGM, having *Sharī'ah* supervision at both the national and bank levels may not always occur. For instance, although Sudan adopts the CSGM and adheres to the AAOIFI governance standards, which recommends the establishment of SSB at the institutional level, the establishment of in-house SSB is not mandatory for the banks as they depend on the *fatwas* by the central *Sharī'ah* authorities as reported by Quttainah et al. (2013), unlike, for instance, Malaysia where each IFI must have an in-house SSB apart from the national *Sharī'ah* supervisory council. In contrast, IBs in Saudi Arabia and Qatar depend on their SSB, adhering to the DSGM. Others in the UAE and Bahrain, classified as those that adopt CSGM, have a central *Sharī'ah* supervision authority, but their role is an advisory role to the central bank (Hamza, 2013), while others, like Kuwait, follow the *Fatwa* Board of the Ministry of *Awqaf* but do not have a centralised *Sharī'ah* council (Hassan et al., 2013).

Thus, the categories of jurisdictions that adhere to the CSGM are classified by those who have national *Shari'ah* supervision regardless of whether the final decision is theirs (e.g., Malaysia) or those that the final decision-making is up to the IB's SSB (e.g., Saudi Arabia) as inferred by Hassan et al. (2013). Table 2.2<sup>7</sup> presents the SG models that some jurisdictions adopt.

Table 2.2 SG Model Across Jurisdictions

Country	Type of SG Model
Malaysia	CSGM
Sudan	CSGM
Pakistan	CSGM
Bahrain	CSGM
UAE	CSGM
Iran	CSGM
Indonesia	CSGM
Bangladesh	CSGM
Afghanistan	CSGM
Oman	CSGM
Nigeria	CSGM
Brunei Darussalam	CSGM
Palestine	CSGM
Morocco	CSGM
Saudi Arabia	DSGM
Qatar	DSGM
Kuwait	DSGM
Jordan	DSGM
Yemen	DSGM
Gambia	DSGM
Singapore	DSGM
United Kingdom	DSGM
Thailand	DSGM
The Philippines	DSGM

Sources: (Grais and Pellegrini, 2006a; Hasan, 2007; Hamza, 2013; Hassan et al., 2013; Bakar, 2016; ICLR, 2016; International *Shari'ah* Research Academy for Islamic Finance (ISRA) and Thomson Reuters, 2016). **Note:** CSGM stands for Centralised *Shari'ah* Governance Model, while DSGM stands for Decentralised *Shari'ah* Governance Model.

<sup>7</sup> The Philippines is yet to have Islamic banking legislation (see, e.g., Haqqi, 2017; Latif, 2019); therefore, the country's SG model is considered decentralised.

### **2.3.5 Prior Literature on *Shari'ah* Supervisory Board and Performance**

Numerous studies have examined the role of SSB on the performance of IBs. For example, Grassa and Matoussi (2014b) compare Islamic and conventional banks' CG attributes in the GCC and SEA regions. The study examines 77 IBs and 85 CBs for the 2000-2009 period. The study considered the characteristics of BOD, CEO, SSB size, SSB cross-membership, SSB scholars with accounting/finance knowledge, and the number of women on SSB. This study used ROE and ROA to measure the performance of the banks in the sample. Using regression analysis, the study found that board fees, CEO duality, and CEO age significantly affected the IBs' performance. Moreover, scholars with accounting/financial skills on the SSB had a positive influence on the performance of IBs. The study has also found that SSB size and cross-memberships negatively influence the performance of IBs in Southeast Asia.

Mollah and Zaman (2015) assessed the impact of SSB size, BoD structure, and CEO power on the financial performance of 86 IBs and 86 CBs across 25 countries between 2005 and 2011. This study has also considered the effect of the 2008 GFC using the panel data technique. To measure the performance of the respective IBs, the authors used five measurements, including ROIAE (operating profit divided by average equity), ROIAA (operating profit divided by total assets), ROAE (return on average equity), ROAA (Return on average assets), and Tobin's Q. The authors used the Random effects Generalized Least Squares (GLS) and the two-step system Generalized Method of Moments (GMM) to analyse the data. This study's findings demonstrated that when SSBs in IBs perform a supervisory role, they positively affect performance, while the impact is negligible when they perform advisory functions. In addition, board size and board independence, CEO-chair duality, and internally recruited CEO were found to harm IBs' performance. On the other hand, the impact of SSB size during the crisis period positively impacted IBs' performance. Interestingly, the study uncovered that the dual governance boards of IBs help them perform better than CBs.

Al-Mutairi and Quttainah (2017) investigated the impact of SSB on the performance of IBs from 82 IBs in 15 countries over the 1993-2014 period using clustered regression and the Two-stage least-squares regression. This study employed ROE, ROA, and Tobin's Q to measure the performance of the IBs. The study's

independent variables are SSB attributes: size, outside members, cross-memberships, SSB membership in the IFSB, SSB membership in the AAOIFI, and postgraduate education. The findings reveal that IBs with SSB outperform IBs without SSB and better monitor management behaviour. Additionally, all SSB attributes (size, outside members, cross-memberships, SSB membership in the IFSB, SSB membership in the AAOIFI, and postgraduate education) significantly and positively impact performance.

Nomran et al. (2017) assessed the effect of SSB characteristics (i.e., size, cross-membership, doctoral qualification, reputation, financial expertise, and rotation) on the performance of 25 IBs in Malaysia and Indonesia from 2007 to 2015 using the Random Effects (RE) Generalized Least Squares (GLS) and GMM methods to analyse the data. The authors utilised ROA and ROE to gauge the performance of IBs. The findings show that large SSB size and cross-memberships enhance performance while SSB doctoral qualification and rotation adversely affect performance.

Ajili and Bouri (2018a) examined the CG quality index of IBs comprising 44 IBs in the GCC countries between 2010-2014 using the random effects model to analyse the data. The dependent variables of this study are ROA and ROE, while the independent variables are Corporate Governance (CG-index), SSB-index (existence of SSB+ SSB size+ SSB education+ SSB financial expertise), BOD-index, and Audit Committee index (AC-index). The results of this study do not document any statistically significant relationship between all the indexes (CG-index, SSB-index, BOD-index, AC-index) and the performance of IBs. The authors shed light on the role of SSB in most IBs in the GCC countries as an advisory rather than a supervisory role and the need for improved CG practices.

Farag et al. (2018) also investigated the impact of the dual board structure on the financial performance of 90 IBs across 13 countries for the 2006-2014 period, utilising the fixed effects model and the GMM estimator for data analysis. The dependent variables of this study are ROA, ROE, Return on Operating Assets (ROOA), and Return on Operating Equity (ROOE), while the independent variables are SSB size, BOD size and BOD independence. The authors found that SSB and BOD sizes enhance the performance of IBs, while BOD independence does not influence performance.

Hakimi et al. (2018) analysed the influence of the dual governance system on the performance of 13 IBs in Bahrain over the 2005-2011 period using the Random effects model and the GMM. ROA and ROE are the dependent variables of this study, while the independent variables are SSB size and financial expertise, BOD size, and institutional members on the BOD. The study reveals that BOD duality, BOD size, and SSB size positively impact performance. In contrast, institutional members on the BOD and SSB expertise in finance and accounting do not affect performance.

Nomran et al. (2018) examined the effect of SSB characteristics on the performance of 15 IBs in Malaysia between 2008 and 2015 using the GMM estimator. Malaysia applies a strict proactive SG model. The dependent variables of this study are ROA, ROE, and operational efficiency (ROIAE), while the independent variables are the SSB characteristics (i.e., size, cross-membership, PhD qualification, reputation, financial expertise, and rotation). Empirical findings of this study indicate a significant positive relationship between SSB size and performance and a significant negative relationship between doctoral qualification, rotation (change in the SSB composition), and performance. Moreover, SSB cross membership and reputation enhance the performance of IBs in Malaysia.

Nomran and Haron (2019) explored the influence of dual boards of IBs (i.e., SSB and BOD) on the performance of 45 IBs from the GCC and SEA regions over the 2007-2015 period using the GMM – First Difference (2-step) method to analyse the data. The independent variables of this study are ROA and Zakat on equity (ZOE). The independent variables are SSB-index, BOD strength, the interaction of SSBs and BODs, SSB attributes (size, cross-membership, PhD qualifications, reputation, financial expertise), and BOD characteristics (size and independence). For the full sample, the study demonstrates that the SSB index and SSB PhD qualification enhance performance, while SSB-BOD interaction, SSB cross-membership, and SSB reputation adversely affect performance. In contrast, strong BODs and SSB financial expertise have a positive impact on ROA and a negative impact on ZOE. Moreover, SSB size and BOD size have a negative effect on ROA and a positive effect on ZOE. At last, BOD independence does not influence performance.

Alsartawi (2019) study assessed the relationship between SSB and the performance of GCC IBs (48 IBs) over the 2013-2017 period. The independence of SSB and the frequency of meetings were considered in this study. The author utilised only one indicator, ROA, to measure the performance of IBs. This study's findings reveal a negative relationship between SSB independence, SSB frequency meetings, and the performance of IBs. Therefore, this study recommends the IBs in the GCC countries follow a more proactive SG model to strengthen their framework.

Nomran and Haron (2020a) investigated the optimal SSB size that maximizes the performance of 113 IBs across 23 countries over the 2007-2015 period using the GMM method to analyse the data. The dependent variables of this are ROA, ROE, ROIAA, and ROIAE, while the dependent variables are SSB size, optimal SSB size (1 to 12 members), small SSBs (3 or fewer members), and large SSBs (3 or more members). The authors found several important results. First, they discovered that SSB size significantly and negatively affects performance. Moreover, in terms of the optimal SSB size, the study highlights the importance of a small SSB size in enhancing the performance of IBs compared to a large SSB size. The findings suggest that the SSB size of IBs should neither be less than three nor greater than six and that the optimal SSB size is five.

Khan and Zahid (2020) examined the CG index, which consists of BOD and SSB attributes that impact the performance of 79 IBs in 19 Asian countries for the 2011-2016 period, using Panel Random effects. The study used ROA, ROE, and Tobin's Q as performance measurements. The study's empirical results demonstrate that the CG index has a significant positive influence on the financial and market performance of IBs. Moreover, SSB size and financial expertise enhance the performance of IBs, while BOD size only positively impacts market performance, as measured by Tobin's Q. In contrast, BOD meetings and institutional ownership do not influence performance.

Trinh et al. (2020) scrutinised the effect of dual boards' characteristics on the performance of 154 IBs and CBs scattered over 14 countries in Asia and Africa over the 2010-2015 period using panel data analysis and Three-Stage Least-square (3-SLS). This study used the return on average equity (ROAE) and COST/INCOME ratios to gauge the financial performance of IBs. The study found several findings. First, the

authors show that busy BODs in CBs improve bank performance, while busy BODs in IBs decrease bank performance and increase cost inefficiency. Second, Busy SSBs in IBs reduce bank performance and increase cost inefficiency, implying that busy SSBs could fail the requirement that IBs comply with *Shari'ah* rules and principles, which could give rise to reputational risk and, thus, could trigger the failure of IBs and cause systematic risk. Third, the study found a significant and positive relationship between SSB compensation and SSB busyness, suggesting that it is more expensive to appoint busy *Shari'ah* scholars relative to their non-busy counterparts. Fourth, busy BODs with financial expertise in IBs negatively influence the performance of IBs, implying that BODs who are busy and have financial expertise might not necessarily meet the effective monitoring needs required for a complex system of governance such as that for IBs.

Furthermore, busy BOD in IBs significantly and positively influences agency costs, implying that busy BOD in IBs increases agency conflicts. The authors attributed this to the constrained business model of IBs, which requires extended monitoring to protect the minority rights of IAAs who engage with the IBs under the profit and loss sharing contracts. Finally, the study demonstrates that SSB doctoral qualification and busy audit committee members enhance the performance of IBs.

Haron et al. (2021a) investigated the impact of SSB characteristics (i.e., size, education, reputation, expertise, remuneration, and cross-memberships) on the financial and social performance of 15 IBs in Malaysia for the 2010-2018 period using the GMM estimator to analyse the data. The authors employed three performance measurements (i.e., ROA, ROE) and one social performance method (i.e., Zakat on equity). The empirical findings demonstrate that size does not affect IBs' performance. The SSB education, reputation, and expertise of SSB members are positively related to performance, while remuneration and cross-membership are negatively associated with performance.

In Indonesia, Hanafi et al. (2021) examined the influence of SSB on the performance (ROA) of 14 IBs in the country over the 2013-2019 period using multiple regression analysis. The authors study the effect of SSB doctoral qualification, members with academic positions (i.e., professors), and members with accounting/finance

expertise. The findings reveal that SSB members with academic positions (i.e., professors) and SSB educational qualifications in different fields enhance the performance of IBs. In contrast, members with doctoral qualifications and expertise in accounting/finance negatively and significantly influence performance.

Baklouti (2022) examined the effect of SSB characteristics on 42 IBs in the Middle East and North Africa (MENA) and some non-Islamic countries. A random effect generalized least squares (GLS) method for the regression analysis was applied in this study. The results show that the number of SSB meetings and large SSB size improve performance, while the SSB cross-membership negatively affects performance. On the other hand, the SSB members' expertise and reputation and the proportion of women in the SSB have no impact on the financial performance of IBs.

Hudayati et al. (2023) assessed the impact of the dual boards on the social performance measured by Zakat payments of a sample of 7 IBs in Indonesia over the 2011-2020 period using the panel fixed effects model. The authors scrutinised the effect of BOD attributes (i.e., size and remuneration) and SSB characteristics (i.e., size and reputation) on Zakat performance. The empirical results showed that the size and remuneration of the BOD and the size of the SSB had a significant positive effect on Zakat, while the reputation of the SSB had no effect. The authors suggest that IBs wishing to improve social performance should consider designing a large BOD and large SSB while also considering increasing BOD remuneration.

Khan et al. (2024) examined the effect of SSB diversity in terms of age, gender, nationality, educational qualification, financial expertise, tenure, size, and cross-membership on the performance of 22 IBs in Pakistan over the 2005-2020 period using random effects model and the GMM estimator. The study found diverse results. First, SSB age diversity (measured by an age index and includes three categories: less than 40 years, less than 50 years, and more than 50 years old), SSB nationality, and SSB cross-membership harm performance. Second, the SSB size and financial expertise enhance performance. Finally, SSB gender diversity, educational qualification, and tenure diversity (measured by a tenure diversity index and includes five categories: less than 3 years tenure, 6, 9, 12, and 15 years or more) do not influence performance.

Notably, several other studies assessed the influence of SSB on risk-taking and efficiency. For instance, Mezzi (2018) explored the impact of CG and SG characteristics on the efficiency of 60 IBs in 15 countries over the 2004-2012 period using Data Envelopment Analysis (DEA) and regression analysis. The study's findings reveal that BOD size, independence, and the CSGM positively and significantly influence efficiency, while SSB size (a proxy for SG) does not affect efficiency.

Safiullah and Shamsuddin (2018) analysed the differences in risk between 188 IBs and CBs from 28 countries with specific attention to the role of SSBs on IBs over the 2003-2014 period. The authors show that SSB members' size and their academic qualifications are negatively related to operational and insolvency risks, while SSB's reputation is positively associated with these risks. Lastly, the study demonstrates that SSB attributes do not have a significant influence on liquidity and credit risks.

Trinh et al. (2020) investigated the effect of SSB busyness and doctoral qualification on various risks of IBs in 14 countries over the 2010-2015 period. The authors found that SSB busyness has a significant positive effect on credit risk and operational risk, while busy SSBs negatively influence insolvency risk, liquidity risk, and asset risk. SSB qualification only affects credit risk negatively.

Lastly, using Panel data analysis, Mukhibad and Setiawan (2022) examined the impact of SSB on the risk-taking of 14 IBs in Indonesia over the 2010-2020 period. The authors measured risk-taking by employing a composite of various risks, including credit risk, market risk, liquidity risk, operational risk, legal risk, reputation risk, strategic risk, *Shari'ah*-compliance risk, rate of return risk, equity investment risk, and insolvency risk. Their findings suggest SSB's busyness, financial expertise, and experience adversely affect these risks. On the other hand, SSB's level of education (i.e., bachelor's, master's, and PhD degrees) positively influences risk, while SSB tenure does not impact risk-taking.

Table 2.3 summarises the findings of previous studies on the relationship between SSB characteristics and the performance of IBs.

Table 2.3 Summary of Literature Review

Study	Sample and Period	Dependent Variables	Independent Variables	Method	Key Findings
Grassa and Matoussi (2014b)	77 IBs and 85 CBs in the GCC and Southeast Asia over the 2000-2009 period	ROA ROE	SSB size SSB cross-membership SSB financial expertise Women in SSB Board size Women in BOD Foreign directors Director fees CEO tenure CEO duality CEO founder CEO age	Panel Regression Analysis	<p>For Southeast Asia: SSB size: <b>significant</b> (-) SSB cross membership: <b>significant</b> (-)</p> <p>For the full sample: SSB financial expertise: <b>significant</b> (+) Director fees: <b>significant</b> (+) CEO duality: <b>significant</b> (+) CEO age: <b>significant</b> (+)</p>
Mollah and Zaman (2015)	86 IBs and 86 CBs across 25 countries for the period between 2005 and 2011	ROA ROE ROIAA (Operational efficiency in terms of assets) ROIAE (Operational efficiency in terms of equity) Tobin's Q	SSB size BOD size BOD independence CEO duality CEO internal	Random Effects (RE) GLS & Two-step system Generalized Method of Moments (GMM)	SSB size: <b>significant</b> (+) BOD size: <b>significant</b> (-) BOD independence: <b>significant</b> (-) CEO duality: <b>significant</b> (-) CEO internal: <b>significant</b> (-)

Study	Sample and Period	Dependent Variables	Independent Variables	Method	Key Findings
Al-Mutairi and Quttainah (2017)	82 IBs in 15 countries over the 1993-2014 period	ROA ROE Tobin's Q	SSB size Outside members of SSB SSB cross-membership SSB IFSB membership SSB AAOIFI membership SSB education	Clustered Regression &  Two-stage Least-Squares Regression	SSB size: <b>significant</b> (+) Outside members of SSB: <b>significant</b> (+) SSB cross-membership: <b>significant</b> (+) SSB IFSB membership: <b>significant</b> (+) SSB AAOIFI membership: <b>significant</b> (+) SSB education: <b>significant</b> (+)
Nomran et al. (2017)	25 IBs in Malaysia and Indonesia over the 2007-2015 period	ROA ROE	SSB size SSB cross-membership SSB PhD qualification SSB reputation SSB financial expertise SSB rotation	RE GLS &  GMM	For the full sample: SSB size: <b>significant</b> (+) SSB cross-membership: <b>significant</b> (+) SSB PhD qualification: <b>significant</b> (-) SSB rotation: <b>significant</b> (-)
Ajili and Bouri (2018a)	44 IBs in the GCC countries over the 2010-2014 period	ROA ROE	CG-index SSB-index (existence of SSB+ SSB size+ SSB education+ SSB financial expertise) BOD-index AC-index	RE Model	No statistically significant relationship was found between all the indexes (CG-index, SSB-index, BOD-index, AC-index) and the performance of IBs.
Farag et al. (2018)	90 IBs across 13 countries for the 2006-2014 period	ROA ROE ROOA (Return on Operating Assets) ROOE (Return on Operating Equity)	SSB size BOD size BOD independence	Fixed Effects (FE) Model &  GMM	SSB size: <b>significant</b> (+) BOD size: <b>significant</b> (+)

Study	Sample and Period	Dependent Variables	Independent Variables	Method	Key Findings
Hakimi et al. (2018)	13 IBs in Bahrain over the 2005-2011 period	ROA ROE	SSB size SSB financial expertise BOD size BOD duality Institutional BOD members	GLS RE Model & GMM	SSB size: <b>significant</b> (+) BOD size: <b>significant</b> (+) BOD duality: <b>significant</b> (+)
Nomran et al. (2018)	15 IBs in Malaysia over the 2008-2015 period	ROA ROE ROIAE	SSB size SSB cross-membership SSB PhD qualification SSB reputation SSB financial expertise SSB rotation	GMM	SSB size: <b>significant</b> (+) SSB cross-membership: <b>significant</b> (+) SSB PhD qualification: <b>significant</b> (-) SSB reputation: <b>significant</b> (+) SSB financial expertise: <b>significant</b> (-) SSB rotation: <b>significant</b> (-)
Nomran and Haron (2019)	45 IBs across the GCC and Southeast Asia over the 2007-2015 period	ROA ZOE (Zakat on equity)	SSB-index BOD-strength SSB-index*BOD-strength SSB size SSB cross-membership SSB PhD qualification SSB reputation SSB financial expertise BOD size BOD independence	GMM – First Difference (2-step)	For the full sample: SSB-index: <b>significant</b> (+) BOD-strength: <b>significant</b> (+ on ROA   - on ZOE) SSB-index*BOD-strength: <b>significant</b> (-) SSB size: <b>significant</b> (- on ROA   + on ZOE) SSB cross-membership: <b>significant</b> (-) SSB PhD qualification: <b>significant</b> (+) SSB reputation: <b>significant</b> (-) SSB financial expertise: <b>significant</b> (+ on ROA   - on ZOE) BOD size: <b>significant</b> (- on ROA   + on ZOE)

Study	Sample and Period	Dependent Variables	Independent Variables	Method	Key Findings
Alsartawi (2019)	48 GCC IBs over the 2013-2017 period	ROA	SSB independence SSB frequency of meetings	Linear Regression Model	SSB independence: <b>significant</b> (-) SSB frequency of meetings: <b>significant</b> (-)
Nomran and Haron (2020a)	113 IBs across 23 countries over the 2007-2015 period	ROA ROE ROIAA ROIAE	SSB size Optimal SSB size	GMM	SSB size: <b>significant</b> (-)  In terms of the optimal SSB size, the study highlights the importance of a small SSB size in enhancing the performance of IBs compared to a large SSB size. The findings suggest that the SSB size of IBs should neither be less than three nor greater than six and that the optimal SSB size is five.
Khan and Zahid (2020)	79 IBs across 19 Asian countries over the 2011-2016 period	ROA ROE Tobin's Q	CG-index (BOD & SSB) SSB size SSB financial expertise BOD size BOD independence BOD meetings Institutional ownership	RE model	For the full sample: CG-index: <b>significant</b> (+) SSB size: <b>significant</b> (+) SSB financial expertise: <b>significant</b> (+) BOD size: <b>significant</b> (+ on Tobin's Q)

Study	Sample and Period	Dependent Variables	Independent Variables	Method	Key Findings
Trinh et al. (2020)	70 IBs and 84 CBs across 14 countries in Asia and Africa over the 2010-2015 period	ROE Cost-to-income ratio	SSB busyness SSB PhD qualification BOD size BOD independence CEO duality Busy outsiders on the BOD BOD outsiders with PhDs Audit committee size Busy audit committees	Panel Data Analysis &  Three-Stage Least-Square (3SLS)	For IBs: SSB busyness: <b>significant</b> (- on ROAE   + on COST/INCOME) SSB PhD qualification: <b>significant</b> (+) BOD size: <b>significant</b> (- on ROAE   + on COST/INCOME) Busy outsiders on the BOD: <b>significant</b> (- on ROAE   + on COST/INCOME) Busy audit committees: <b>significant</b> (+ on ROAE)
Haron et al. (2021a)	15 IBs in Malaysia over the 2010-2018	ROA ROE ZOE	SSB remuneration SSB size SSB cross-membership SSB doctoral qualification SSB reputation SSB financial expertise	GMM	SSB remuneration: <b>significant</b> (-) SSB cross-membership: <b>significant</b> (-) SSB doctoral qualification: <b>significant</b> (+) SSB reputation: <b>significant</b> (+) SSB financial expertise: <b>significant</b> (+)
Hanafi et al. (2021)	14 IBs in Indonesia over the 2013-2019 period	ROA	SSB doctoral qualification Professors in SSBs SSB financial expertise SSB education CG-score	Multiple Regression Analysis	SSB doctoral qualification: <b>significant</b> (-) Professors in SSBs: <b>significant</b> (+) SSB financial expertise: <b>significant</b> (-) SSB education: <b>significant</b> (+) CG-score: <b>significant</b> (+)
Baklouti (2022)	42 IBs in the MENA region and non-Islamic countries over the 2011-2018 period	ROA ROE	SSB size SSB cross-membership SSB expertise SSB reputation SSB meetings Women on the SSB	RE- GLS	SSB size: <b>significant</b> (+) SSB cross-membership: <b>significant</b> (-) SSB meetings: <b>significant</b> (+)

Study	Sample and Period	Dependent Variables	Independent Variables	Method	Key Findings
Hidayati et al. (2023)	7 IBs in Indonesia over the 2011-2020 period	Zakat payments	SSB size SSB reputation BOD size BOD remuneration	FE Model	SSB size: <b>significant</b> (+) BOD size: <b>significant</b> (+) BOD remuneration: <b>significant</b> (+)
Khan et al. (2024)	22 IBs in Pakistan over the 2005-2020 period	ROA ROE OE (Operational efficiency)	SSB age diversity (index) SSB cross-membership SSB gender diversity SSB nationality diversity SSB education SSB financial expertise SSB tenure (index) SSB size	RE Model &  GMM	SSB age diversity: <b>significant</b> (-) SSB cross-membership: <b>significant</b> (-) SSB nationality diversity: <b>significant</b> (-) SSB financial expertise: <b>significant</b> (+) SSB size: <b>significant</b> (+)

### 2.3.5.1 Gaps in the Literature

Lately, numerous studies have assessed the relationship between SSB and the performance of IBs across jurisdictions. Most studies have examined SSB characteristics such as size, educational qualification, financial expertise, cross-memberships, reputation, and meetings. However, these studies overlooked some prominent SSB attributes such as independence, remuneration, and busyness.

First, the independence of SSB has been rarely emphasized in previous literature. Although Alsartawi (2019) empirically investigated the SSB independence on IBs' performance, the study measured SSB independence using a single proxy as a binary variable "zero" if the SSB member has a direct or indirect relationship with the IB; "one" indicates otherwise. However, this study suffers from several limitations. First, this study is limited to the GCC region; hence, its findings cannot be generalised to the other IBs in other countries. Second, the author's study period is only four years (i.e., 2013-2017); hence this study extends the study period. Third, the study utilised only one accounting-based performance indicator (i.e., ROA) to capture the performance of IBs. Nevertheless, employing a more appropriate performance measurement that could reflect the nature of IBs is vital. Previous studies have suggested Zakat as an applicable measurement to IBs to capture their social performance. Finally, since most IBs in SEA and GCC do not usually disclose direct and indirect relationships of SSB to the IBs, it would be impractical to employ the same measurement as Alsartawi (2019) to capture SSB independence.

Therefore, this study employs a different measurement of SSB independence. Nomran and Haron (2020b) suggest that SSB independence is measured in several ways, including the entity responsible for their appointment. Therefore, following this study, SSB independence is measured by a binary variable, i.e., "1" if shareholders appoint SSB; "0" otherwise. The reason for selecting this measurement is that most IBs in SEA and GCC disclose who appoints the SSB. Also, it can be argued that SSB scholars can show higher independence when appointed by shareholders in the annual general meeting compared to, for instance, when appointed by the management or the BOD. If the SSB is appointed by the management or BOD, the SSB decisions (*fatwas*)

could be compromised as *Sharī'ah* scholars may approve suspicious activities to guarantee their position on the SSB.

Second, the impact of SSB remuneration on performance has not been widely studied. To the best of the researcher's knowledge, only the study of Haron et al. (2021a) assessed the impact of SSB remuneration on the performance of IBs and found a negative association. However, this study suffers from some limitations. This study is only based on the IBs of Malaysia, and therefore, it neglected other major Islamic finance jurisdictions, especially the GCC. Hence, this study aims to address such a gap by analysing the impact of SSB remuneration on the performance of IBs across the GCC and Southeast Asia (SEA) regions.

Third, although directors' busyness in boardrooms has been studied widely in the CG debate, SSB busyness has rarely been explored. To the best of the researcher's knowledge, only one study (i.e., Trinh et al., 2020) has examined the link between SSB busyness and the performance of IBs. Nevertheless, this study has several limitations. First, the authors used only the accounting-based performance measurement (i.e., ROE and cost efficiency) to study the said relationship. Therefore, besides the accounting performance measurements, this study employs Zakat as a social performance indicator of IBs. Furthermore, their study period is only five years (i.e., 2010-2015); thus, this study extends the study period.

Fourth, although the effect of SG models (i.e., CSGM vs. DSGM) on the performance and efficiency of IBs has been undertaken by a few studies such as Mezzi (2018), Alam et al. (2019), and Nomran and Haron (2020c), there are still some gaps that need to be addressed. Using dummy variables, Mezzi (2018) documents a positive and significant association between CSGM and the efficiency of IBs, while Alam et al. (2019) found the same result between CSGM and the performance of IBs. Moreover, the findings of the descriptive analysis study of Nomran and Haron (2020c) demonstrate that IBs that operate under the CSGM showed, on average, higher levels of financial performance.

The current study differs from these studies. First, unlike Mezzi (2018) and Alam et al. (2019), the current study divided the sample IBs into two sub-samples

consisting of those who adopt the CSGM versus those who embrace the DSGM to compare the effect of SSB effectiveness on the performance of IBs adopting the CSGM versus the DSGM. Second, although Nomran and Haron (2020c) divided IBs into two groups based on which SG models they adopt, the authors only compared the financial performance of countries that adhere to the CSGM versus those that embrace the DSGM. Therefore, this study compares the financial and social performance of the two sub-samples and takes into account the effect of SSB effectiveness. Third, these studies used conventional performance measurements, neglecting an Islamic approach to capture IBs' performance; thus, besides the accounting-based measurement, this study employs annual Zakat payments by IBs to gauge the Islamic social performance of IBs. At last, the current study extends the study period.

Fifth, this study considers the effect of SSBs during crisis and non-crisis periods. The researcher examines the impact of SSBs on the performance of IBs during the 2008 GFC and the COVID-19 Pandemic crises. To the best of the researcher's knowledge, only two studies (i.e., Mollah and Zaman, 2015; Wahyuni and Aidah, 2022) considered the influence of effective SSBs in crisis and non-crisis periods. The former study considered the impact of SSB on performance in the 2008 GFC, while the latter considered the effect of SSB on the recent COVID-19 pandemic crisis. However, these studies have various limitations. First, they used only one SSB characteristic (i.e., SSB size) to capture the influence of SSB on the performance of IBs. Second, they used the conventional performance measurements. Therefore, this study differs by using an overall SSB score that consists of six important attributes and employing Islamic social performance measurement (i.e., Zakat payments).

That said, the current study aims to fulfil these gaps and limitations of previous studies. This study scrutinises the relationship between SSB independence, remuneration, and busyness characteristics and the performance of IBs across GCC and SEA regions. It assesses the influence of effective SSBs on the performance of IBs in crisis and non-crisis periods. Moreover, the moderating effect of SG models on the relationship between SSB effectiveness and IBs' performance is investigated in this study.

## **2.4 THE INFLUENCE AND IMPORTANCE OF INSTITUTIONAL SHAREHOLDING TO FINANCIAL INSTITUTIONS**

There has been a phenomenal growth in the number of institutional shareholders, such as pension funds, mutual funds, banking firms, and insurance companies, who possess the essential resources and expertise to carry out their fiduciary duty of ascertaining good governance by monitoring portfolio firms actively (Hawkins, 1997; Sherman and Chaganti, 1998; Becht et al., 2003; Klettner, 2021). In jurisdictions where IFIs operate, Zouari and Taktak (2012) and Khamis et al. (2015b) found that Institutional ownership is the most common form of ownership structure in the Middle East, Southeast Asia, and North Africa.

Moreover, Waheed and Malik (2021) report that such shareholders have become the largest owners in corporations in the developed world, such as the U.S. and U.K. Their market capitalization was increasing in Latin America and Asia. The expanding growth of their global investments permits them the potential to influence the behaviour of investee firms through their monitoring activities (Aggarwal et al., 2011; Gillan and Starks, 2003; Mallin, 2016). The role of institutional shareholder activism has gained increased prominence as equity holders, and their role has also evolved (Gillan and Starks, 2000; Fichtner, 2020). The rapid growth of equity markets and the fact that households increasingly shifted from direct stock ownership to holdings through asset managers have contributed to this trend (Fichtner, 2020). The paramount significance of “shareholder activism” has been to focus on the poorly performing companies in their portfolio and pressure the company's management for enhanced performance, hence improved shareholder value (Gillan and Starks, 2000). Notably, Institutional shareholders are documented to serve an effective role as corporate monitors (e.g., Hartzell and Starks, 2003; Almazan et al., 2005; Fich et al., 2015; Sakawa and Watanabel, 2020).

Monitoring may include the acquisition of information, voting engagement, and more active intervention in management activities and is frequently used synonymously with “shareholder activism” and “active investing” (Maug, 1998; Yaron, 2005; Idowu et al., 2013). Myners (2001) focuses on institutional investors’ need to engage in active monitoring, encourage shareholder activism, and ensure good CG. The monitoring view

is consistent with some prior evidence in the literature that institutional investors' activism influences corporate events and enhances firm value (e.g., Gillan and Starks, 2000; McCahery et al., 2008; Brav et al., 2008a; Brav et al., 2008b; Klein and Zur, 2009; Helwege et al., 2012; Ling et al., 2021).

Unlike other investors, Steele (2005) asserts that the responsibility and incentive of institutional investors to engage with investee firms emanates from the pressure posed by the organisations or individuals who contributed their funds for investment. According to Hellman (2005), beneficiaries expect high returns from fund managers and, therefore, should ensure that firm management furnishes good CG to maximize shareholder value. Further, institutional shareholders have motives to show concern for CG as a component of their fiduciary obligation, as they are bound by law to act in the best interest of their investors (clients) (Black, 1990).

Therefore, since institutional investors are entrusted with funds and are expected to invest money on behalf of clients and members, this responsibility may prompt them to actively monitor management and engage with investee companies to generate maximum returns for their beneficiaries. Consequently, this pressures corporate managers to create more shareholder value and make the firm attractive to institutional investors (Hellman, 2005). Empirical studies such as Ajay and Madhumathi (2015), Kim et al. (2016), and Ramalingegowda et al. (2021) demonstrate that institutional investors reduce opportunistic earnings management because such owners will pressure the firm to adopt better accounting policies (Chung et al., 2002).

Institutional shareholders can influence and discipline management when they are unsatisfied with a portfolio firm directly through their ownership, i.e., "voice," or indirectly by trading their shares, i.e., "exit" (Hirschman, 1970; Gillan and Starks, 2003; Ferreira and Matos, 2008). Theoretical models of some studies show that governance advantages of corrective actions through "voice" (see, e.g., Shleifer and Vishny, 1986; Huddart, 1993; Kahn and Winton, 1998; Bolton and Thadden, 1998; Faure-Grimaud and Gromb, 2004) and others document that treat to "exit" can discipline management (see, e.g., Admati and Pfleiderer, 2009; Edmans, 2009; Edmans and Manso, 2011; McCahery et al., 2016). While the reactionary method of exiting by selling shares rather than dialogue has been discussed in the literature, this step is generally not encouraged,

and a more responsible approach would be a shareholder-active investment (Allcock, 2018). Additionally, since the “exit” option is considered costly, large institutional shareholders opt to engage with their portfolio firms to change unfavourable governance structures and correct undesirable performance (McCahery et al., 2016; McNulty and Nordberg, 2016).

Indeed, because of their sizeable shareholding, institutional owners are entitled to voting rights at the annual general meetings. Thus, they may exercise their rights as significant shareholders to make their “voices” heard or “exit” by selling their shares. Although engaging with investee firms by active interaction, i.e., “voice,” through voting rights and meetings with management is encouraged, studies such as Admati and Pfleiderer (2009), Edmans (2009), Edmans and Manso (2011), and McCahery et al. (2016) suggest that threat to exit will discipline the investee firms. For instance, when institutional shareholders depart, Parrino et al. (2003) found that when such owners sell their shares, it influences the decision of the BOD to fire a CEO. Hartzell and Starks (2003) also found that institutional shareholders play a crucial role in mitigating agency problems and closely monitoring CEO behaviour. In addition, Ferreira and Matos (2008) document that firms with higher levels of ownership by independent institutional shareholders exhibit reduced managerial over-investing and better monitoring roles, which was reflected in better firm performance.

It is worth mentioning that not all shareholders are motivated to engage with investee firms because of their different incentives to do so. Practically, it is costly and time-consuming for investors to collect firm-specific information, analyse the information with professional expertise, monitor firm activities, and intervene through shareholder activism (Ward et al., 2017). Nevertheless, when considering institutional shareholders, they possess more professional knowledge (El-Gazzar, 1998; Lin and Fu, 2017; Huo et al., 2021), and they have access to information (Michaely and Shaw, 1994; Elyasiani and Jia, 2010; Huo et al., 2021) for investment purposes, not available for private investors; thus, making them better able to offer active monitoring of investee firms than individual investors (Alshabibi, 2021).

Bartov et al. (2000), Jiambalvo et al. (2002), and Ferreira and Matos (2008) indicate that institutional shareholders are sophisticated investors of company

information, therefore making them better informed than individual investors. Institutional investors, such as pension funds, are independent and usually have long-term investment horizons (Cao and Donnelly, 2010). Notably, institutional shareholders are observed to serve as effective corporate monitors (Hartzell and Starks, 2003; Hartzell and Starks, 2005; Gillian and Starks, 2007; Ferreira and Matos, 2008; Fich et al., 2015).

To sum up, institutional shareholders differ from other shareholders in various ways. First, institutional shareholders owing to their sizeable ownership often exercise their “voice” and influence the CG of financial institutions through their voting rights and behind-the-scenes engagement with management (Appel et al., 2016; McCahery et al., 2016; Bebchuk et al., 2017); other forms of engagement with investee firms can be one-to-one meeting, shareholder proposal and resolutions, focus lists, and CG rating systems (Martin et al., 2007; Mallin, 2016). Second, institutional shareholders have greater ability and incentives to monitor their portfolio firms (Agrawal and Mandelker, 1990; Fich et al., 2015) because of the pressure from clients and the fact that large shareholders mainly bear agency costs and are exposed to firm risk more than other shareholders. Third, it is generally asserted that institutional shareholders are better informed than individual and smaller shareholders (Wermers, 2000; Parrino et al., 2003; Carpentier and Suret, 2020) due to economies of scale (research and information costs) and their continued presence in the market (Lakonishok and Shleifer, 1992). These shareholders have lower monitoring cost functions since they gain firm- and manager-specific knowledge over time (Ghaly et al., 2020).

Fourth, institutional shareholders’ monitoring benefits may be sufficient to offset the associated costs (e.g., the free-riding problem of some shareholders) (Ryan and Schneider, 2002; Chen et al., 2007). Fifth, institutional shareholders advocate for higher representation of independent outside directors on the BOD to oversee the executives and management (Pass, 2004; Pucheta-Martinez and Chiva-Ortells, 2020). At last, some studies highlight financial institutions’ governance role as jurisdictions where the market for corporate control is less effective (see, e.g., Morck and Nakamura, 1999), with weaker governance controls (see, e.g., Kim et al., 2016), or with political instability (see, e.g., Al-Janadi, 2021).

On the other hand, Institutional shareholders can substantially benefit financial institutions in several ways. First, as argued above, active institutional shareholders' incentives to monitor are thought to enhance CG, benefit other shareholders, especially the passive ones, and improve performance. Second, given their sizable relationships with financial markets, institutional investors can bring the firm increased Wall Street coverage, raising demand for, and improving the liquidity of its shares and, thereby, decreasing the firm's transaction and financing costs<sup>1</sup> (Elyasiani and Jia, 2010), and thus, supporting the firm in times of financial distress. As such, institutional investors are better able to help enhance investee firms' performance by sharing their professional knowledge, management skills, and fundraising networks with their portfolio firms than individual investors (Lin and Fu, 2017).

## **2.5 INSTITUTIONAL SHAREHOLDING AND CORPORATE GOVERNANCE OF ISLAMIC BANKS**

In IBs, The BOD and the SSB are appointed by shareholders to monitor management (Nomran and Haron, 2019). As part of their duties and rights, institutional shareholders participate in the process of appointing the respective boards. However, as mentioned earlier, the SSB members are not always appointed by the shareholders and sometimes could be assigned by the BOD or management. Accordingly, they are employed by the IFI, and their remuneration is proposed by the management and approved by the BOD (Grais and Pellegrini (2006a), raising questions about their independence and *Shari'ah*-compliance monitoring. Although IBs have similar agency problems with their conventional counterparts, they also have agency problems unique to them, resulting from their very nature of being Islamic and the additional layer that oversees *Shari'ah*-compliance.

Besides the regular principal-agent conflicts, IBs are also likely to face another type of agency problem in case managers deviate from their duty to ensure that all funds are invested in *Shari'ah*-compliant assets (Zainuldin et al., 2018). Another potential

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<sup>1</sup> "Smart companies think of institutional shareholders as partners, who stick with them in bad times and can help them raise large pools of capital in good times," says David Liu, senior vice president of investment bank Broadview International, a division of Jefferies Group (Tech Firms Seek Stability in Arms of Institutional Holders; Wall Street Journal, August 26, 2004).

problem unique to IBs is “*fatwa shopping*.” Hosen (2008) and Oseni (2017) have assessed the “*fatwa shopping*” problem, which is a concept of searching for lenient SSB members. This problem may be prevalent in jurisdictions with weak regulatory frameworks and jurisdictions adhering to DSGM. Consequently, due to a lack of independence, the managers of IBs may pressure the SSB to certify their certain investments or services and their other decisions to meet their earnings target (Alam and Miah, 2021), thus increasing the *Sharī‘ah* non-compliance risk, which is a part of operational risks that can lead to legal, financial, and reputation risks (AAOIFI, 2018).

Another conflict of interest may emerge between the dual governance boards (i.e., SSB and BOD). Due to the lack of SSB independence and the absence of strong legislation in some countries, the BOD may not consider or refuse the decisions made by the SSB deemed as counter-productive to the bank’s profit-oriented objectives, and in some cases, BOD may alter SSB decisions to accommodate its interests (Razak, 2018). This elevates conflict between the SSB, which has fiduciary duties in ensuring *Sharī‘ah* compliance, and the BOD. Consequently, these factors can harm SG and *Sharī‘ah*-compliance supervision role by the SSB and may negatively influence IB’s performance

That being the case, given their significant holdings, professional knowledge, incentives to monitor, and access to firm-specific information, institutional shareholders can constructively monitor the management to ascertain the achievement of corporate goals, reduce potential opportunistic behaviours, and help minimize agency costs. Such shareholders can enable the SSB to discharge their responsibilities independently and freely without favour or fear from management or the BOD. They can ensure that managers of IBs refrain from engaging in activities that are not *Sharī‘ah*-compliant by enabling and strengthening the role of SSB in safeguarding sound and effective SG as well as ensuring high SSB independence. Therefore, large institutional shareholding may monitor management and guarantee a high level of SSB independence from the management.

The empirical findings of Kang et al. (2018) suggest that information advantages and industry governance experience of institutional shareholders obtained from their multiple holdings are important channels in which such shareholders perform

effective monitoring. The authors highlight that such owners facilitate effective monitoring and increase firm value thanks to their large ownership, industry expertise/knowledge, and past activism/governance experience accumulated from their portfolio holdings. It is expected that with their large equity holdings, access to superior resources, and the power inherent in voting rights, institutional owners would be able to have a significant impact on CG (David and Kochhar, 1996). Therefore, given their professional knowledge and the greater resources they possess, sophisticated institutional shareholders have the capacity to monitor corporate management and may highly influence performance (Pound, 1988).

## **2.6 PRIOR STUDIES OF THE MODERATING EFFECT OF INSTITUTIONAL SHAREHOLDING**

Various studies have examined institutional shareholders' effects as moderators on the relationship between CG characteristics and financial performance. For instance, Guizani (2013) shows that institutional ownership positively moderates the relationship between board characteristics (i.e., independence and size) and the performance of a sample of 30 firms listed on the Tunis Stock Exchange over the 2004-2010 period, supporting institutional shareholders' activism. This study implies that board independence on performance is more robust for high-institutional ownership firms, while the effect is insignificant for low-institutional ownership firms. Moreover, although institutional shareholders positively moderate the relationship between CEO duality and performance with high-institutional ownership firms and negatively with low-institutional ownership firms, the interaction coefficients are statistically insignificant. Therefore, this study argues that given the sophistication of institutional shareholders, they are effective monitors and moderate the relationship between CG characteristics and performance.

Likewise, Waheed and Malik (2021) examined the same relationship with the later study and found that institutional shareholders positively and significantly moderate the relationship between board independence and firm performance. In addition, such shareholders positively and significantly moderate the negative

interaction between board size and performance, while their effect on the relationship between CEO duality and performance is insignificant.

Boachie (2021) investigated the influence of local and foreign institutional shareholding on the relationship between CG characteristics and the financial performance of Ghanaian banks. The empirical findings show that foreign institutional banks positively and significantly moderate the relationship between board size and performance and CEO duality and performance.

Although many studies examine the effect of institutional ownership and board attributes on performance, the interaction effect of SSB and institutional shareholding on the performance of IBs is largely overlooked. However, few researchers have explored the ownership structure of the performance of IBs (see, e.g., Zouari and Taktak, 2014; Bourkhis and Omri, 2016; Zeineb and Mensi, 2018; Djeutcheu, 2019; Alsartawi, 2019).

Notably, few studies have investigated the institutional shareholding and performance nexus. Zouari and Taktak (2014) and Djeutcheu (2019) investigated the influence of institutional ownership on the performance of IBs and found negative and positive links, respectively. In contrast, Khan and Zahid (2020) found no relationship between Institutional shareholding and the performance of IBs. However, as mentioned earlier, these studies have failed to employ an Islamic performance measure such as Zakat to reflect on the nature of IBs. No previous studies have assessed the moderating effect of institutional shareholding on the relationship between SSB and IBs' performance. Thus, this study will contribute to the literature on the level of importance of institutional shareholders to the SG of IBs by assessing their effect on SSBs.

## **2.7 CONCLUSION**

This chapter provides the definitions of CG and SG. In addition, the SSB characteristics and the extent to which they are essential to the IBs are discussed. It also has critically analysed previous literature on the relationship between SG and the performance of IBs. Moreover, this chapter has emphasized the importance of institutional shareholders as a monitoring mechanism.

## CHAPTER THREE

### THEORETICAL FRAMEWORK AND HYPOTHESIS DEVELOPMENT

#### 3.1 INTRODUCTION

This chapter provides the related theories of the CG of financial institutions. More specifically, the theoretical justifications are utilised to hypothesise the relationships between the study variables. At first, the applicable theories are discussed. Then, the theoretical framework is illustrated, followed by the development of hypotheses.

#### 3.2 UNDERPINNING THEORIES

This study employs three theories to explain the relationship between study variables. The agency theory, resource dependence theory, and stakeholder theory are used to develop a hypothetical association between the characteristics of SSB and the performance of IBs.

##### 3.2.1 Agency Theory

Agency Theory (AGT) discusses the relationship between business agents (managers) and their principals (owners). Jensen and Meckling (1976) defined agency relationship “*as a contractual relationship between the shareholder as the principal and the managers as the agents who are given some authority to perform services on behalf of the principal.*” This relationship is ruled by a contract between the parties specifying the agent’s duties and responsibilities in exchange for compensation. AGT is concerned with guaranteeing that managers act in the interest of shareholders. It also concerns the natural conflict of interest between principles and agents (Fama and Jensen, 1983).

Jensen and Meckling (1976) suggested that agency problems in a firm emerge from the principal-agent conflict of interest. The managers or agents might not augment

the interests of the shareholders or principles and may pursue personal maximizing welfare. As a result of possible misalignment between these parties, agency costs arise. Jensen and Meckling (1976) regarded agency costs as the sum of monitoring, bonding, and residual costs. Monitoring costs are incurred by principles associated with overseeing and evaluating agents, while bonding costs are incurred by the management to ensure shareholders' interests are safeguarded. On the other hand, the residual costs are costs incurred by principles resulting from the inability of monitoring and bonding costs to align the interests of the managers and that of the principles. Thus, to reduce agency costs and information asymmetries between agents and principles, AGT suggests that CG mechanisms are the tool to ensure that their investments are secured, and their values are enhanced by monitoring, controlling, and the decisions of the management (Jensen and Meckling, 1976).

Corporate governance is a mechanism by which the BOD monitors and lessens the conflict of interest and the agent-principals' problem (Berle and Means, 1932). An efficient governance system reduces agency costs and improves a firm's financial performance (Eisenhardt, 1989). Therefore, AGT suggests monitoring and control systems are vital to mitigating agent-principal conflict (Fama and Jensen, 1983).

### **3.2.2 Resource Dependence Theory**

Resource dependence theory (RDT), first developed by Pfeffer (1973), specifies that a corporation is an open system dependent on contingencies in the external environment (Pfeffer and Salancik, 1978). The theory suggests that appointing the board of directors is crucial in linking the firm and social resources such as human, information, or capital resources (Pfeffer, 1973). Specifically, the board's functionality is not only monitoring managerial behaviours as suggested by agency theory but also providing essential resources needed to enhance firm performance and/or ensuring those resources through connections with the external environment (Hillman et al., 2000). The theory proposes that effective directors with adequate skills and expertise will likely give organisations good ratings and connections to investors and other relevant stakeholders (Hillman et al., 2000; Haniffa and Cooke, 2002; Hillman and Dalziel, 2003).

Directors provide crucial resources for the company (Hillman and Dalziel, 2003) by, for instance, enhancing the public image of the firm, furnishing expertise, building external relationships, advising, and counselling management, and so on (Bathula, 2008). These directors' resources would enhance performance and shareholders' wealth (Pfeffer, 1972).

Moreover, Hillman et al. (2000) contends that outside directors may become an information resource for the company because of their contacts and experts. Correspondingly, the company may benefit from these directors regarding transaction cost reductions between the firm and other parties. Therefore, outside directors may present firms with industry information, making them more competitive. In addition, RDT advocates that larger boards are better than smaller boards because larger panels can link the firm with a larger external environment and thus help the firm achieve its goals (Pfeffer, 1972).

### **3.2.3 Stakeholder Theory**

Unlike agency theory, Stakeholder Theory (SKT) contends that not only the principles and agents are the owners, but also broader parties are involved. Freeman (1984), who developed the theory, defines stakeholders as *“a group of constituents who have a legitimate claim on the corporation or a person who contributes directly or indirectly to the firm.”* Freeman (1984) argued that business organisations should be more concerned with the interests of neglected stakeholders to make better decisions using a strategic and holistic approach. Freeman did not agree that firms were developed sufficiently enough to address and explain the complicated communication between different stakeholder groups in firms. Therefore, he suggested the SKT, which caters to the interests of different firm stakeholders.

Freeman (1984) suggests that a firm's success depends on the successful relationships with its stakeholders. The theory asserts that all parties that affect the firm's performance are important to the success of the firm. The theory provides a vehicle for connecting ethics and strategy (Phillips, 2003), and firms that diligently seek to serve the interests of a broad group of stakeholders will create more value over time

(Freeman, 1984; Freeman et al., 2010). Corporate actions affect stakeholders, who are groups or individuals that benefit from or are harmed by and whose rights are violated or respected by such action (Freeman, 2001). SKT suggested that the business considers the interests of groups affected by the firm (Gibson, 2000). Regarding BOD responsibilities, the SKT expects corporate boards to pay regard to the different stakeholder groups, including interest groups linked to social, environmental, and ethical considerations (Freeman, 1984; Freeman et al., 2004). Therefore, a firm has fiduciary duties not only to the shareholders but to the related stakeholders.

Freeman (1984) has identified key stakeholder groups, namely shareholders, customers, government, employees, suppliers, society, and competitors. From an Islamic perspective, various studies have assessed the stakeholders of IFIs (see, e.g., Beekun and Badawi, 2005; Greuning and Iqbal, 2008; Khandelwal, 2009; Abu-Tapanjeh, 2009; Mohammed and Muhammed, 2017a). According to Greuning and Iqbal (2008), *Sharī'ah* endorses a stakeholder-oriented model of CG in light of Islamic tenets of property rights and contracts where such a stakeholder-oriented model recognizes the rights and responsibilities of different stakeholders and seeks to preserve the rights of all stakeholders. The authors highlight that in contrast to the conventional system, the Islamic financial system is based on the active participation of public policy institutions, regulatory and supervisory authorities, and *Sharī'ah* authorities. These participants collectively monitor the performance of the firm and its commitment and faithfulness to explicit and implicit contracts. This structure and process of CG incorporate stakeholders' legitimate rights and claims whenever a stakeholder's rights are at "risk" due to the firm's activities (Greuning and Iqbal, 2008).

As shown in Figure 1.1, unique stakeholders in IFIs include SSBs and various account holders (e.g., IAHs). The SSB is one of the dual governance layers in IFIs to ensure that such institutions comply with *Sharī'ah* in all activities. According to Mohammed and Muhammed (2017a), SSBs are an important stakeholder in IBs through their role in ensuring *Sharī'ah* compliance; thus, they play a significant role in influencing the performance of IBs. On the other hand, account holders are also a significant stakeholder in IBs. According to Alman (2012), IBs are mainly funded by deposits, current and investment accounts as their main financing source. Among these accounts, investment accounts raise the most CG challenges for IBs (Greuning and

Iqbal, 2008). Although IAHs share risks with IBs, they do not have voting rights, are not allowed to intervene in funds management, nor do they have board representation (see, e.g., Alman, 2012; Magalhaes and Al-Saad, 2013; Adznan, 2018). Hence, the Islamic stakeholder theory suggests that IBs recognize and ensure the rights of these account holders as they are considered shareholders without governance rights (Greuning and Iqbal, 2008).

Abdullah (2013) outlines that the requirement for considering the interest of the various stakeholders arises from the very obligation of *Sharī'ah*-compliance in IBs, which is the responsibility of the SSB. IBs must pursue social and ethical goals beyond profit maximization (Haron and Azmi, 2009; Musa et al., 2020). Thus, the responsibility of banks is not limited to the focus on boosting annual revenues but also to the well-being of all stakeholders (Al-Shamali, 2013). Mohammed and Muhammed (2017a) state that SSB's role, in relation to the SKT, is to refrain *Sharī'ah* board members from aligning their decisions to suit shareholders' and managers' interests. Instead, their role is coordinated with the *Sharī'ah* principles. Therefore, since *Sharī'ah* promotes fairness and justice to all stakeholders, this theory may uniquely explain the role of SSBs in IBs.

### **3.3 THE THEORETICAL FRAMEWORK**

The theoretical framework utilised as a guidance for this study is shown in Figure 3.1. The current study examines the influence of SG mechanisms on the performance of IBs in the GCC SEA. Three theories, namely AGT, RDT, and SKT, have been employed to explain the relationship between the study variables.

SSB and BOD are appointed in IBs as dual governance layers to safeguard corporate and *Sharī'ah* governance. Previous studies have used the AGT, RDT, and SKT theories to explain the relationship between the dual boards and the performance of IBs (see e.g., Musibah and Alfattani, 2014; Nomran et al., 2017; Nomran et al., 2018; Almutairi and Quttainah, 2017; Hakimi et al., 2018; Nomran and Haron, 2019; Haron et al., 2021a; Baklouti, 2022). The AGT is relevant as it suggests that the appointment of BOD provides the control mechanism of agency costs (Fama and Jensen, 1983), whilst the RDT is relevant as the theory explains the role of directors as valuable

resources to the firm that could offer expertise, experience, access to external resources, and strategic business decisions (Pfeffer and Salancik, 1978; Farag et al., 2018; Rahayu and Sabir, 2019). Lastly, the SKT is relevant as BOD should consider the interests of various stakeholder groups, such as groups related to social, environmental, and ethical considerations (Donaldson and Preston, 1995; Freeman et al., 2004).

Similarly, from the AGT perspective, SSB can act as an extra layer of governance and monitoring to ensure that IBs' operations comply with *Sharī'ah*. Abdelsalam et al. (2016) contend that SSB offers additional governance and moral accountability constraints as they act as important mechanisms in mitigating opportunistic behaviour and controlling the overall agency costs in IBs. Furthermore, the RDT is relevant to the SSBs as such scholars contribute to the board and will, in turn, enhance the decision-making process. Lastly, SKT is useful to SSB as the board should consider the interests of associated stakeholders such as IAHs, depositors, local communities, and shareholders.

The current study considers various SSB characteristics, namely independence, size, remuneration, busyness, financial expertise, cross-memberships, reputation, educational qualification, and meetings, that could determine how they conduct their duties. The above-mentioned theories are used to explain the link between these characteristics and the performance of IBs. The study's theoretical framework (see Figure 3.1) depicts the independent variables on the left, dependent variables on the right, and moderator variables on the middle. Independent variables are SSB characteristics (i.e., independence, remuneration, cross-membership, busyness, size, financial expertise, reputation, educational qualification, and meetings), whilst dependent variables are performance measurements (i.e., ROA, ROE, Lnzakat). Finally, the moderating variables are SG models and institutional shareholding.

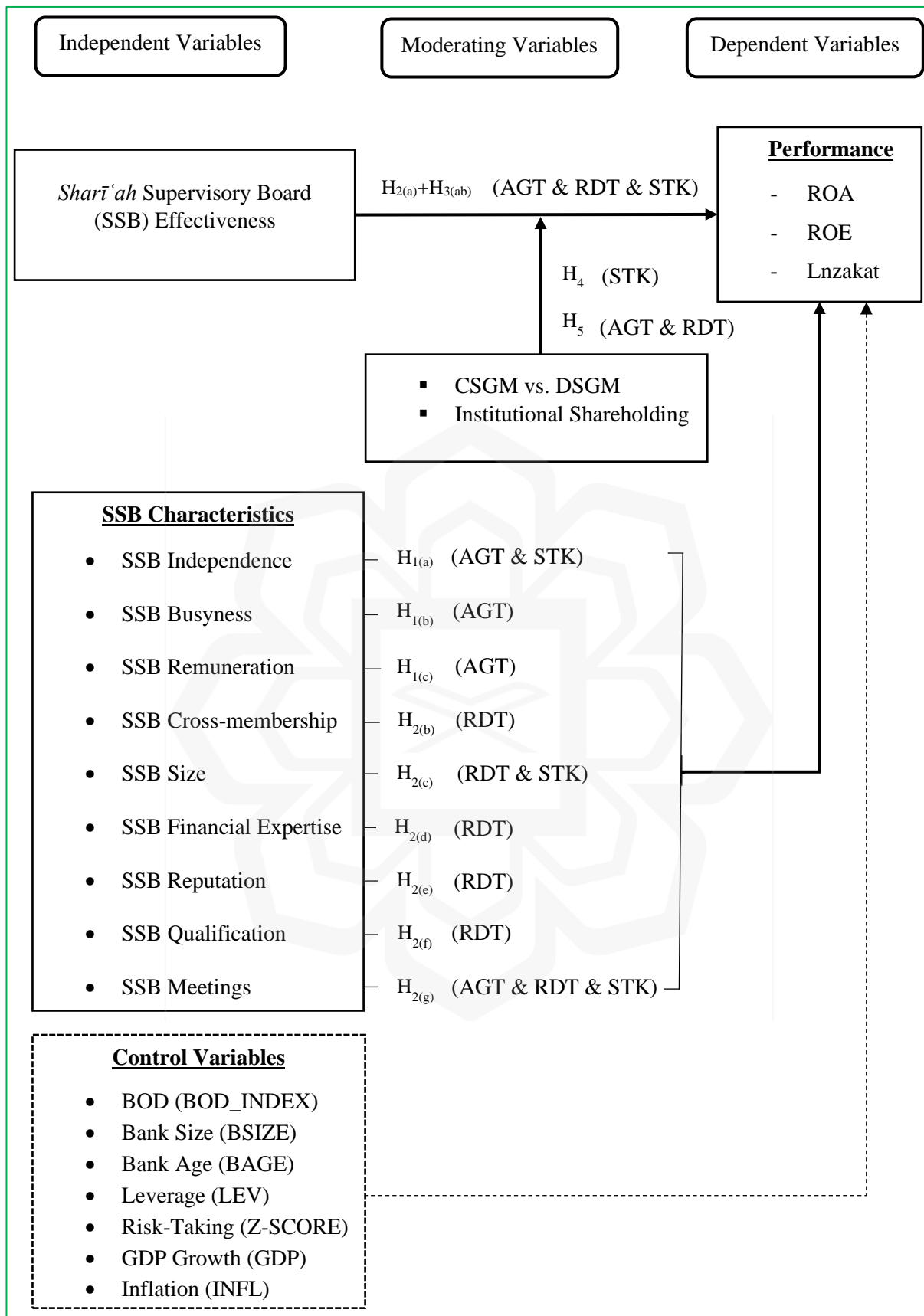


Figure 3.1 Research Theoretical Framework

### **3.4 HYPOTHESIS DEVELOPMENT**

The hypotheses of this study are developed based on the aforementioned theoretical framework to explain the relationship between SSB attributes and the performance of IBs. The hypothesis consists of the following characteristics: SSB characteristics, the moderating effect of institutional ownership, and control variables.

#### **3.4.1 *Sharī'ah* Supervisory Board Independence and Performance**

AGT suggests that a strong CG mechanism mitigates the agency problem in firms (Jensen and Meckling, 1976). Corporate boards are an essential monitoring mechanism for reducing agency conflicts and safeguarding shareholders' interests (Fama and Jensen (1983). The board of directors are the primary and dominant internal corporate governance mechanism and plays a key role in monitoring management (Rose, 2005; Brennan, 2006). The BOD is responsible for care and diligence, which includes ensuring that financial controls are effective (Rashid, 2018). Boards may provide management strategic guidelines and may act to review and ratify management proposals (Jonsson, 2005). However, their degree of monitoring is contingent on the extent to which they are independent of any inside influence and can ratify management decisions. For this reason, the AGT proposes that boards should be highly independent in the form of a high number of independent outside directors (Fama and Jensen, 1983).

As outlined earlier, IBs have, besides the BOD, a SSB that ensures such banks adhere to the *Sharī'ah* rules and principles in their activities. SSBs are responsible for monitoring the ethical and moral aspects of corporate management behaviour and are accountable for guiding top management in applying Islamic rules in daily transactions (Zainuldin et al., 2018). The SSB, in ensuring that the profits are generated within ethical parameters, has the right to provide advice on the distribution of income or expenses among the bank's shareholders and IAHs, and they are also responsible for Zakat calculation and payment and disposal of *Sharī'ah* non-compliant earnings (Grais and Pellegrini, 2006a). That said, the SSBs in IBs are expected to play a leading role in ensuring sound SG (IFSB, 2009)

IBs have additional agency problems besides the common agent-principal conflicts. The unique contractual arrangements of investment accounts also pose another type of agency problem that arises from the separation of cash flow and control rights (Sarker, 1999; Safieddine, 2009). Although IAHs share risks with IBs, IAHs do not have the right to vote and appoint the board of directors and auditors, suggesting that their cash flow rights are separate from the rights to monitor and control investments (Zainuldin et al., 2018; Hassan et al., 2022). Therefore, the SSB's responsibility is to restrain the management and the board from excessive risk-taking (Mollah and Zaman, 2015). Moreover, in addition to the agency problems that ordinarily take place in conventional banks when managers seek to maximize their interests as opposed to shareholders' wealth, IBs are also likely to face another type of agency problem in case managers deviate from their duty to ensure that all funds are invested in *Shari'ah*-compliant assets (Zainuldin et al., 2018). Hence, SSBs play a crucial role in mitigating agency problems by acting as an additional monitoring mechanism (see, e.g., Abdelsalam et al., 2016; Quttainah and Almutairi, 2017). In other words, SSBs offer additional governance and moral accountability constraints, thus controlling the overall agency costs of IBs (Abdelsalam et al., 2016).

Nonetheless, similar to the BOD, SSB's ability to effectively conduct their tasks relies on the extent to which they are independent. The independence of SSB members is one of the utmost essential characteristics that can highly influence the way such members perform their fiduciary duties. A lack of SSB independence can exacerbate agency problems in IBs. The inferiority of SSB independence can result in poor governance that might affect firms' performance, profitability, the possibility of market failure, and the image of IBs (Alam and Miah, 2021). The study of Hassan et al. (2022) concludes that independent SSB members provide positive and independent advice on *Shari'ah*-compliant products, avoiding conflict of interests and agency problems. Therefore, the independence of SSB reduces agency problems, mitigates financing costs, and improves the performance of IBs (Alsartawi, 2019).

To maintain the independence of SSBs, the major standard-setting organisation (i.e., AAOIFI, IFSB, and BNM) for IFIs expresses that SSBs should be acknowledged as independent from the BOD, whereby they have the freedom in exercising their duties to make informed and independent decisions (see, IFSB, 2009; BNM, 2010; AAOIFI,

2015). According to these organisations, SSB members should not be employees of the same bank. They should not be involved in the bank's operational responsibilities and should make objective judgments on matters related to *Sharī'ah* without influence from management or inappropriate outside interest. AAOIFI's Governance Standard No. 1 states that IFIs shall have an SSB appointed by the shareholders in their annual general meetings. This ensures their independence from management as managers do not have the authority to appoint or dismiss them (see, AAOIFI, 2015). Additionally, Alsartawi (2019) reports that the SSB is not only independent from the BOD, but the SSB can also attend BOD meetings to scrutinise the religious aspects of their decisions.

On the other hand, from the SKT perspective, Freeman (1984) suggests that a firm's success depends on the successful relationships with its stakeholders. Accordingly, the independence of SSB is critical to building the confidence of the stakeholders in IBs concerning compliance with *Sharī'ah* (Kasim et al., 2013). The SKT suggests that the independence of SSB members is one of the crucial factors that will determine the *Sharī'ah* governance process (Mohammed and Muhammed, 2017a; Islam and Bhuiyan, 2019). Notably, Mohammed and Muhammed (2012) emphasize that religious supervision came along with the emergence of Islamic banking to ensure investors and other groups had confidence in the *Sharī'ah*-compliance of IBs. Unlike the AGT, SKT regards SSB members as liable not only to the shareholders but to all stakeholders, including IAHs, customers of IBs, investors, and social welfare, hence the necessity of independent SSBs to safeguard their interests. This is because governance in Islam requires "fairness" to all stakeholders, which can be achieved through greater transparency and accountability (Chapra and Ahmed, 2002). The involvement of other stakeholders is derived from their ability to influence the firm (Mohammed and Muhammed, 2017a).

In line with SKT principles, numerous studies (e.g., Akhtar, 2006; Grais and Pellegrini, 2006a; Abu-Tapanjeh, 2009; Bhatti and Bhatti, 2009; Kasim et al., 2013) suggest that information and transparency on *Sharī'ah*-compliance are increasingly required for the various stakeholders including the Muslim society. Indeed, SSB members have a responsibility to the public, who rely on the services they provide, which entails independence (AAOIFI, 2015). As per AAOIFI, the public includes, for instance, clients, investors, governments, and others who rely on the integrity of SSBs

to ensure that IFIs' activities comply with *Sharī'ah*. Therefore, SSB independence enhances the confidence of stakeholders in the decisions of *Sharī'ah* scholars as well as IFI's transactions and activities (Garas and Pierce, 2010; Kasim et al., 2013; AAOIFI, 2015).

A lack of SSB independence can adversely affect IBs in several ways. First, as discussed earlier, the lack of SSB independence can increase agency costs in IBs because SSB acts as an additional monitoring mechanism besides the BOD. Second, the lack of independence of SSBs can compromise their *Sharī'ah*-compliance assurance function. For instance, due to a lack of independence, the managers of IBs may pressurize the SSB to certify and legitimate certain investments, services, and prior decisions to meet their earnings target (Alam and Miah, 2021). Failure to comply with *Sharī'ah* can raise *Sharī'ah* non-compliance risk, which is a sub-set of operational risks and may lead to legal, financial, or reputational risks (AAOIFI, 2018). *Sharī'ah* non-compliance can damage stakeholders' confidence, disrupting the IBs' stability (Chapra and Ahmed, 2002; Haqqi, 2014; Ali and Hassan, 2019). Fund withdrawals and nullification of investment contracts can be a direct consequence of *Sharī'ah* non-compliance, and this, in turn, can cause a downturn in profits and increased risk for IBs (Hamza, 2013; Basiruddin and Ahmed, 2019). These factors may adversely influence the performance of IBs. On the other hand, higher SSB independence can enhance the performance of IBs. El-Khelaifi (2002) asserts that in their role of creating *Sharī'ah* compliant products, SSB can maximize the stakeholders' trust in IFI's activities and increase its profits.

Empirically, Alsartawi (2019) found a negative association between SSB independence and the performance of IBs. However, this study has several limitations, including using only one performance indicator (i.e., ROA), a short study period, and focusing only on the GCC countries. That being said, the following hypothesis is developed:

**H<sub>1(a)</sub>:** There is a significant positive relationship between SSB independence and the performance of IBs.

### 3.4.2 *Sharī'ah* Supervisory Board Busyness and Performance

The issue of cross-membership has been the subject of much debate in the CG literature. Cross-memberships, multiple directorships, or interlock mean that board directors serve more than one board (see, e.g., Zahra and Pearce, 1989; Haniffa and Cooke, 2002). The cross-membership of directors has been emphasized from two different points of view.

First, based on the “reputation hypothesis”, directors who hold multiple board seats are arguably high-quality directors who can be more experienced, provide better advice, and offer better monitoring (Ahn et al., 2010), thus enhancing firm performance. The number of outside board memberships may signal director quality (Fama and Jensen, 1983). In other words, the number of directorships a director holds might be a proxy for reputational capital, with such directors regarded as high-quality (Kaplan and Reishus, 1990; Vafeas, 1999). The theoretical underpinning of the “reputation hypothesis” is embedded in the resource dependence theory (Latif et al., 2020). The RDT suggests directors on multiple boards have better access to information and can bring external resources to the company, allowing them to gain new skills, knowledge, and experiences acquired from the various boards they serve on (Hundal, 2017). According to Latif et al. (2020), each additional board appointment may bring new linkages and resources to the board, with directors holding multiple board seats and gaining new expertise and network connections from the external environment, which will benefit the firm. Moreover, Ferris et al. (2003) outline that interlocked directors permit firms to contract with a broader environment where such directors will allow the firm to strengthen its contracting relations with other firms.

Similarly, cross-membership of SSB can be beneficial to the board and the Islamic bank. Moreover, various studies assert that *Sharī'ah* scholars serving many SSBs can be exposed to different *Sharī'ah* debates and discourses on the legality of different practices of the Islamic banking industry from an Islamic perspective, which enables them to broaden their knowledge of *Sharī'ah* law and enrich their experience (see, e.g., Farook and Lanis, 2007; Farook et al., 2011). This variety of knowledge and experience aids in improving the quality of the SSB's decisions and products offered by the Islamic bank and, therefore, its performance (Baklouti, 2022). Hence, *Sharī'ah* scholars who serve multiple SSBs can be regarded as high-quality scholars with high

experience who offer better *Shari'ah* advisory and supervisory functions. Moreover, such scholars can bring external resources, skills, knowledge, experience, and new connections to the bank. Accordingly, SSB scholars serving multiple IBs may enhance the performance of IBs.

In contrast, cross-memberships of directors may not always be beneficial. Based on the “busyness hypothesis”, Fich and Shivdasani (2006), Ahn et al. (2010), and Clements et al. (2015) assert that over-committed directors (i.e., directors serving many boards) might be less effective corporate monitors due to their busyness. The theoretical underpinnings of the “busyness hypothesis” stem from the agency theory (Latif et al., 2020). According to this theory, the firm owners (principals) expect that agents (directors) will dedicate their efforts toward maximizing the interests of the firm and its owners, whereas, in the case of directors serving multiple boards, these agents subordinate the interest of the organisation to their benefits, exacerbating agency problems (Jensen and Meckling, 1976). Consequently, busy directors may not monitor management adequately, leading to high agency costs (Ahn et al., 2010; Latif et al., 2013; Saleh et al., 2020; Latif et al., 2020). Ahn et al. (2010) underline that the decreased monitoring capability of busy directors may lead to more severe agency conflicts because managers are better able to pursue their own private benefits at the expense of shareholders. Therefore, built on the grounds of agency theory, it can be stated that directors’ diminished oversight due to busyness can foster managerial opportunism (Chiranga and Chiwira, 2014).

Likewise, in the context of IBs, *Shari'ah* scholars sitting on many SSBs of IFIs can make them busy to fulfil their supervising and advising tasks effectively. These scholars tend to be over-committed across several banks, countries, or even continents (Mollah and Zaman, 2015). Consequently, due to the decreased competence of SSB scholars due to busyness, such members may not monitor management effectively, which can lead to additional agency problems. According to Quttainah and Almutairi (2017), SSBs add great value to IBs as a CG mechanism by overseeing managerial behaviour and mitigating the likelihood of unethical practices; hence, over-committed SSB scholars can be linked to high *Shari'ah* non-compliance risks. Moreover, it is also important to outline that serving many SSBs could raise several issues, including the

independence and information confidentiality of SSB scholars, as it is a common practice for such scholars to serve many IFIs' SSBs.

Busyness of directors has been measured as those serving three or more boards (or, in other words, two or more outside directorships) (see, e.g., Core et al., 1999; Ferris et al., 2003; Fich and Shivdasani, 2006; Ahn et al., 2010; Cooper and Uzun, 2012; Elyasiani and Zhang, 2015; Ferris and Liao, 2019). While the number of board memberships held by a director was linked to the director's reputational capital by some studies, others suggest that too many memberships may diminish the effectiveness of directors as corporate monitors (see, e.g., Core et al., 1999; Shivdasani and Yermack, 1999). Core et al. (1999) demonstrate that busy outside directors provide CEOs with excessive compensation packages, leading to weaker firm performance. Fich and Shivdasani (2006) linked board busyness with weak corporate governance, where these firms exhibit lower market-to-book ratios, weaker profitability, and lower sensitivity of CEO turnover to firm performance. Moreover, Falato et al. (2014) find busyness is detrimental to the effectiveness of board monitoring and thus reduces firm performance and shareholder value. Jiraporn et al. (2009) shows that individuals with multiple seats exhibit a higher tendency to be absent from board meetings. Further, Cooper and Uzun (2012) reveal that busy boards are associated with increased bank risk.

In IBs, *Sharī'ah* scholars serving many SSBs are common in the Islamic financial industry. As of 2018, there are about 1162 *Sharī'ah* scholars globally who occupy SSBs across 52 countries (Thomson Reuters, 2018). Out of this number, 20 per cent (227) occupied two to three *Sharī'ah* board memberships, 6 per cent (72) held four to nine, while two per cent (28) held ten or more *Sharī'ah* board memberships. Razak (2020a) states that the Islamic banking industry, from its inception in the early 1970s until the late 1990s, suffered from a shortage of *Sharī'ah* scholars with strong expertise in the fields of *Sharī'ah* law and finance. Therefore, this has made IFIs share similar *Sharī'ah* scholars to serve in their respective SSBs.

However, Razak (2020a) argues that the shortage of proficient *Sharī'ah* scholars may not be true nowadays, where, in fact, the Islamic financial industry possesses a sufficient number of qualified *Sharī'ah* scholars who are equipped with industry-relevant expertise. According to Hasan (2014), the issue of lack of skilled *Sharī'ah*

scholars is, to a certain extent, not true, and it's possible that IFIs recruit certain reputable *Sharī'ah* scholars primarily to increase the marketability of their products and services. Garas (2012) points out that IFIs generally desire top *Sharī'ah* scholars (who usually serve multiple SSBs) because of their social reputation, which can serve as an effective marketing tool to boost stakeholders' confidence and the IFI's reputation.

On this note, Siddiqui (2010) reported that there are enough *Sharī'ah* experts, but IFIs prefer to have prominent and well-known *Sharī'ah* scholars, whilst potential *Sharī'ah* advisors are not given a fair chance to serve on *Sharī'ah* boards. Additionally, Baklouti (2022) emphasizes that having well-reputable *Sharī'ah* scholars attracts a significant number of customers and depositors, which can reduce the liquidity risk of IBs. Also, Razak (2020a) outlines that certain IFIs prefer to appoint top *Sharī'ah* scholars to their *Sharī'ah* boards who bring more added value to the IFIs in terms of credibility and reputation. Consequently, this has led to the concentration of SSB memberships amongst a specific group of scholars, neglecting other qualified and available scholars (Razak, 2020a).

Notably, it is important to highlight that busy *Sharī'ah* scholars may imply that *Sharī'ah*-compliance can be at stake. Serving many SSBs can place an excessive burden on such scholars, as such an issue can restrain scholars' time and commitment to each Islamic financial institution, putting stakeholders' interests at risk (Razak, 2020a). In the event of a *Sharī'ah*-compliance issue, they may have to be ready to dedicate much time to settling the problem and the possibility of neglecting their fiduciary obligations to other IFIs (Razak, 2020a). For example, in the case of *Sharī'ah* non-compliance event of any transaction, the returns of such transactions are declared void and credited to the bank's charity accounts (Ayub et al., 2019). Such *Sharī'ah* non-compliant income will be discarded from the bank's books, leading to net losses on these transactions for the Islamic bank (Basiruddin and Ahmed, 2019). Consequently, *Sharī'ah* non-compliance can harm the reputation of IBs and decrease the confidence of depositors, investors, customers, and other stakeholders (Nawaz et al., 2020) and can lead to fund withdrawals and cancellation of investment contracts, which can cause a downturn in performance and increase the risk of IBs (Hamza, 2013; Basiruddin and Ahmed, 2019). Thus, it is important for SSB members to be available to cater to the bank's need to conform to *Sharī'ah* rules and principles.

According to Razak (2020a), having top *Sharī'ah* scholars in the SSB does not necessarily guarantee optimal *Sharī'ah*-compliance monitoring. The SSB members must make certain that they have the time and commitment to prepare and attend the meetings in the IFIs they are serving on their SSBs (Abidin et al., 2021). Concerning this, Hasan (2014) underlines that *Sharī'ah* scholars should limit the number of their SSB memberships due to time constraints. Therefore, due to the time and cognitive abilities of individuals that can be limited, this study asserts that *Sharī'ah* scholars serving three SSBs or more are busy and, hence, can negatively affect the performance of IBs.

Empirically, Trinh et al. (2020) shows that busy SSB members in IBs are associated with negative financial performance and higher cost inefficiency. Thus, based on these contentions, the following hypothesis is developed:

**H<sub>1(b)</sub>:** There is a significant negative relationship between SSB busyness and the performance of IBs.

### **3.4.3 *Sharī'ah* Supervisory Board Remuneration and Performance**

The remuneration of the BOD and executives needs to be considered in CG because the level of remuneration must be attractive enough to motivate the board members and executives to run the firm effectively (Harymawan et al., 2020). The AGT explains that effective incentives provided to executives tend to mitigate agency problems and enhance firm performance (Fama and Jensen, 1983). High remuneration may motivate and retain directors to fulfil their duties diligently and exert greater effort in serving the best interests of shareholders (Razali et al., 2018). Existing literature demonstrates a positive association between directors' remuneration and firm performance (see, e.g., Becher et al., 2005; Lee and Isa, 2015; Oziegbe and Cy, 2021). However, the director's pay may not always enhance performance. Jaafar et al. (2012) outline that in family firms, possibly executive family may be awarded higher remuneration without links to performance and abilities.

Regarding SSB, the members must receive adequate compensation because of their extensive responsibilities (Al Qari, 2002; Muhammad et al., 2021). Remuneration provided to the SSB's members can affect the quality of their work (Alman, 2012). The SSB members are entitled to appropriate compensation for their work, which constitutes one of the commercial inputs in IBs (Al Mannai and Ahmed, 2019). Hassan et al. (2010) emphasises that the role and task of SSB are vital in developing and improving the Islamic banking and financial industry. Accordingly, SSB members deserve compensation as they are dedicating most of their time to issuing *fatwa* and providing *Sharī'ah* guidance (Mnif and Tahari, 2021) and are often quite busy devoting time to IBs' matters to honour their contractual commitments (Ginena and Hamid, 2015). Indeed, IBs have a wide business segmentation, including funding activities, financing, and services provided and, thereby, the complexity of the tasks of SSB in directing, reviewing, and *Sharī'ah*-compliance assurance (Muhammad et al., 2021). Consequently, SSB members must be compensated appropriately, which can enhance the performance of IBs.

On the other hand, some studies argue that SSB remuneration may adversely affect IBs' performance in certain circumstances. According to Garas and Pierce (2010), the board of directors' remuneration is usually related to the annual net income, whereas the remuneration *Sharī'ah* scholars is a fixed amount independent from the net income, which can affect the IFI's negatively during financial distress. Moreover, other studies, such as Haron (2018), argue that because of the ethical values attached to Muslim directors, such directors may not see attractive remuneration as a catalyst and motivator to do their best. This implies that ample incentives in the form of high remuneration may not motivate SSB members; instead, Islamic ethics and values may motivate them to do their duties faithfully.

To the best of the researcher's knowledge, except for Haron et al. (2021a), no previous studies have assessed the influence of SSB remuneration on IBs' performance. Haron et al. (2021a) found a negative association between SSB remuneration and performance. However, this study is limited to Malaysia, and its findings cannot be generalised to other IBs in other countries. Thus, further studies are required. However, several other studies linked SSB members' compensation to different aspects. Muhammad et al. (2021) examined the influence of characteristics, including SSB

remuneration, on *Sharī'ah* compliance of IBs in Asia and the GCC. The study's empirical findings demonstrate that the remuneration of SSB members does not influence the *Sharī'ah*-compliance of IBs. Mnif and Tahari (2021) investigated the effect of specific CG characteristics on compliance with the disclosure requirements of AAOIFI governance standards. The study concluded that SSB members' remuneration is positively associated with compliance with AAOIFI's governance standards.

In summary, from the AGT perspective, to mitigate the agency problem, firms should improve remuneration (Jensen and Meckling, 1976). Therefore, better remuneration can help maintain and motivate SSB members to enhance bank performance. Hence, based on these arguments, the following hypothesis is developed:

**H<sub>1(c)</sub>:** There is a significant positive relationship between SSB remuneration and the performance of IBs.

#### **3.4.4 *Sharī'ah* Supervisory Board Effectiveness Performance**

As shown in Figure 1.1, SSB is one of the stakeholders of IBs. According to Mohammed and Muhammed (2017a), SSB is one of the four stakeholders that influence the performance of IBs besides the board, shareholders (i.e., large shareholding), and external auditor. The SSB in IBs ensures that the products offered by IBs are acceptable under *Sharī'ah* (Rammal, 2006; Zainuddin et al., 2018; Alam et al., 2021), and the SSB influences the day-to-day practices of the IFIs profoundly by providing advice and *fatwas* (opinions) (Grassa, 2013a). Essentially, SSBs are responsible for safeguarding SG, which is a system conducted to ensure that the activities of IBs are in accordance with *Sharī'ah* (Grassa, 2013a; Grassa, 2013b).

Generally, the SSB is responsible for *ex-ante* and *ex-post* duties of *Sharī'ah*-compliance, which involves advising IFIs before the initial offering of products and undertaking post-offering tasks, including reviewing the product after offering to ensure the compatibility of its *Sharī'ah*-compliance status (see IFSB, 2009). As such, the SSB can invalidate any transactions or products that do not accord with the *Sharī'ah*. If, however, the transaction is performed and later discovered to be *Sharī'ah* non-

compliant, the SSB declares the returns of such undertaking to be non-permissible and should be taken out of the bank's income accounts and transferred to a charity account (Rammal, 2006; Ayub et al., 2019). Thus, it is evident that the existence of SSB can highly influence the performance of IBs.

As discussed earlier, various studies have assessed the effect of individual SSB characteristics on the performance of IBs. Several studies have also employed a SSB score to capture the overall effectiveness of SSB. For instance, Abdullah et al. (2014) measured the SSB score by combining three characteristics (i.e., size, expertise, and cross-memberships). Mollah and Zaman (2015) and Farag et al. (2018) used the SSB size to capture the SSB effectiveness, and Musibah and Alfattani (2014) used the educational level. Ajili and Bouri (2018a) and Ajili and Bouri (2018b) employed a SSB score consisting of three SSB attributes (size, education level, and expertise) besides the existence of SSB. However, these studies suffer from limitations by either using a single proxy or triad characteristics, neglecting other important characteristics.

In contrast to these studies, Farook and Lanis (2007) and Farook et al. (2011) employ a more inclusive SSB score consisting of five important characteristics, namely SSB existence, size, cross-membership, doctoral qualification, and reputation, while Rahman and Bukair (2013) replaced the existences of SSB by the expertise of SSB. Following these studies, Nomran and Haron (2019) recently used a SSB score consisting of important SSB characteristics, including SSB size, cross-membership, educational qualification, reputation, and financial expertise. The study found that the overall SSB score constructed from these attributes positively affects performance. Notably, some other studies also considered the effect of SSB frequency of meetings as a proxy for their effectiveness (see, e.g., Alsartawi, 2019; Baklouti, 2022; Haddad and Souissi, 2022).

Therefore, from the AGT, RDT, and STK perspectives, the effectiveness of SSB would influence the performance of IBs (see, e.g., Musibah and Alfattani, 2014; Nomran et al., 2018; Nomran and Haron, 2019; Alsartawi, 2019). Accordingly, the following hypothesis is developed:

**H<sub>2(a)</sub>**: SSB effectiveness, captured by an SSB score<sup>2</sup>, significantly and positively influences the performance of IBs.

### **3.4.5 SSB Score Characteristics and Performance**

This section discusses the effect of SSB score individual characteristics (i.e., cross-membership, size, financial expertise, reputation, educational qualification, and meetings) on IBs' performance.

#### ***3.4.5.1 Sharī'ah Supervisory Board Cross-Memberships and Performance***

As argued earlier, the issue of cross-membership has been the subject of much debate in the CG literature. Past studies have scrutinised the benefits and detriments of cross-membership of directors. These studies have approached the issue from two different points of view. First, From the perspectives of “*reputation hypothesis*” and RDT, directors serving multiple boards may be more experienced and offer better advice and monitoring than directors with fewer seats (Cooper and Uzun, 2012; Saleh et al., 2020) and can bring network connections and resources to the firm (Latif et al., 2020).

Similarly, In IBs, Farook and Lanis (2007) and Farook et al. (2011) outline that *Sharī'ah* scholars that serve multiple SSBs can expose its members to various *Sharī'ah* debates and discussions on the legality of IFI's different activities, allowing them to expand their knowledge in Islamic law and enhance their experience. This variety of knowledge and experience aids in improving the quality of the SSB's decisions and products offered by the Islamic bank and, therefore, its performance (Baklouti, 2022). Some studies, like Almutairi and Quttainah (2017) and Nomran et al. (2018), found a positive association between SSB cross-membership and the performance of IBs. Also, Nomran et al. (2017) found a positive relationship between cross-membership and the performance of IBs in Malaysia and Indonesia. This positive influence result found by

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<sup>2</sup> SSB SCORE is a score that sums the value of six dichotomous SSB characteristics that takes a score bounded by 0-6 with a higher score indicating higher effectiveness and vice versa. These six SSB characteristics are cross-memberships, size, doctoral qualification, reputation, financial expertise, and meetings (see Table 4.2).

the authors can be attributed to Malaysia and Indonesia restricting the number of memberships<sup>3</sup> a *Sharī'ah* scholar can hold (Nomran et al., 2017), indicating the availability of SSB members to perform their fiduciary duties effectively.

On the other hand, from the outlooks of the “*busyness hypothesis*” and AGT, cross-memberships of directors can make directors too busy to monitor management (see, e.g., Fich and Shivdasani, 2006; Cooper and Uzun, 2012; Latif et al., 2020).

Likewise, serving multiple SSBs can make *Sharī'ah* scholars over-committed and busy. *Sharī'ah* scholars across IFIs usually hold multiple SSB seats simultaneously (Grassa, 2015b; Razak, 2020a). It is worth mentioning that some countries (e.g., Malaysia and Indonesia) restrict SSB cross-memberships (Grassa, 2013a; Grassa, 2015b). However, most Middle Eastern countries (e.g., Bahrain, Kuwait, UAE) do not restrict cross-memberships of SSB members (ISRA and Thomson Reuters, 2016). The high number of memberships held by SSB members may impose undue pressure on *Sharī'ah* scholars by limiting their time commitment and attention to each IFI, compromising the interests of both shareholders and stakeholders (Razak, 2020a).

Moreover, due to serving on competitors' boards, cross-membership of SSB may raise confidentiality problems and a conflict of interest because of the director's access to each bank's strategic information (Hamza, 2013; Hamdi and Zarai, 2014; Nomran et al., 2017). That is to say, a member of a SSB with confidential information about a bank may decide to disclose it to the competitors, negatively affecting the bank's performance (Baklouti, 2022). In addition, SSB cross-membership can also raise the absenteeism of members and the possibility of reduced effective control (Baklouti, 2022). The study of Baklouti (2022) demonstrated a negative association between SSB cross-memberships and the performance of IBs.

Therefore, based on the RDT view, this study contends that SSB cross-memberships can be, to some extent, beneficial to IBs because it exposes SSB members

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<sup>3</sup> In Malaysia, BNM restricts that a SSB member can only serve three boards (one licensed Islamic bank, one takaful operator, and one prescribed institution) (BNM, 2019). In Indonesia, Rahman and Haron (2019) state that according to the central bank of Indonesia (Bank Indonesia) regulations, SSB members can only serve on the boards of not more than four IFIs (i.e., two IBs and two non-bank financial institutions).

to different *Shari'ah* and *fiqh* debates, allowing them to enrich and improve their experience and knowledge about Islamic banking products and services, which can enhance the performance of IBs. Thus, based on these assertions, the following hypothesis is developed:

**H<sub>2(b)</sub>**: There is a significant positive relationship between SSB cross-memberships and the performance of IBs.

#### **3.4.5.2 *Shari'ah* Supervisory Board Size and Performance**

The board size is one of the most important characteristics of CG because it is regarded as a technique for monitoring and resolving agency conflicts (Baysinger and Butler, 1985; Haat et al., 2008). Consequently, two different views emerge in terms of whether the board size should be small or large. AGT assumes that smaller boards are more constructive because they provide better communication and effectiveness (Lipton and Lorsch, 1992; Sonnenfeld, 2002). Small boards reduce agency costs and improve coordination among board members (Quttainah et al., 2013). According to Jensen (1993), increased board size may jeopardize a company's value by reducing communication, coordination, and monitoring effectiveness.

In the context of SSB, several empirical studies, in line with the AGT, demonstrate an adverse effect between SSB size and IBs' performance (Matoussi and Grassa, 2012; Rahman and Haron, 2019). These studies attribute this result to the fact that the small size of SSB increases communication and coordination among its members, thus enhancing the decision-making process and improving performance. Nomran and Haron (2020a) illustrate the importance of small SSB sizes in improving the performance of IBs and state that the optimal SSB size is five.

In contrast, RDT argues that larger boards are better positioned to satisfy the firm's dependence on external resources, mitigate the uncertainties it faces, and furnish a body of knowledge and valuable resources (Dalton et al., 1999; Hillman and Dalziel, 2003). Larger boards are linked with a range of business contacts, skills, and experience, which may assist in securing critical resources (Haniffa and Hudaib, 2006). Moreover,

from the stakeholder perspective, large boards containing more directors will represent and work towards the interests of the various stakeholders (Kalsie and Shrivastav, 2016; Badu and Appiah, 2017) in monitoring and controlling, and thereby enhancing firm performance (Kalsie and Shrivastav, 2016). According to Pearce and Zahra (1992), large boards allow the representation of diverse stakeholders, thereby enabling the firm to effectively respond to their demands. The authors highlight that large board size enhances a firm's ability to understand and respond to the stakeholders.

In IBs, from the RDT perspective, a larger SSB that contains members with various skills, knowledge, and experience will enhance performance (Nomran et al., 2017; Nomran et al., 2018; Safiullah and Shamsuddin, 2018; Baklouti, 2022). The various backgrounds of SSB would permit broader insight in planning, implementing, and evaluating the operations of IBs (Ulfi et al., 2020). Moreover, a variety of knowledge will enrich the debates among the SSB members, which in turn solidifies the banks' creditability to stakeholders and customers' confidence (Hamza, 2013). Additionally, a large SSB may improve the monitoring quality of its members and, therefore, can help IBs avoid *Sharī'ah* non-compliant events (Haron et al., 2021a). Similarly, from the STK perspective, large SSBs will allow more representation of the various stakeholders of IBs (e.g., IAHs, depositors, customers, local community, regulators, and shareholders) and will work to ensure their interests. In this manner, more SSB members act as representatives of the various stakeholders of IBs to safeguard their rights.

Consistent with these views, empirical studies such as Mollah and Zaman (2015), Nomran et al. (2018), Almutairi and Quttainah (2017), Farag et al. (2018), Hakimi et al. (2018), and Baklouti (2022) document a positive relationship between SSB size and IBs' performance. Similarly, this study argues that larger SSBs will enhance bank performance. Therefore, based on these arguments, the following hypothesis is developed:

**H<sub>2(c)</sub>:** There is a significant positive relationship between SSB size and the performance of IBs.

### ***3.4.5.3 Sharī'ah Supervisory Board Financial Expertise and Performance***

RDT argues that BOD is essential for managing resource dependencies (Pfeffer and Salancik, 1978). Corporate boards bring bundles of knowledge, experience, skills, ideas, and professional contacts (Carpenter et al., 2004; Hundal, 2017), improving companies' performance (Pfeffer, 1972). Regarding directors' expertise in banking industry-related qualifications, Guner et al. (2008) stress that it is vital that directors understand accounting principles and financial statements, which will lead to better board oversight. In an audit context, this means audit committees with directors with accounting and/or finance backgrounds are more likely to lessen financial errors, thereby improving disclosure quality (McDaniel et al., 2002).

Although typically, SSB members possess expertise in *Sharī'ah* and *fiqh al-mu'amalat*, members must have banking industry-related expertise. Using the perceptions of RDT, Rahman and Bukair (2013) revealed that members of SSBs with financial and accounting knowledge perform their duties more efficiently compared to scholars without these capabilities. Moreover, Mnif and Tahari (2021) assert that the presence of SSB members with accounting and financial expertise can influence the level of disclosure because of their awareness of the importance of transparent reporting and are more likely to seize the importance of disclosure to stakeholders. For instance, during the *Sharī'ah* review process, an SSB member with accounting and financial expertise can influence managers to disclose more information (Abdullah, 2013). Hence, IFSB (2009) suggests that in addition to their *Sharī'ah* expertise, SSB members should possess some exposure in the financial fields.

The SSB members are not only demanded for their *Sharī'ah* education but also for their expertise because banking institutions are complex business entities (Ginena and Hamid, 2015; Khan et al., 2018). Furthermore, IBs in their operations encounter different risks, including credit risk, market risk, liquidity risk, and operational risk, and these risks are interlinked, thereby, the need for better understanding and knowledge in consideration of *Sharī'ah*-compliance (Hassan et al., 2010). According to Bakar (2016), numerous IBs have replaced their SSBs because the scholars possessed insufficient knowledge of the products and could not function well. Because of the lack of accounting and financial expertise, SSB members may lack knowledge of the true

implications of the complex financial products and transactions brought before them (Grassa, 2015). Therefore, having financial-related qualifications will increase the SSB members' effectiveness in performing their duties, responsibilities, and functions (Muhammad et al., 2021).

It is worth mentioning that most SSB members in IBs are *Sharī'ah* scholars, and only some of them have expertise in accounting, finance, banking, and economics (Abdullah et al., 2014; Nomran et al., 2018). Ghayad (2008) outlines that members of SSB generally have substantial knowledge and proven religious skills but rarely have a good understanding of financial analysis, management, and banking regulations, which could hinder making the right decisions (Matoussi and Grassa, 2012). The imbalance in the SSB members' expertise may affect their ability to issue a well-informed decision on the bank's financial products and activities (Ginena and Hamid, 2015). For instance, Muhammad et al. (2021) empirically demonstrate that SSB members with financial expertise positively influence *Sharī'ah*-compliance in IBs. Thus, SSB members must possess knowledge in necessary fields such as accounting, finance, and economics. SSB members' financial competence will allow them to grasp the day-to-day operations of the IBs.

Because SSB's mission is similar to an audit committee's, having SSB members with expertise in accounting, finance, and/or economics may positively impact bank performance (Almutairi and Quttainah, 2017). Various empirical studies conclude that SSB financial expertise positively influences IBs' performance (see, e.g., Matoussi and Grassa, 2012; Hakimi et al., 2018; Nomran et al., 2018; Nomran and Haron, 2019; Haron et al., 2021a). In contrast, studies such as Nomran et al. (2018), Nomran and Haron (2021b), and Haddad and Souissi (2022) document a negative association. Accordingly, based on the above arguments, the following hypothesis is developed:

**H<sub>2(a)</sub>:** There is a significant positive relationship between SSB financial expertise and the performance of IBs.

#### **3.4.5.5 *Sharī'ah Supervisory Board Reputation and Performance***

The RDT asserts that corporate boards furnish important resources for companies (Hillman and Dalziel, 2003), such as information and skills (Abdullah and Valentine, 2009), which, in turn, can improve performance (Pfeffer, 1972). Besides their knowledge, board members bring their reputation to the firm (Clarysse et al., 2007), which is considered an important resource for improving performance (Baklouti, 2022). In the context of IFIs, the majority of previous studies have measured SSB reputation as those serving on the *Sharī'ah* board of AAOIFI (see, e.g., Farook and Lanis, 2007; Farook et al., 2011; Rahman and Bukair, 2013; Nomran et al., 2017; Nomran et al., 2018; Nomran and Haron, 2019; Nomran and Haron, 2020a; Haron et al., 2021a; Nomran and Haron, 2021b; Baklouti, 2022). This is because AAOIFI's *Sharī'ah* board is the highest *Sharī'ah* board in the world, and scholars affiliated with the AAOIFI are regarded as having a higher reputation (Nomran et al., 2018). AAOIFI's SSB comprises of highly reputable *Sharī'ah* scholars who represent, to a large extent, the best *Sharī'ah* minds of both the Islamic world and Islamic Finance (Bakar, 2016).

Similar to the BOD, the SSB can bring their reputation to their banks (Nomran et al., 2018; Baklouti, 2022), as these members represent industry knowledge (Farook et al., 2011). According to Safiullah and Shamsuddin (2018), the presence of reputable SSB scholars is conducive to effective *Sharī'ah* monitoring since they are well-positioned to mitigate the operational risk resulting from non-compliance with *Sharī'ah*. Moreover, having reputable SSB members can help IBs become more credible in the eyes of their stakeholders and customers (Baklouti, 2022), consequently lessening withdrawal risk and liquidity risk exposure (Safiullah & Shamsuddin, 2018) and enhancing the performance of IBs (Nomran et al., 2018). Empirically, studies such as Nomran et al. (2018) and Haron et al. (2021a) document a positive relationship between SSB reputation and the performance of IBs.

On the contrary, however, because the reputation of SSB scholar implies that they serve many SSBs, questions regarding their effectiveness and availability may arise. As argued earlier, scholars serving many SSBs may signal their busyness. For

instance, as shown in Table 3.1<sup>4</sup>, twelve members of AAOIFI's SSB sat on almost 40% of all SSBs in IFIs in the year 2010 (Ünal, 2011), with most of these scholars sitting on SSBs of IBs of different countries. Consequently, several studies document a negative relationship between SSB reputation (those sitting on AAOIFI's SSB) and the performance of IBs (see, e.g., Nomran et al., 2017; Nomran and Haron, 2019).

Table 3.1 AAOIFI Scholars' Memberships at the SSB of IFIs in 2010

No.	Name of AAOIFI's SSB Scholar	Number of positions held at the SSB Of IFIs
1	Abdul Satar Abdul Karim Abu Ghuddah	85
2	Nizam Mohammed Yacoubi	85
3	Mohammed Ali Elgari	71
4	Abdullah Sulaiman Al Manee'a	36
5	Hussein Hamid Hassan	31
6	Mohammed Daud Bakar	27
7	Ali Mohuddin Al'Qura Daghi	25
8	Ajeel Jasem Al-Nashmi	24
9	Esam Khalaf Al-Enezi	21
10	Mohammed Taqi Usmani	16
11	Mohammed A. Sultan Al Olamaa	9
12	Yusuf Talal De Lorenzo	9

Hence, based on the effect of SSB reputation and the fact that reputable scholars are highly knowledgeable in *Shari'ah* and *fiqh* matters and are exposed to Islamic banking practices across jurisdictions, they are anticipated to enhance the performance of IBs. Accordingly, the following hypothesis is developed:

**H<sub>2(e)</sub>**: There is a significant positive relationship between SSB reputation and the performance of IBs.

<sup>4</sup> Source: (Ünal, 2011).

#### ***3.4.5.5 Sharī'ah Supervisory Board Educational Qualification and Performance***

Board members with a good degree of education are better equipped to deal with any scenario in the best way (Hambrick and Mason, 1984). Knowledge and skills can enable directors to think more critically, which is vital in their key tasks of monitoring, advising, and providing important resources (Tricker, 2012). From the RDT perspective, qualified and skilful board members can be regarded as a strategic resource to provide strategic links to different external resources (Ingley and Walt, 2001), with these directors bringing expertise to the board (Francis et al., 2015). Therefore, qualified board members enhance the company's competitiveness (Gabrielsson and Huse, 2005). Moreover, board members with higher qualifications would ensure board effectiveness, which requires “high levels of intellectual ability, experience, soundness of judgment and integrity” (Hilmer, 1998, p. 62).

Higher qualified board members are advantageous to the companies because they bring a variety of competencies and capabilities (Carpenter and Westphal, 2001; Carver, 2002), which aids in creating diverse perspectives when making decisions (Milliken and Martins, 1996; Biggins, 1999). More qualified members would broaden the board's knowledge base, encourage members to consider other alternatives and enhance the thoughtful processing of problems (Cox and Blake, 1991). Board members with higher educational qualifications in general and research and analysis-intensive qualifications like doctorates, in particular, will offer a rich source of innovative ideas to develop policy initiatives with analytical depth and rigour that will provide unique perspectives on strategic issues (Westphal and Milton, 2000).

Regarding the SSB, SSB members must have academic qualifications to deliver the necessary *Sharī'ah* guidelines (Ginena and Hamid, 2015). The level of SSB education qualifying in specific knowledge would improve their ability to make decisions about *Sharī'ah*-compliant products or services provided by IBs (Muhammad et al., 2021). For this purpose, SSB members should have the necessary knowledge in different fields to perform their fiduciary duties. Besides the competency of SSB in *fiqh* and Islamic finance (Ginena and Hamid, 2015; Hassan et al., 2010), it is also vital that SSB members must have sufficient knowledge in the fields of Islamic law, accounting, and economics to deal with legal and economic issues (Farook and Lanis, 2007).

Muhammad et al. (2021) empirically demonstrate that SSB members with doctoral degrees positively influence *Sharī'ah* compliance.

In terms of the association between SSB educational (i.e., PhD) qualifications and IBs' performance, Almutairi and Quttainah (2017), Nomran and Haron (2019), and Haron et al. (2021a) document a positive relationship, while Nomran et al. (2018) found a negative association. Notably, Nomran et al. (2018) emphasize the importance of SSB members with PhD degrees in enhancing the performance of IBs and the need for SSB scholars with PhD in accounting and finance. Therefore, this study attempts to assess the impact of the highest level of SSB educational qualification, namely a PhD, on IBs' performance. The current study argues that SSB doctoral qualification will improve the performance of IBs. On that account, the following hypothesis is developed:

**H<sub>2(f)</sub>:** There is a significant positive relationship between SSB doctoral qualification and the performance of IBs.

#### ***3.4.5.6 Sharī'ah Supervisory Board Meetings and Performance***

From the AGT perspective, the intensity of a board's activities is measured by the frequency of its meetings and the quality or effectiveness of its monitoring (Conger et al., 1998; Vafeas, 1999). A higher frequency of board meetings can lead to a higher quality of managerial monitoring, and such meetings offer board members more opportunities to discuss corporate strategy and risks, thus positively influencing a firm's performance (Vafeas 1999). According to Ntim and Osei (2011), corporate boards that meet more frequently have an increased capacity to advice, monitor effectively, and discipline management, resulting in improved corporate performance. Moreover, Frequent meetings with informal side-line interactions can create and strengthen cohesive bonds among directors (Lipton and Lorsch 1992).

From the RDT perspective, regular meetings may be helpful in allowing directors to strategize, plan, and assess executive performance, which could be especially constructive in a period of heightened financial uncertainty, competition, and reform (Ntim et al., 2017). Conger et al. (1998) view board meetings as an important

resource in improving the board's effectiveness. In addition, in line with the STK, frequent board meetings may enhance stakeholder representation (Freeman, 1984). Accordingly, many studies show that the frequency of BOD meetings is positively associated with firm performance (see, e.g., Ntim and Osei, 2011; Eluyela et al., 2018; Buchdadi et al., 2019).

Similarly, the extent of the SSB effectiveness can be measured by the meetings they hold as more frequent meetings will offer these scholars more opportunities to confer, monitor *Sharī'ah*-compliance, and advice management and BOD regarding issues related to the legality or permissibility of Islamic banking products and services. The SSBs are expected to convene meetings to supervise bank operations and to carry out *ex-ante* and *ex-post* tasks. The *ex-ante* (advisory function) includes the issuance of *Sharī'ah* resolutions and compliance checks before the products are offered to the customers, while the *ex-post* entails monitoring the compatibility of products' *Sharī'ah* compliance and effectively overseeing any *Sharī'ah* compliance risk that may emerge over time (IFSB, 2009).

Furthermore, Shittu et al. (2016) assert that the more the SSBs meet, the quicker they discuss solutions to tackle unforeseen issues for IBs. Indeed, since *Sharī'ah*-non-compliance events can occur at any time, it can be argued that increased SSB meetings will offer SSB members the adequate time needed to address and solve these events and, hence, mitigate the *Sharī'ah*-non-compliance risk and enhance the performance of IBs. According to Haddad and Souissi (2022), SSB's role in IBs is not limited to only verifying the *Sharī'ah*-compliance state of products and services but their functions also encompass reviewing board, audit committee, and the CEO decisions to ensure their compliance with *Sharī'ah*. Empirically, several studies show that the frequency of SSB meetings enhances the performance of IBs (see, e.g., Baklouti, 2022; Haddad and Souissi, 2022).

Nonetheless, contrary to the above contentions, Vafeas (1999) argues that normally, the limited time directors spend together is not used for meaningful exchange of ideas among themselves or with management. Instead, routine tasks, such as the presentation of management reports and various formalities, absorb much of the meetings, and this limits the amount of time that directors would have to effectively

monitor management (Lipton and Lorsch 1992), which can influence firm performance negatively. Also, higher meeting frequency implies higher costs to hold these meetings. According to Vafeas (1999), board meetings are costly in the form of managerial time, travel expenses, and directors' meeting fees; this can negatively impact corporate performance. For this reason, Jensen (1993) suggests that an effective board can occasionally remain inactive. Instead, the author suggests that the board should be flexible by increasing the frequency of board meetings in response to urgent issues and during crises and decreasing the number of meetings when there are limited emerging issues. Empirically, in the context of IBs, Alsartawi (2019) documents a negative link between SSB meetings and the performance of IBs in the GCC region.

Despite the conflicting arguments mentioned above, it is essential to emphasize the SSB's function in IBs is not limited to ensuring whether products and services provided to customers are *Sharī'ah*-compliant but also to safeguard the interests of the associated stakeholders (e.g., IB's depositors and IAHs). Hence, the SSBs are expected to hold regular meetings to respond to any inquiries from the management, BOD, and other stakeholders and detect and resolve *Sharī'ah* non-compliance. Therefore, based on these assertions, it is expected that increased SSB meetings can offer SSB scholars sufficient time to address all these issues. Accordingly, informed by the AGT, RDT, and STK, the following hypothesis is developed:

**H<sub>2(g)</sub>**: There is a significant positive relationship between SSB frequency of meetings and the performance of IBs.

#### **3.4.6 The Global Financial Crisis of 2008 and the COVID-19 Pandemic**

Given the colossal failure of firms such as Enron and World-com in the early 2000s, the 1997 Asian financial crisis, and the GFC, the topic of CG continues to gain much attention. Among these crises, the GFC in 2008 is regarded as the most serious crisis since the 1930s Great Depression (Francis et al., 2012). The 2008 contagious GFC that had shaken the stability of world economies highlighted the importance of a sound and effective CG of financial institutions. Although problems in subprime mortgage

markets initiated the GFC, failure and weaknesses in CG arrangements were, to an important extent, the causes of the crisis (Kirkpatrick, 2009).

It is worth mentioning that IFIs are also not exempt from CG breaches as various banks were closed, chiefly due to factors attributed to poor CG and *Sharī'ah* non-compliance. For instance, The Islamic Bank of South Africa collapsed in 1997, and Nathie (2010) reported that inferior and weak CG and SG practices led to its failure. Furthermore, Faisal Islamic Bank halted its operations in the UK for regulatory reasons (Husna and Abdulrahman, 2012). Moreover, the demise of the Ihlas Finance (Ihlas Finans) House in Turkey in 2001 (Ginena, 2014) and the corporate fraud seen in the Dubai Islamic Bank in 2004 (Ausat, 2018) demonstrate IBs' poor CG as well as SG.

As mentioned above, shortcomings in the CG mechanism were attributed to the development of the GFC (Kirkpatrick, 2009). The extant that the CG mechanism is effective is one of the internal factors that determine the survival of firms, and it has implications for firm performance; hence, it is found that well-governed firms significantly outperform poorly governed firms (see, e.g., Bauer et al., 2008; Bistrova et al., 2014; Aman et al., 2019). Notably, a robust CG system is vital during financial uncertainties. In an economic crisis period, Abatecola et al. (2014), in a survey of existing literature on corporate board effectiveness and corporate crisis, report that most of the empirical evidence demonstrates that board attributes may enhance the survival chances of firms undergoing a corporate crisis. Francis et al. (2012) show that BOD affected firm performance during the GFC.

On the other hand, the COVID-19 Pandemic has emerged and evolved into a global health crisis that has considerably weakened the growth prospects of advanced and emerging economies. The novel coronavirus, originating from Wuhan, China, spread worldwide and disrupted economic activities due to the frozen economies and global lockdowns (Anas et al., 2023). The COVID-19 Pandemic has brought external risk, which led executives to restructure their capital, policies, and organisational design in case of long and short-run emergencies (Foss, 2020; Shen et al., 2020). According to Anas et al. (2023), the survival and growth of firms, especially during a crisis period, is one of the significant challenges for corporate boards, and how they tackle it demonstrates their effectiveness. Khatib and Nour (2021) underlined that COVID-19

has highlighted the role of the board's oversight in reducing uncertainty risk. The role of boards during a crisis such as the COVID-19 Pandemic is to exert a more supportive role not only to focus on the typical monitoring role and maintain its independence but also the policy-setting role incorporated with active oversight (Crocini et al., 2020; Khatib et al., 2020). Anas et al. (2023) show that BOD affected firm performance during the recent COVID-19 pandemic.

Many studies have assessed the effect of BOD on firm performance during financial crises such as the GFC and the COVID-19 pandemic. However, when it comes to IBs, few studies have explored the role the SSB plays in periods of uncertainty and financial crisis. In terms of GFC, only one study (Mollah and Zaman, 2015), to the best of the researcher's knowledge, has examined the role of SG proxied by SSB size in mitigating the impact of such a crisis. The study found that SSB positively affects the performance of IBs during the GFC. The authors conclude that SG, represented by the SSB, mitigates the adverse effects of excessive risk-taking and improves IBs' performance. On the other hand, it seems that few studies, such as Wahyuni and Aidah (2022), have assessed the role of SSB in the performance of IBs during the COVID-19 pandemic. The study found that SSB size (a proxy for SG) does not influence the performance of Indonesian IBs amid the COVID-19 crisis.

That being the case, the current study extends these studies by employing a more suitable measurement to capture the role of SSB during the GFC and COVID-19 crises. Alman (2012) highlights that it is important to study the impact of SSB, particularly in periods of crisis. Effective SSBs are anticipated to be more responsive in periods of crisis and better able to respond to emerging risks, helping IBs to be more stable. Hence, effective SSBs are expected to enhance the performance of IBs during the GFC and the COVID-19 pandemic crisis. Consequently, the following hypotheses are developed:

**H<sub>3(a)</sub>:** The effect of SSB effectiveness, captured by the SSB score, has a significant positive impact on the performance of IBs during the global financial crisis of 2008.

**H<sub>3(b)</sub>:** The effect of SSB effectiveness, captured by the SSB score, has a significant positive impact on the performance of IBs during the COVID-19 pandemic crisis.

### **3.4.7 The Moderating Effect of *Sharī'ah* Governance Models**

Different jurisdictions have different approaches to SG mechanisms. Some prefer more prominent involvement with the regulatory authorities and implement a regulatory framework governing *Sharī'ah* supervision at both the national and institutional levels. In contrast, others favour less intervention and have adopted *Sharī'ah* supervision only at the institutional level (Grassa, 2013a). Regulators and supervisors are some of the most vital stakeholders of IFIs (Greuning and Iqbal, 2008). There has been a vast emphasis on the SG models (i.e., *Sharī'ah* supervision) practiced across countries embracing IFIs. This is because different SG mechanisms in different countries have implications for the performance of IBs. Nomran and Haron (2020c) contend that variations in the SG practices across countries can influence bank performance through variations in the regulatory models that regulate the characteristics, roles, and duties of SSBs, which in turn may affect the SSB's effectiveness in carrying out its roles.

Notably, the differences in regulatory approaches to SG systems have led IFIs across the world to embrace different SG models; however, the two most famous models are CSGM and DSGM. The centralised SG model (CSGM) refers to the *Sharī'ah* supervision at both the national and institutional levels, while the decentralised SG model (DSGM) refers to the *Sharī'ah* supervision at the institutional level only (see Figure 2.1).

Some authors believe that CSGM is better (e.g., Hamza, 2013; Oseni et al., 2016) because CSGM furnishes more standardisation and uniformity and enhances SSB independence from the management. CSGM also reduces “*fatwa* shopping”, which is a concept of searching for flexible and lenient opinions from SSB members, as Oseni et al. (2016) argued. In contrast, authors such as Grais and Pellegrini (2006a) and Alman (2012) support the idea that the DSGM is better than the CSGM because the decentralised model offers more opportunities for innovation. Quttainah et al. (2013)

contend that CSGM causes time constraints due to waiting until an IB receives a *fatwa* from the central authorities, which may cause the bank some opportunities and adversely affect performance. Moreover, Ajili and Bouri (2018a) argue that under the CSGM, central authorities may impose firm control over the IBs' contracts.

It is evident that each model has certain advantages and disadvantages. However, it can be argued that CSGM may offer more benefits than DSGM. The DSGM mostly adhered to jurisdiction in the Middle East, like Kuwait, has been criticized for allowing *Sharī'ah* scholars to serve many boards, lack of concise guidelines on how to report *Sharī'ah* non-compliant events, or possible relationships between the SSB members and bank employees (ISRA and Thomson Reuters, 2016) because a central authority does not appoint such SSB members. Therefore, questions about SSB independence may arise under the DSGM, which may put *Sharī'ah*-compliance at stake. Some of the disadvantages linked to the DSGM include “*fatwa shopping*”, lack of binding SSB opinions, SSB's opinions inconsistency, jeopardized SSB independence, the decisions of SSB not being respected by the BOD, and exposure to *Sharī'ah* non-compliance risks (See, Razak, 2018). Moreover, according to Alam et al. (2019), monitoring of IBs towards *Sharī'ah*-compliance can be costly and difficult, and this problem could be eliminated by establishing a centralised *Sharī'ah* supervision (i.e., CSGM) at the national level.

Empirically, Mezzi (2018) and Alam et al. (2019) document a positive relationship between CSGM and IBs' efficiency and performance, respectively. Moreover, the findings of the descriptive analysis of Nomran and Haron (2020c) demonstrate that IBs that operate under the CSGM showed, on average, higher levels of financial performance. Therefore, SSB effectiveness in jurisdictions that follow the CSGM is expected to show better bank performance than those that adhere to the DSGM. With that being said, the following hypothesis is developed:

**H4:** The effect of SSB effectiveness, captured by the SSB score, on the performance of IBs, is significantly and positively higher for jurisdictions that adopt CSGM compared to jurisdictions that adopt DSGM.

### **3.4.8 The Moderating Effect of Institutional Shareholding**

Due to the separation between ownership and control, AGT assumes that agents (managers) are opportunistic (Jensen and Meckling, 1976) and are resourceful in doing so (McCullers and Schroeder, 1982). Thus, a conflict of interest arises between the agents and principles (shareholders). These agency conflicts can be mitigated through monitoring (Andres, 2008). Monitoring may entail information acquisition, voting, and more active intervention in management activities and is frequently used synonymously with “shareholder activism” and “active investing” (Maug, 1998; Yaron, 2005; Idowu et al., 2013).

From an AGT perspective, the monitoring by shareholders will mitigate the opportunistic behaviour of agents and, thus, reduce agency problems. In this regard, there has been much emphasis on the role that institutional shareholders can play in the CG process of firms. Such shareholders have been viewed as constructive and active corporate monitors because they usually own larger blocks than individual investors and have an incentive to develop specialized expertise in making and monitoring investments (Bainbridge, 2005; Cao and Donnelly, 2010; Al-Janadi, 2021). In IBs, ownership structure, especially large shareholding, is one of the three dimensions of governance that can influence performance, in addition to the dual boards (BOD and SSB) (Mohammed and Muhammed, 2017a).

Large shareholders are said to be more motivated to monitor firms’ performance because of their large blocks and resources (Schiehll, 2006). Interestingly, institutional shareholders represent sophisticated, knowledgeable market participants, generally have fiduciary responsibilities, and are likely to be active monitors (Hardin et al., 2005). According to Shleifer and Vishney (1986) and Senteza et al. (2005), institutional shareholders, owing to their significant shareholdings, experience, and knowledge in interpreting financial information, are better informed than individual investors and they have high incentives and reap benefits from monitoring corporate performance, and have greater voting power, which allows for corrective action when necessary. Because they are skilled, professional, and experienced, institutional shareholders can play a significant role in safeguarding shareholders’ interests and developing corporate governance in their investee firms (Fatima et al., 2018), thus enhancing performance.

Moreover, based on the RDT, institutional shareholders furnish more resources to the company to increase performance (Shleifer and Vishney, 1986). The theory suggests that such shareholders provide new sources and experience for their portfolio firms (Al-Janadi, 2021).

Dobrzynski (1993) argues that sophisticated institutional shareholders with large ownership stakes tend to monitor and discipline managers to ascertain that the firm's investment strategy corresponds to maximizing long-term value rather than meeting short-term earning goals. Notably, various empirical studies document that active institutional shareholders effectively mitigate opportunistic earning management behaviour (e.g., Jalil and Rahman, 2010; Njah and Jarboui, 2013; Ajay and Madhumathi, 2015; Kim et al., 2016; Ramalingegowda et al., 2021).

However, institutional shareholders may not always be effective corporate monitors. Pound (1988) explores the influence of institutional shareholders on firm performance and puts forward three hypotheses: *efficient-monitoring hypothesis*, *conflict-of-interest hypothesis*, and *strategic-alignment hypothesis*. According to the *efficient-monitoring hypothesis*, institutional shareholders have greater expertise and can monitor managerial actions lower than small atomistic shareholders. In this view, institutional shareholding is expected to enhance firm performance. Therefore, based on this hypothesis, the institutional investors have an investment relationship with the investee firms.

The *conflict-of-interest hypothesis* suggests that institutional investors may have a business association with investee firms. Institutional investors are pressured into voting their shares with management. For instance, an insurance firm may own a significant stake in a company's stock and concurrently serve its primary insurer; therefore, voting against management may significantly affect its business relationship with the incumbent management. The *strategic-alignment hypothesis* asserts that institutional shareholders and managers find cooperating mutually beneficial. Cooperation decreases the positive benefits on the firm value that result from large shareholders' monitoring. Thus, unlike the *efficient-monitoring hypothesis*, the *conflict-of-interest and strategic-alignment hypotheses* predict a negative relationship.

Similarly, other studies also categorized the influence of institutional shareholding on firm performance into two different arguments (i.e., the *performance-improvement* and the *performance-reduction* arguments). The *performance-improvement* argument asserts that financial institutions enhance corporate efficiency and company performance (see, e.g., Shleifer and Vishny, 1986; Admati et al., 1994) in two ways. First, financial institutions conduct quality research to identify efficient firms to invest in, putting scarce resources to the best possible use. Second, financial institutions with large institutional holdings have strong economic incentives to monitor managers; such monitoring can improve management efficiency and the quality of corporate decision-making. This view is consistent with Pound's (1988) *efficient-monitoring hypothesis*.

In contrast, the *performance-reduction* argument assumes that institutional shareholders may not monitor managers because of their passivity, myopic goals, and conflicts of interest (Yuan et al., 2008). David and Kochhar (1996) assert that many financial institutions take a myopic view of their investments led only by the short-term (e.g., quarterly) goal of beating some key market benchmarks such as return on invested assets. This short-termism may trigger overreaction to information and excessive trading, thus making these investors unable to monitor managers effectively (Yuan et al., 2008). Therefore, it can be stated that this view is consistent with Pound's (1988) *conflict-of-interest hypothesis* and *strategic-alignment hypothesis*.

Based on these hypotheses and arguments, existing literature documented both positive (see, e.g., Cornett et al., 2007; Yuan et al., 2008; Elyasiani and Jia, 2010; Sakawa and Watanabel, 2020) and negative effects (see, e.g., Bhattacharya and Graham, 2007; Charfeddine and Elmarzougui, 2010; Satt et al., 2021) of institutional shareholders on firm performance. Other studies do not find evidence of a relationship between institutional ownership and performance (see, e.g., Al-Najjar, 2015; Alsartawi, 2019).

With regards to IBs, based on the above hypotheses and arguments, two arguments emerge on the influence of institutional shareholding on the role of SSB in safeguarding SG. First, according to the "active monitoring" view, large institutional shareholdings have the incentives to monitor managers where such monitoring

sequentially enhances managerial efficiency and quality of decision-making. Additionally, such shareholders are better informed than other individual shareholders because they have the resources and ability to gather and analyse firm-specific information as well as the experience accumulated from their multiple holdings, hence putting them in a better position to monitor managerial actions. In this manner, large institutional shareholding can enable the SSBs to perform their duties and responsibilities freely and independently without manipulation or intervention from the management.

On the other hand, they may not serve as effective corporate monitors because of their passivity, myopic goals, conflicts of interest, and possible business relations with their portfolio firms. It has been argued that some institutional shareholders are either passive, have myopic views, and have conflicts of interest and possible business relations with investee firms; hence, they are not motivated or willing to engage with the firm's activities and CG. In this way, large institutional shareholding may not enable the SSB of IBs to perform their tasks independently and effectively because of their inactivity (passivity), myopia (short-termism), conflicts of interest, and possible business associations with the management of IBs.

Large shareholders are one of the four key stakeholders that can affect the performance of IBs, in addition to other stakeholders such as BOD and SSB (Mohammed and Muhammed, 2017a). In general, owing to their large stakes and sophisticated knowledge, institutional shareholders may actively monitor the activities of IBs' management. As argued earlier, IBs have additional agency problems besides the regular principal-agent conflicts. In addition to the common agency problem in conventional banks when managers seek to maximize their interests as opposed to shareholders' wealth, IBs are also likely to face another type of agency in case managers of IBs may depart from their obligation to ensure that the funds are invested in *Shari'ah*-compliant assets (Zainuldin et al., 2018).

Particularly, institutional shareholders can play an active role in ensuring good and sound SG. Garas (2012) highlights that SSB members are appointed (in some jurisdictions) by the shareholders or after the BOD recommends to the shareholders, directly by the BOD or management. The management proposes their remuneration and

is approved by the BOD (Graiss and Pellegrini, 2006a). Therefore, concerns about SSB independence and *Shari'ah*-compliance monitoring may arise, especially when appointed by the management. The lack of SSB independence can jeopardize their role as *Shari'ah*-compliance monitors, leading to more agency costs and can cause shareholders to bear these costs.

Moreover, a unique problem in IBs is related to “*fatwa shopping*,” which is a concept in which managers search for flexible and lenient opinions from SSB members. This problem usually stems from the lack of SSB independence. “*Fatwa shopping*”, or opinion shopping, is a process of searching opinions from SSB scholars for a convenient and suitable *fatwa* to suit the management at the minimum level of *Shari'ah*-compliance (Salisu et al., 2020). “*Fatwa shopping*” increases the inconsistency between Islamic financial products, prompting customers and investors to be uncertain about the *Shari'ah*-compliance of the offered products and gradually driving them to completely lose faith in Islamic finance (Malik et al., 2011). Moreover, due to a lack of independence, the managers of IBs may pressurize the SSB to certify and legitimate certain investments, services, and prior decisions to meet their earnings target (Alam and Miah, 2021), increasing *Shari'ah* non-compliance risk.

Moreover, another conflict may arise between SSB and BOD due to the subordination of the SSB's role in IBs. Razak (2018) states that due to the lack of SSB independence and the absence of strong legislation in some countries, the BOD may refuse the decisions made by SSB deemed as counter-productive to the bank's profit-oriented objectives, and in some cases, BOD may alter SSB decisions to accommodate its interests. This may not be a surprise because, in some jurisdictions, the BOD appoints the SSB (Razak, 2018). All these factors can harm SG and *Shari'ah*-compliance supervision role by the SSBs and may negatively influence the IBs' performance.

It is worth mentioning that non-compliance with *Shari'ah* can negatively affect the performance of IBs, damage their reputation, increase their risk, and even endanger their existence. *Shari'ah* non-compliance is an operational risk that can lead to legal, financial, and reputation risks (AAOIFI, 2018). *Shari'ah* non-compliance is an apparent risk to the shareholders, especially those who hold significant shares like institutional owners. That being said, large Institutional shareholders, combined with the

sophisticated knowledge, information they gather, and their direct access to management, can monitor the management of IBs to ensure the absence of any unethical activities and the survival of IBs. Since SSBs are the guardians of *Sharī'ah*-compliance, large institutional shareholders can enable and ensure that the SSB executes its duties independently without fear or favour from the management or the BOD.

Indeed, institutional shareholders, with the virtue of their significant shareholding combined with their sophisticated knowledge and skills, may be best positioned to monitor the IBs better. As argued earlier, large shareholders may have the resources and incentives to engage with investee firms. Thus, incorporating significant shareholding with professional knowledge and experience may suggest that institutional shareholders can be effective corporate monitors and are highly motivated to oversee their portfolio firms more closely than individual shareholders. Therefore, institutional shareholders are expected to monitor the IBs to ascertain good corporate and *Sharī'ah* governance. Such shareholders' incentives and expertise to monitor managerial actions may enable SSBs to conduct their tasks effectively.

To summarise, institutional shareholders usually explore their portfolio firms' activities and may highly influence their CG. Several studies have investigated the influence of institutional shareholding on the performance of IBs (see, e.g., Abbas et al., 2009; Zouari and Taktak, 2014; Djeutcheu, 2019). Abbas et al. (2009) and Djeutcheu (2019) document a positive association between institutional ownership and performance, while Zouari and Taktak (2014) found a negative effect. These studies illustrate that the majority of their sample banks are institutionally owned. Khamis et al. (2015a), Zouari and Taktak (2012), and Khamis et al. (2015b) found that institutional ownership is the most common form of ownership structure in the Middle East, Southeast Asia, and North Africa. Hence, it is crucial to explore whether institutional shareholders influence the SSB of IBs. Based on the above arguments, the following hypothesis is developed:

**H<sub>5</sub>:** SSB effectiveness, captured by the SSB score, is likely to influence the performance of IBs significantly and positively in the presence of large institutional shareholding.

### **3.4.9 Firm and Country-Level Control Variables**

#### ***3.4.9.1 Firm-level Control Variables***

##### ***3.4.9.1.1 Board of Directors Effectiveness***

Because shareholders are unable to be involved in day-to-day managerial decision-making directly, agency theory suggests that shareholders have to rely on the BOD as the board is one of the vital mechanisms that monitor management decisions and safeguard the interests of shareholders (Jensen and Meckling, 1976). Monitoring is a crucial board role (Fama, 1980; Zahra and Pearce, 1989) as BODs are “the apex of the internal control system” (Jensen, 1993, p. 862), and they furnish the controlling mechanism that mitigates agency costs (Fama and Jensen, 1983). Vafeas (2005) reports that the BOD is accountable for monitoring the top managerial actions, especially those relating to performance, sub-committees’ tasks, and financial disclosure. On that account, monitoring a firm’s managers and internal control system and providing expert advice are the significant functions of the BOD (Omer and Al-Qadasi, 2019), hence, the importance of effective BODs.

AGT suggests various attributes that could determine the effectiveness of the monitoring role of BOD, including its size, independence, and frequency of meetings. Moreover, from the RDT perspective, since BOD provides crucial resources for the company (Hillman and Dalziel, 2003), such as providing expertise, knowledge, and experience (Carpenter et al., 2004; Bathula, 2008), it can be stressed that directors’ expertise and competency in accounting and finance will lead to better board monitoring.

The AGT theory suggests that smaller boards are better because they provide better communication and effectiveness than larger boards (Lipton and Lorsch, 1992; Sonnenfeld, 2002; O’Regan and Oster, 2005) and that an increase in board size may compromise the value of a firm through reduced effectiveness in terms of communication, coordination, and monitoring (Jensen, 1993), and can result in a slow-down of decision making and increase in costs (Callen et al., 2003; O’Regan and Oster, 2005). In contrast, the RDT assumes that large boards provide firms with more links and knowledge and, therefore, are better than small boards (Kiel and Nicholson, 2003).

Board independence is also one of the essential attributes of the BOD. Board independence would strengthen the role of the board (Fama and Jensen, 1983). From the AGT perspective, Fama and Jensen (1983) suggest that an effective board should contain an adequate number of independent outside directors to monitor managers and ensure that they are running the firm effectively to achieve the desired performance and safeguard the interests of shareholders. Their independence assures their objectivity when monitoring the management, reducing managers' opportunistic behaviour and increasing the firms' efficiency (O'Regan and Oster, 2005).

Dalton et al. (2007) contend that board independence is one of the principal methods of minimizing agency problems and that an independent board should contain more outside directors (i.e., non-executive directors) than inside directors (i.e., executive directors). Researchers examining the monitoring function have asserted that boards comprised mainly of insiders are not autonomous of management or the firms (because of possible associations) and have less motivation to monitor managers (Weisbach, 1988); thus, the crucial role of outside directors in providing independent oversights over the firm. Besides, from the RDT perspective, firms may appoint outsiders to the board to benefit from the external resources these directors may bring (Pfeffer, 1972). However, in contrast, the stewardship theory argues that the board should contain larger inside directors because they understand the business better, are better positioned to govern than outside directors, and can, thus, make superior decisions (Donaldson and Davis, 1991).

Regarding BOD meetings, the AGT suggests that increased board meetings are viewed as intensity in board activities and a proxy of the quality of their monitoring (Conger et al., 1998; Vafeas, 1999). Board meetings are a component of the board process and are regarded as a sign of the board's diligence (Carcello et al., 2002). A higher frequency of board meetings can lead to a higher quality of managerial monitoring, thereby positively influencing firm performance (Vafeas, 1999; Ntim, 2009). Regular board meetings allow directors more time to confer, set strategy, and assess managerial performance (Vafeas 1999) and can assist directors in remaining informed and knowledgeable about important developments within the firm, hence placing them in a better position to promptly address emerging critical issues (Mangena and Taurigana, 2008).

Regarding BOD expertise, Guner et al. (2008) stress that it is important that directors have an understanding of accounting principles and financial statements, which will lead to better board oversight. The numerous financial and accounting scandals that have hit the business sector since the late 1990s (with Enron being the emblematic example) have highlighted the necessity of enhancing both corporate governance and financial reporting (Jeanjean and Stolowy, 2009). Many scandals turned on specific accounting and financial arrangements (Benston & Hartgraves, 2002), casting doubts over the ability of directors, especially audit committee members, to understand such operations (Jeanjean and Stolowy, 2009). Moreover, the 2008 financial crisis represented instances of board members lacking accounting or financial expertise (see Sharpe, 2010). Therefore, board financial expertise can allow directors to grasp complex financial activities, better judgment on a particular investment strategy, and better overall monitoring.

With that said, informed by the AGT and the RDT, this study argues that smaller boards with higher independence and higher financial expertise who convene regular meetings are more effective in conducting their duties and, hence, can enhance the performance of IBs. Empirically, Nomran and Haron (2019) found that board effectiveness enhances the performance of IBs. Therefore, a positive relationship is expected between BOD effectiveness and IBs' performance.

#### 3.4.9.1.2 Bank Size

The bank size variable has been extensively covered in previous studies as a control variable (e.g., Zouari and Taktak, 2012; Mollah and Zaman, 2015; Nomran et al., 2018; Nomran and Haron, 2019; Alsartawi, 2019; Nomran and Haron, 2020a; Nomran and Haron, 2021b). Economic theory suggests that market structure affects firm performance because larger institutions offer services at a lower cost (Terraza, 2015; Highfield et al., 2021). Many Studies, such as Alsartawi (2019), Aslam and Haron (2020), and Nomran and Haron (2021b), documented a significant positive relationship between bank size and IBs' performance. Therefore, a positive relationship is expected.

#### 3.4.9.1.3 Bank Age

Bank age is another bank-level variable that has been widely examined (e.g., Zouari and Taktak, 2012; Zouari and Taktak, 2014; Mollah and Zaman, 2015; Nomran et al., 2018; Nomran and Haron, 2019; Nomran and Haron, 2020a; Nomran and Haron, 2021b; Baklouti, 2022). Because of the learning effect, a bank that has been in operation for a long time should perform better than a new bank (Adusei, 2011). The visibility of an experienced bank's quality to its customers (Petersen and Rajan, 1997) and its creditworthiness to loan and equity providers (Niskanen and Niskanen, 2006) should present some operational advantages over its less experienced counterparts. Numerous researchers, such as Zouari and Taktak (2014), Nomran and Haron (2019), and Nomran and Haron (2021b), found a positive relationship between bank age and IBs' performance. Thus, a positive sign is expected.

#### 3.4.9.1.4 Leverage

The previous empirical literature has widely included leverage as a control variable (e.g., Zouari and Taktak, 2012; Bukair and Rahman, 2015; Hakimi et al., 2018; Alsartawi, 2019). Previous studies have reported that more capitalized banks are more profitable and are less sensitive to financial difficulties (Sinkey and Greenawlat, 1991). Hakimi et al. (2018) document a positive relationship between leverage and IBs' performance. In contrast, A high degree of leverage increases the possibility of a bank defaulting (Baxter, 1967). According to Ben-Amar and Boujenoui (2007), banks with high leverage should be linked to a higher risk of bankruptcy. Empirically, various studies such as Ajili and Bouri (2018a), Bukair and Rahman (2015), and Aslam and Haron (2020) found a negative relationship. Therefore, based on this assertion, a negative sign is expected.

#### 3.4.9.1.5 Risk-Taking

Risk-taking is another control variable included in previous studies (e.g., Mollah and Zaman, 2015; Nomran and Haron, 2021b). Based on the "high-risk, high-return" notion, a positive sign is expected between bank risk-taking and performance. Mollah and

Zaman (2015) document a positive association between risk-taking and the performance of IBs.

### ***3.4.9.2 Country-level Control Variables***

#### ***3.4.9.2.1 Gross Domestic Product (GDP) Growth***

Gross Domestic Product (GDP) is a measure of a country's economic activities through goods and services production and is one of the most used country-level variables in the corporate governance-performance literature (see, e.g., Zouari and Taktak, 2012; Mollah and Zaman, 2015; Bukair and Rahman, 2015; Nomran and Haron, 2019; Nomran and Haron, 2020a; Baklouti, 2022). In the presence of a high GDP, the demand for financing increases, which helps boost the profitability of IBs (Aslam and Haron, 2020). When economic growth increases, it is anticipated that bank deposits will grow too, which means an increase in IB funds that leads to more investments and, thus, better performance (Bukair and Rahman, 2015). Zouari and Taktak (2014) and Aslam and Haron (2020) document a positive relationship between GDP and the performance of IBs. These studies explain this result as the possibility that higher GDP prompted an increasing demand for banks' financial services and loans, therefore, a higher output. Based on these arguments, a positive sign is expected.

#### ***3.4.9.2.2 Inflation***

Inflation reflects the general hike of the prices of goods and services and is also a country-level control variable that has been used extensively in the previous literature (see, e.g., Zouari and Taktak, 2012; Zouari and Taktak, 2014; Mollah and Zaman, 2015; Nomran and Haron, 2019; Nomran and Haron, 2020a). The effect of inflation on bank performance depends on whether inflation is expected or unexpected (Perry, 1992). The inflation rate is anticipated to have a positive sign. According to Sitompu et al. (2021), if inflation rises, purchasing power declines, and the demand for financing increases, leading to better performance of IBs. Zouari and Taktak (2014) and Aslam and Haron (2020) document a positive sign. Table 3.2 summarises this research's hypotheses.

### 3.5 CONCLUSION

This chapter concludes with this study's hypotheses. This chapter has discussed the theoretical background of the relationships between the study variables. At first, the related theories such as agency, resource dependence, and stakeholder theories were presented. Then, based on these theories, the hypotheses were developed.

Table 3.2 Summary of Hypotheses

Hypothesis	Independent variables	Expected sign
Effect of SSB characteristics on IBs' performance:		
H <sub>1(a)</sub>	SSB independence	Positive (+)
H <sub>1(b)</sub>	SSB busyness	Negative (-)
H <sub>1(c)</sub>	SSB remuneration	Positive (+)
Impact of SSB effectiveness (captured by a score) and its attributes on IBs' performance:		
H <sub>2(a)</sub>	SSB effectiveness	Positive (+)
H <sub>2(b)</sub>	SSB cross-membership	Positive (+)
H <sub>2(c)</sub>	SSB size	Positive (+)
H <sub>2(d)</sub>	SSB financial expertise	Positive (+)
H <sub>2(e)</sub>	SSB reputation	Positive (+)
H <sub>2(f)</sub>	SSB educational qualification	Positive (+)
H <sub>2(g)</sub>	SSB meetings	Positive (+)
SSB effectiveness during crisis periods:		
H <sub>3(a)</sub>	Effective SSB during the 2008 financial crisis	Positive (+)
H <sub>3(b)</sub>	Effective SSB during the COVID-19 pandemic crisis	Positive (+)
The moderating effect of <i>Shari'ah</i> governance models:		
H <sub>4</sub>	SSB effectiveness for IBs adopting the CSGM compared to IBs adopting the DSGM	Positive (+)
The moderating effect of institutional shareholding:		
H <sub>5</sub>	The moderating effect of institutional shareholding on the SSB effectiveness-performance relationship	Positive (+)

## **CHAPTER FOUR**

### **RESEARCH METHODOLOGY**

#### **4.1 INTRODUCTION**

The current study investigates the influence of SSB on the performance of IBs. This chapter presents research methods to achieve the objectives of this study. Specifically, the following section explains the sample selection, study period, data collection method, and data analysis techniques. Then, the measurement of dependent, independent, moderating, and control variables are then presented.

#### **4.2 SAMPLE SELECTION, DATA COLLECTION, AND STUDY PERIOD**

The sample selection of this study is drawn from a target population in the SEA region (i.e., Brunei Darussalam, Indonesia, Malaysia, Thailand, and the Philippines) and the GCC countries (i.e., Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates). There are several reasons for purposively selecting IBs in these jurisdictions. First, most IBs are located in the GCC and Southeast Asia countries (Grassa and Matoussi, 2014a).

Second, according to ISRA-Thomson Reuters (2016), Bahrain, Brunei, Indonesia, Malaysia, Oman, and the United Arab Emirates are among the top countries where global Islamic finance assets are located. Likewise, Thomson Reuters (2016) shows that Bahrain, Indonesia, Kuwait, Malaysia, Oman, Qatar, Saudi Arabia, and the UAE are among the top ten jurisdictions in Islamic finance assets with different regulatory environments. Third, in terms of the overall Islamic banking CG framework, Bahrain, Indonesia, Kuwait, Malaysia, Oman, Qatar, and the UAE are among the top ten countries with standards of good practices regarding regulations, CG, and SG (see Thomson Reuters, 2016).

Fourth, one of the criteria for selecting the sample countries in this study is the level of CG disclosure, as most of the necessary data to carry out this research are

available in the form of annual reports. Finally, to compare the effect of SG models (i.e., CSGM and DSGM) on the performance of IBs, the selected jurisdictions are the most suitable choice because they adhere to different SG models. Malaysia, Indonesia, Brunei Darussalam, Bahrain, UAE, and Oman adopt the CSGM, while the other selected jurisdictions (i.e., Saudi Arabia, Qatar, Kuwait, Thailand, and the Philippines) adopt the DSGM (see Table 2.2).

The target population is the IBs in the GCC (i.e., Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates) and SEA (i.e., Malaysia, Brunei Darussalam, Indonesia, Thailand, and the Philippines). The number of IBs in each country was obtained from the websites of the central banks in the respective countries. Accordingly, the number of IBs in these countries is discovered to be 70. This study uses unbalanced panel data over the 2006-2021 period. All banks should have data of at least three consecutive years to conduct a panel regression. Consequently, 10 IBs are excluded from the initial sample as the required data is unavailable or incomplete. A final sample of 60 IBs across eleven GCC and SEA countries has been selected, as shown in Table 4.1 and Appendix D. A total number of 860 firm-year observations were used for final analysis over the study period (2006-2021).

Financial data is obtained from the FitchConnect database. Country-level data is sourced from the World Bank macroeconomic indicators, while the rest of the data, including SSB and ownership attributes, were hand-collected from IBs' annual reports. Data on which countries adhere to CSGM or DSGM is taken from the existing literature (see Table 2.2).

Regarding the study period, this study considers crisis and non-crisis periods. Therefore, the pre-global financial crisis period (2006-2007), amid (2008-2009), the post-crisis period (2010-2018), and the COVID-19 pandemic crisis (2020-2021) are covered in this study. Alman (2012) and Mollah and Zaman (2015) suggest that different periods should be considered when investigating SSB characteristics; taking crisis and non-crisis periods would help IBs adopt an appropriate SSB structure that will enhance their performance (Nomran and Haron, 2020b).

Table 4.1 Sample Distribution

<b>No.</b>	<b>Country</b>	<b>Sample Banks</b>
1.	Bahrain	11
2.	Brunei Darussalam	1
3.	Indonesia	12
4.	Kuwait	5
5.	Malaysia	16
6.	Oman	2
7.	Qatar	4
8.	Saudi Arabia	4
9.	Thailand	1
10	The Philippines	1
11.	United Arab Emirates	3
	Total	60

Notably, the SSB remuneration variable in this study is only limited to the IBs in the sample that report the remuneration of SSB members in their annual reports, as not all banks disclosed it. This lowers the number of IBs that disclose SSB remuneration to 44 from 60 in the sample banks. Therefore, SSB remuneration data is narrowed to 44 IBs.

Likewise, Zakat, an additional performance measurement that can reflect the Islamic nature of IBs, is limited to the banks that report the annual Zakat payment, as not all IBs report it. This reduces the number of IBs that disclose Zakat payment in the annual reports to 38 from 60 in the sample banks. Thus, the Zakat performance measurement is shortened to 38 IBs.

### 4.3 DATA ANALYSIS

This study utilises different statistical techniques, namely descriptive and multivariate panel regression analyses. At first, various diagnostic tests, including outliers, normality, linearity, multicollinearity, homoscedasticity, and autocorrelation are discussed. Then, the panel data analysis method is presented. Finally, descriptive analysis and regression models are introduced to test the study's hypotheses. Stata software (version 17) is employed in this study for statistical analysis.

#### 4.3.1 Diagnostic Tests

Running regression analysis requires that basic assumptions be satisfied to attain reliable results. It is imperative in social research where the primary goal is to make data-based inferences about the phenomena under study (Berrington et al., 2006). As a result, to utilise the estimated regression function to generalize, it is vital to examine the adequacy of the model before making a decision (Johnson and Wichern, 2007). Correspondingly, basic assumptions must be tested, namely, outliers, normality, linearity, multicollinearity, autocorrelation, and homoscedasticity. Osborne (2000) emphasizes that violating these assumptions renders the results less generalizable or underestimated.

**Outliers:** Univariate or multivariate outliers are values in a data set far from other data values and can distort statistical analysis. Stevens (1984) and Rahaman et al. (2012) have compatibly defined outliers as the points in a data set that are very different from the other points. Univariate outliers in continuous variables are identified using the standardised values ( $z$  scores). Cases are deemed potential univariate outliers where  $z$  scores are greater than the value of 3.28 (Osborne and Waters, 2002). When an outlier is found, the initial step is determining if data transformations may lessen its influence (Osborne and Waters, 2002; Tabachnick and Fidell, 2007) since removing outliers entirely is not recommended (Osborne and Overbay, 2019). According to Tabachnick and Fidell (2007), any abnormal outliers should be deleted, but they can also be resolved by estimating their value from the next most extreme score (i.e., Winsorizing).

On the other hand, multivariate outliers are often identified using Mahalanobis distance (Verardi and Dehon, 2010; Hair et al., 2010; Osborne and Overbay, 2019). Nonetheless, some studies argue that this test “should be used with caution” and occasionally may produce unreliable results (Tabachnick and Fidell, 2007). Alternatively, Weber (2010) proposed the BACON test, which is based on the methodology suggested by Billor et al. (2000). Thus, the current study uses the BACON test to detect multivariate outliers.

**Normality:** Normality refers to one of the fundamental assumptions about the residual errors in the model rather than the variables themselves. For a regression model to meet the assumptions of many inferential statistics, these residuals should be normally distributed (i.e., follow a normal distribution). There are several methods to test the normality. Graphical techniques can be utilised, such as normality plots and tests like the Kolmogorov-Smirnov and the Shapiro-Wilk (Osborne and Waters, 2002). Nonetheless, according to Tabachnick and Fidell (2007), graphical techniques are more efficient than numerical tests—which can yield different results—in identifying the non-normality of residuals. Hence, normality plots using histograms are used in this study to examine the normality of residuals.

**Linearity:** Multiple regression analysis assumes the linear relationship between dependent and independent variables. Accordingly, testing linearity is essential for robust results (Tabachnick and Fidell, 2007). Plotting residuals against fitted values is often employed to test for linearity. Moreover, a statistical method based on residuals can also be used. Hair et al. (2010) reveals that, in regression analysis, non-linearity is not an issue if the standard deviation of the residuals is less than the standard deviation of the predictor value. Hence, the residual method to detect linearity is employed in this study.

**Multicollinearity:** Multicollinearity is a situation where the independent variables in a regression model are linearly dependent. Regression analysis assumes that predictor variables are not strongly correlated. The incidence of multicollinearity makes the coefficients of the regression output insignificant due to larger standard errors (Tabachnick and Fidell, 2007; Gujarati and Porter, 2009). To test multicollinearity, several methods, such as the correlation matrix, can show the independent variables that

are strongly correlated. Also, the Variance Inflation Factor (VIF) can be indicative of multicollinearity and can be run after the regression test. As a rule of thumb, if the VIF exceeds the value of 10, a variable is said to be strongly collinear (Tranmer and Elliot, 2008).

**Autocorrelation:** Autocorrelation or serial correlation refers to the correlation between error terms over successive time intervals. When errors exhibit autocorrelation, it leads to biased standard errors and weakens the results (Drukker, 2003; Hoehle, 2007). Hoffman (2010) points out autocorrelation is common in panel data studies. If there is autocorrelation, then the OLS estimator is not BLUE (best linear unbiased estimator) because the independence of errors assumption is violated. The Wooldridge and the Durbin-Watson tests are the most used methods to test for autocorrelation. The current study utilises the Wooldridge test to examine autocorrelation. As later shown in diagnostic results in chapter five, the Wooldridge test shows the presence of an autocorrelation in the data. Therefore, to address this issue, the Generalized Least Squares (GLS) estimation is commonly used (Kantar, 2015).

**Homoscedasticity:** Regression analyses presume that different continuous variables exhibit similar variance in scores. A violation of this assumption results in heteroscedasticity, which refers to the situation where the variance of the error terms is not constant across observations. Heteroscedasticity “biases the standard errors and causes the results to be less efficient” (Drukker, 2003). If heteroscedasticity exists, the OLS estimator is not BLUE (best linear unbiased estimator) because the constant variance assumption is violated. The Breusch–Pagan/Cook–Weisberg or the White test can be used to test for heteroscedasticity. The current study uses the Breusch–Pagan/Cook–Weisberg test. Using this test, the heteroscedasticity results, as later shown in diagnostic tests in chapter five, reveal the presence of heteroscedasticity. If there is heteroscedasticity, the GLS estimation is usually used (Kantar, 2015).

#### **4.3.2 Panel Data Analysis Method**

The current study uses the panel data technique to examine the relationship between the variables. Panel data is “the pooling of time series observations across various cross-sectional units, including countries, regions, states, firms or households” (Baltagi and

Song, 2006; p.494). By integrating features from both time-series and cross-sectional data, panel data presents numerous implications for the reliability of research. At first, the data size widens the variations and diminishes the incidence of collinearity, deriving more reliable results and testing complicated relationships (Baltagi and Song, 2006; Hsiao, 2007; Gujarati and Porter, 2009). Furthermore, panel data permits control for firm-specific differences and studying dynamic issues (Baltagi and Song, 2006; Gujarati and Porter, 2009). Lastly, panel data reduces bias if individual data are accumulated into broad sets (Gujarati and Porter, 2009). Fourth, panel data controls for the effect of omitted variables (Hsiao, 2007).

The panel data, based on data availability, takes two distinct forms. While all study years are observed for all firms in the balanced form of panel data, some firm observations are missing in the unbalanced form. The current study is unbalanced and extends from 2006 to 2021.

The current study uses the Generalized Least Squares (GLS) regression estimation since there is an autocorrelation and heteroskedasticity issue in the panel data. Unlike the Ordinary Least Squares (OLS), which assume constant error variance and independence of observations, the GLS accommodates the presence of correlated and heteroskedastic errors. Therefore, GLS offers an effective solution to these challenges by allowing for the estimation of regression coefficients while accounting for both autocorrelation and heteroskedasticity. Many studies utilised the GLS method to overcome the autocorrelation and heteroscedasticity problem (see, e.g., Zouari and Taktak, 2012; Zouari and Taktak, 2014; Djéutcheu, 2019; Abdallah and Bahloul, 2021).

### **4.3.3 Regression Models**

#### **Model 1 (direct models):**

- The objective of the following model is to measure the effect of SSB independence and busyness on the performance of IBs.

- $PERFORMANCE_{it} = \beta_0 + \beta_1 SSB\_INDP_{it} + \beta_2 SSB\_BUSY_{it} + \beta_3 BOD\_INDEX_{it} + \beta_4 BSIZE_{it} + \beta_5 LEV_{it} + \beta_6 Z\_SCORE_{it} + \beta_7 BAGE_{it} + \beta_8 GDP_{it} + \beta_9 INFL_{it} + \varepsilon_{it} \dots\dots\dots(1)$

**Model 2 (direct models):**

- The objective of the following model is to measure the effect of SSB remuneration on the performance of IBs.

- $PERFORMANCE_{it} = \beta_0 + \beta_1 SSB\_REM_{it} + \beta_2 BOD\_INDEX_{it} + \beta_3 BSIZE_{it} + \beta_4 LEV_{it} + \beta_5 Z\_SCORE_{it} + \beta_6 BAGE_{it} + \beta_7 GDP_{it} + \beta_8 INFL_{it} + \varepsilon_{it} \dots\dots\dots(2)$

**Model 3 (direct models):**

- The Objective of the following model is to measure the effect of SSB effectiveness measured by SSB score on the performance of IBs.

- $PERFORMANCE_{it} = \beta_0 + \beta_1 SSB\_SCORE_{it} + \beta_2 BOD\_INDEX_{it} + \beta_3 BSIZE_{it} + \beta_4 LEV_{it} + \beta_5 Z\_SCORE_{it} + \beta_6 BAGE_{it} + \beta_7 GDP_{it} + \beta_8 INFL_{it} + \varepsilon_{it} \dots\dots\dots(3)$

**Model 4 (direct models):**

- The Objective of the following model is to measure the effect of individual SSB score characteristics on the performance of IBs.

- $PERFORMANCE_{it} = \beta_0 + \beta_1 SSB\_SIZE_{it} + \beta_2 SSB\_CRMEM_{it} + \beta_3 SSB\_EXPERT_{it} + \beta_4 SSB\_REPT_{it} + \beta_5 SSB\_DRQ_{it} + \beta_6 SSB\_MEET_{it} + \beta_7 BOD\_INDEX_{it} + \beta_8 BSIZE_{it} + \beta_9 LEV_{it} + \beta_{10} Z\_SCORE_{it} + \beta_{11} BAGE_{it} + \beta_{12} GDP_{it} + \beta_{13} INFL_{it} + \varepsilon_{it} \dots\dots\dots(4)$

**Model 5 (moderating models):**

Moderating effect of SSB effectiveness during GFC and COVID-19 Pandemic crises:

Model 5a&5b: GFC period:

- The objective of the following model aims to test the effect of SSB effectiveness on the performance of IBs for two sub-periods (i.e., the GFC period versus the non-GFC period).
- $PERFORMANCE_{it} = \beta_0 + \beta_1 SSB\_SCORE_{it} + \beta_2 BOD\_INDEX_{it} + \beta_3 BSIZE_{it} + \beta_4 LEV_{it} + \beta_5 Z-SCORE_{it} + \beta_6 BAGE_{it} + \beta_7 GDP_{it} + \beta_8 INFL_{it} + \varepsilon_{it}$   
.....(5A &5B)

Model 5c&5d: COVID-19 Pandemic period:

- The objective of the following model aims to test the effect of SSB effectiveness on the performance of IBs for two sub-periods (the COVID-19 period versus the non-COVID-19 period).
- $PERFORMANCE_{it} = \beta_0 + \beta_1 SSB\_SCORE_{it} + \beta_2 BOD\_INDEX_{it} + \beta_3 BSIZE_{it} + \beta_4 LEV_{it} + \beta_5 Z-SCORE_{it} + \beta_6 BAGE_{it} + \beta_7 GDP_{it} + \beta_8 INFL_{it} + \varepsilon_{it}$   
.....(5C&5D)

**Model 6 (moderating models)**

The moderating effect of SG Models

- The objective of this model is to test the moderating effect of SG models on the relationship between SSB effectiveness and the performance of IBs for two sub-samples (i.e., CSGM and DSGM).

- $PERFORMANCE_{it} = \beta_0 + \beta_1 SSB\_SCORE_{it} + \beta_2 BOD\_INDEX_{it} + \beta_3 BSIZE_{it} + \beta_4 LEV_{it} + \beta_5 Z\_SCORE_{it} + \beta_6 BAGE_{it} + \beta_7 GDP_{it} + \beta_8 INFL_{it} + \varepsilon_{it}$   
.....(6A & 6B)

**Model 7 (moderating models)**

*The moderating effect of institutional shareholding*

- The Objective of the following model is to test the moderating effect of institutional shareholding on the relationship between SSB effectiveness and the performance of IBs for three sub-samples (i.e., IBs where Institutional shareholding > 50%, IBs where institutional shareholding  $\leq 50 \geq 20$ , and IBs where institutional shareholding < 20).
- $PERFORMANCE_{it} = \beta_0 + \beta_1 SSB\_SCORE_{it} + \beta_2 BOD\_INDEX_{it} + \beta_3 BSIZE_{it} + \beta_4 LEV_{it} + \beta_5 Z\_SCORE_{it} + \beta_6 BAGE_{it} + \beta_7 GDP_{it} + \beta_8 INFL_{it} + \varepsilon_{it}$   
.....(7A, 7B, & 7C)

Where for bank *i* at year *t*:

PERFORMANCE= performance measurements of IBs,  
 SSB\_SCORE= SSB effectiveness,  
 SSB\_INDP= SSB independence,  
 SSB\_REM= SSB remuneration,  
 SSB\_CRMEM= SSB cross-membership,  
 SSB\_BUSY= SSB busyness,  
 SSB\_SIZE= SSB size,  
 SSB\_EXPERT= SSB financial expertise,  
 SSB\_REPT= SSB reputation,  
 SSB\_DRQ= SSB doctoral qualification,  
 SSB\_MEET= SSB meetings,  
 BOD\_INDEX= BOD effectiveness,  
 BSIZE= Bank size,

LEV= Leverage,  
Z-SCORE= Risk-taking,  
BAGE= Bank age,  
GDP= GDP growth rate,  
INFL= Inflation rate

#### **4.4 MEASUREMENT OF VARIABLES**

Variables in this study are dependent variables, independent variables, moderator variables, and control variables. Dependent variables are IBs' performance measurement, while independent variables are SSB characteristics. Control variables are firm-level and country-level variables, whilst the moderator variable is institutional shareholding. Moreover, there are categorical moderator variables, namely GFC, COVID-19, and the CSGM versus DSGM.

##### **4.4.1 Measurement of Dependent Variables**

Dependent variables are the performance measurement of IBs. This study employs three dependent variables. Two variables are the most popular and used accounting-based measurements: ROA and ROE<sup>5</sup> (see, e.g., Grassa and Matoussi, 2014a; Rahim and Mahat, 2015; Almutairi and Quttainah, 2017; Hakimi et al., 2018; Baklouti, 2022). The other dependent variable is the annual Zakat payment by IBs. As argued earlier, when measuring the performance of IBs, an Islamic approach should be employed; thus, Zakat has been suggested (see, e.g., Ibrahim et al., 2004; Mohammed and Muhammed, 2017b; Nomran and Haron, 2019). The studies that used Zakat as a performance measurement are minimal; however, several studies employed Zakat as an Islamic performance approach (see Mohammed and Muhammed, 2017b; Nomran and Haron, 2019; Haron et al., 2021a; Haron et al., 2021b). Nomran and Haron (2021) empirically show that Zakat is valid for use as a performance measurement. In terms of market

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<sup>5</sup> According to Hakimi et al. (2018), ROA and ROE are the most popular and used in previous and recent literature.

performance measurement, this study has to ignore the market-based model (i.e., Tobin's Q) as most IBs in the sample are non-listed.

#### ***4.4.1.1 Return on Assets (ROA)***

ROA is the most common ratio employed to measure bank performance (Adewale and Rahmon, 2014). ROA demonstrates the ability of a bank's management to convert assets into net profits and is seen as an important metric of managerial efficiency (Kosmidou, 2008; Rasiah, 2010). Thus, a higher ROA indicates higher firm performance (Al-Matari et al., 2014). ROA ratio is measured by dividing net income by total assets (Mollah and Zaman, 2015; Almutairi and Quttainah, 2017; Hakimi et al., 2018; Nomran et al., 2018; Nomran and Haron, 2019; Nomran and Haron, 2020a; Baklouti, 2022).

#### ***4.4.1.2 Return of Equity (ROE)***

ROE is an internal performance measure of shareholder value and is considered a vital performance measure as it observes both profitability and equity indicators (Hakimi et al., 2018). ROE describes the percentage of profit the company makes for every monetary unit of equity invested in the company (Berzkalne and Zelgalve, 2014). ROE ratio is calculated by dividing net income by total equity (Mollah and Zaman, 2015; Hakimi et al., 2018; Almutairi and Quttainah, 2017; Nomran et al., 2018; Nomran and Haron, 2020a; Baklouti, 2022).

#### ***4.4.1.3 Zakat as a Performance Measurement***

The majority of the previous studies examining the relationship between CG and the performance of IBs have used traditional methods to assess performance. Because IBs are distinct from CBs in various ways, including business models, Ibrahim et al. (2004) argue that the performance of IBs should be measured by the *Sharī'ah* approach, including the examination of Zakat. Zakat is a term to describe donation as prescribed by the *Sharī'ah*, and IBs are obliged to pay Zakat annually (Mohammed and

Muhammed, 2017b). Zakat is not a government tax; instead, it is an amount paid by Muslims as a religious duty. However, not only individuals must pay Zakat, but business entities must pay too (Nomran and Haron, 2021a) because businesses are one way to accumulate wealth and are subject to Zakat (Abbas et al., 2018). The purpose of IBs to pay Zakat is to enhance justice and wealth in society and reduce poverty (Mohammed and Muhammed, 2017b).

That said, the performance of IBs should be assessed based on an indicator that reflects on their *Sharī'ah*-based activities, and Zakat can be one of their social performance indicators (Nomran and Haron, 2021a). Some studies have suggested that the Zakat should be used as a performance measurement of IBs (see Ibrahim et al., 2004; Mohammed and Muhammed, 2017b; Nomran and Haron, 2019; Nomran and Haron, 2020a; Nomran et al., 2021; Nomran and Haron, 2021a).

There are several reasons for using Zakat as a performance measurement. First, Zakat has the dynamic ability to reflect the profitability and health of IBs, thus, the more profit IBs make, the more Zakat they pay (Mohammed and Muhammed, 2017b; Sarif and Kamri, 2012). Second, the higher the net worth of IBs, the higher the amount of Zakat payable (Ibrahim et al., 2004). Therefore, this study employs the annual Zakat payment by IBs as an Islamic social performance approach.

#### **4.4.1.3.1 Zakat Payment**

An Islamic bank's shareholders and investment account holders are responsible for paying Zakat (Abdullah et al., 2013). Following the suggestions of Ibrahim et al. (2004), Mohammed and Muhammed (2017b), Nomran and Haron (2019), Haron et al. (2021a), and Haron et al. (2021b), Zakat is used as an additional social performance measurement. Similar to Abbas (2020) and Pramesti and Fahrullah (2023), Zakat is measured as the natural logarithm of annual Zakat payment by IBs.

## **4.4.2 Measurement of Independent Variables**

### **4.4.2.1 *Sharī'ah Supervisory Board Effectiveness***

Various studies have assessed the influence of SSB characteristics that could determine their effectiveness on the performance of IBs, including SSB size, reputation, educational level, expertise, SSB cross-memberships (see, e.g., Farook et al., 2011; Grassa and Matoussi, 2014a; Musibah and Alfattani, 2014; Mollah and Zaman, 2015; Almutairi and Quttainah, 2017; Quttainah et al., 2017; Nomran et al., 2018; Nomran and Haron, 2019; Baklouti, 2022).

Researchers like Farook and Lanis (2007) and Farook et al. (2011) have initially used a SSB score to capture the overall effect of SSB on the performance of IBs. These two studies constructed a SSB score that sums the value of five dichotomous SSB characteristics, namely the existence of SSB, SSB size, cross-membership, doctoral qualification, and SSB reputation. Following this method, Rahman and Bukair (2013) also constructed a SSB score comprising five SSB characteristics, including SSB size, cross-membership, doctoral qualification, reputation, and expertise. A similar approach to Rahman and Bukair (2013) is also employed by Nomran and Haron (2019).

Rahman and Bukair (2013) and Nomran and Haron (2019) measure the SSB effectiveness by using a SSB score that sums the value of five dichotomous characteristics of SSB (i.e., size, cross-membership, doctoral qualification, reputation, and expertise), which takes a score bounded by 0-1.

In addition to these attributes, this study adds a sixth variable: SSB meetings. It has been argued that the intensity of board meetings is measured by the frequency of their meetings and the quality or effectiveness of their monitoring (see, e.g., Conger et al., 1998; Vafeas, 1999). Similarly, the extent to which the SSB effectively performs their duties and tasks can depend on the number of meetings they convene. Hence, besides the score mentioned above that consists of five dichotomous SSB characteristics employed by Rahman and Bukair (2013) and Nomran and Haron (2019), the current study adds SSB meetings (see Table 4.2).

Table 4.2 SSB Score Construction

SSB size	“1” for banks with 5 or more members, “0” otherwise.
SSB cross-memberships	“1” if at least one SSB scholar with cross-membership, “0” otherwise
SSB doctoral Qualification	“1” if at least one SSB scholar with PhD, “0” otherwise
SSB reputation	“1” if at least one SSB scholar sits on the SSB of AAOIFI, “0” otherwise
SSB expertise	“1” if at least one SSB scholar with experience and knowledge in the field of accounting/finance/ economics, “0” otherwise
SSB meetings	“1” if SSB meetings are higher than the median, “0” otherwise.

**Note:** The SSB score measures SSB effectiveness and sums the value of six dichotomous attributes bounded by “0-6”, with a higher score indicating higher effectiveness and vice versa.

#### 4.4.3 *Shari’ah* Supervisory Board Characteristics

##### 4.4.3.1 *Shari’ah* Supervisory Board Independence

Alsartawi (2019) measured SSB independence using a single proxy as a binary variable, i.e., “0” if the SSB member has a direct or indirect relationship with the IB, “1” otherwise. However, most IBs in SEA and GCC do not usually disclose direct and indirect relationships of SSB to the IBs, and it would be impractical to employ the same measurement as Alsartawi (2019) to capture SSB independence. Nomran and Haron (2020b) suggest that SSB independence is measured in several ways, including the entity responsible for their appointment. Therefore, following this study, SSB independence is measured by a binary variable that takes “1” if shareholders appoint the SSB; “0” otherwise.

#### **4.4.3.1.1 Shari'ah Supervisory Board Remuneration**

SSB remuneration is measured following two steps. In the first step, the total compensation paid to SSB members, including cash and non-cash compensation (Haron et al., 2021a), is collected from the annual reports. In the next step, a dummy variable that takes “1” if the annual SSB remuneration is higher than the country mean of SSB remuneration and “0” otherwise, is created. This method is consistent with some prior studies such as Henry (2010), who measured remuneration by employing a dummy variable that is coded “1” if annual board remuneration is above the median value and “0” otherwise to capture whether high remuneration motivates directors to enhance firm performance.

#### **4.4.3.1.2 Shari'ah Supervisory Board Cross-Membership**

Cross-membership of SSB is measured by the percentage of the total number of SSB members that serve more than one SSB (see, e.g., Grassa, 2015b; Almutairi and Quttainah, 2017; Nomran et al., 2018; Nomran and Haron, 2019; Baklouti, 2022). Hence, the number of SSB members who serve more than one or multiple SSBs across IFIs is divided by the total number of SSB members to attain the percentage.

#### **4.4.3.1.3 Shari'ah Supervisory Board Busyness**

BOD busyness has been measured as those serving three or more boards (or, in other words, two or more outside directorships) (see, e.g., Core et al., 1999; Ferris et al., 2003; Fich and Shivdasani, 2006; Ahn et al., 2010; Cooper and Uzun, 2012; Elyasiani and Zhang, 2015; Ferris and Liao, 2019). Similarly, regarding SSB busyness, Trinh et al. (2020) measured it as the percentage of members serving three or more SSBs. Therefore, following this study, SSB busyness is measured by the number of SSB members who serve three or more SSBs divided by the total number of SSB members.

#### **4.4.3.1.4 Sharī'ah Supervisory Board Size**

SSB size is the total number of SSB members in an IB (see, e.g., Mollah and Zaman, 2015; Nomran et al., 2018; Hakim et al., 2018; Nomran and Haron, 2019; Nomran and Haron, 2020a; Baklouti, 2022). Therefore, the SSB is measured by the overall number of SSB members in a given bank at the end of each year.

#### **4.4.3.1.5 Sharī'ah Supervisory Board Financial Expertise**

SSB financial expertise is measured as the percentage of SSB members' accounting/finance/economic knowledge (see, e.g., Matoussi and Grassa, 2012; Grassa, 2015b; Nomran et al., 2018; Nomran and Haron, 2019; Khan and Zahid, 2020). The number of SSB members with accounting/finance/economics expertise is divided by the total number of SSB members to find the percentage.

#### **4.4.3.1.6 Sharī'ah Supervisory Board Reputation**

Prior literature measures SSB reputation either as the number of SSB members that serve on AAOIFI's *Sharī'ah* board or if at least one SSB member serves on the said board (see, e.g., Farook and Lanis, 2007; Farook et al., 2011; Rahman and Bukair, 2013; Nomran et al., 2017; Nomran et al., 2018; Nomran and Haron, 2019; Nomran and Haron, 2020a; Haron et al., 2021a; Nomran and Haron, 2021b; Baklouti, 2022). Hence, SSB members who serve on AAOIFI's *Sharī'ah* board are divided by the total number of SSB members. The SSB reputation data is collected from Ünal (2011) for the year 2010 data and the remaining years from AAOIFI's published standards, which provide the names of their *Sharī'ah* board members and AAOIFI's annual reports.

#### **4.4.3.1.7 Sharī'ah Supervisory Board Qualification**

SSB qualification is measured as those members with a doctoral qualification (see, e.g., Almutairi and Quttainah, 2017; Nomran et al., 2017; Nomran et al., 2018; Nomran and

Haron, 2019; Haron et al., 2021a). Therefore, following these studies, SSB members with a PhD degree are divided by the total number of SSB members.

#### **4.4.3.1.8 Shari'ah Supervisory Board Meetings**

Following previous studies, SSB frequency of meetings is measured as the total number of SSB meetings held in a year (see, e.g., Alsartawi, 2019; Baklouti, 2022; Haddad and Souissi, 2022).

### **4.4.4 Measurement of Moderating Variables**

#### ***4.4.4.1 The Global Financial Crisis and COVID-19 Pandemic Crisis***

To capture the effect of the 2008 GFC on bank performance, prior studies used a dummy variable, “1” for the 2008-2009 period, “0” otherwise (see, e.g., Zouari and Taktak, 2014; Hakimi et al., 2018). Likewise, Previous studies employed a dummy variable, “1” for the 2020-2021 period, “0” otherwise to capture the COVID-19 Pandemic effect (see, e.g., Wastuti and Hasan, 2022).

In this study, similar to Mollah and Zaman (2015), the influence of SSB effectiveness during crisis and non-crisis periods is captured by dividing the study period into two sub-periods. Therefore, the 2008 GFC period is divided into two periods (i.e., 2008/2009 GFC period and non-GFC crisis period). Similarly, the COVID-19 pandemic period is divided into two periods (i.e., the 2020/2021 period and the non-COVID-19 period). Taking crisis and non-crisis periods would help IBs adopt an appropriate SSB structure to enhance their performance (Nomran and Haron, 2020b).

#### ***4.4.4.2 Shari'ah Governance Models***

Countries that embrace the CSGM versus those that adopt the DSGM are shown in Table 2.2. Studies such as Alam et al. (2019) and Mezzi (2018) employed a dummy variable if there is a central *Shari'ah* supervision (i.e., CSGM) and “0” otherwise.

However, Nomran and Haron (2020c) employed a more efficient measurement by dividing their sample IBs into two sub-samples of countries that adopt the CSGM versus those that embrace the DSGM. Thus, similar to Nomran and Haron (2020c), the current study divides the main sample into two sub-samples of IBs in countries that embrace the CSGM versus those that operate under the DSGM.

#### ***4.4.4.3 Institutional Shareholding***

Large institutional shareholding (blockholding) is measured following two steps. In the first step, the percentage of significant shareholding of 5% ownership level or more of bank shares is collected following several studies (see, e.g., Zouari and Taktak, 2014; Djeutcheu, 2019; Khan and Zahid, 2020). Next, an ordinal variable is created, taking a value bounded by 0-2. This ordinal variable takes “0” if the institutional shareholding is  $< 20\%$ , “1” if the institutional shareholding is  $\geq 20 \leq 50\%$ , and “2” if the institutional shareholding is  $> 50\%$ . The ownership of more than 50% of outstanding shares constitutes control, while  $\geq 20 \leq 50\%$  implies significant influence. Institutional ownership of shares less than 20% infers no significant influence.

#### **4.4.5 Measurement of Control Variables**

The current study has two types of control variables: bank-level control variables (i.e., BOD effectiveness index, bank size, bank age, leverage, and risk-taking) and country-level control variables (i.e., GDP growth and inflation).

BOD is an important organ in banks. In IBs, shareholders appoint the BOD, alongside the SSB, to monitor management. Therefore, the BOD will have a considerable influence on the performance of IBs; hence, it is vital to control the effect of the BOD. Most prior studies have used BOD size and independence to capture their effectiveness/strength (see, e.g., Mollah and Zaman, 2015; Nomran and Haron, 2019; Mollah et al., 2021). This study extends these characteristics to include BOD financial expertise and frequency of meetings. Therefore, the current study employs four BOD

characteristics (size, independence, financial expertise, and meetings) to gauge its effectiveness. Consequently, a BOD index/score is constructed based on these four attributes. Such a BOD index/score sums the value of four dichotomous BOD characteristics (i.e., size, independence, financial expertise, and meetings) that take a score bounded by 0-4 (see Table 4.3).

Table 4.3 BOD Effectiveness Index Construction

BOD size	“1” if the board size is less than the median of the BOD size of the sample, “0” otherwise.
BOD independence	“1” if board independence is higher than the median of BOD independence of the sample, “0” otherwise.
BOD financial expertise	“1” if board financial expertise is higher than the median of BOD financial expertise of the sample, “0” otherwise.
BOD meetings	“1” if board meetings are higher than the median of BOD meetings of the sample, “0” otherwise.

**Note:** The BOD-Index/score measures BOD effectiveness and sums the value of four dichotomous attributes bounded by “0-4”, with a higher index/score indicating higher effectiveness and vice versa.

Bank size is measured by the natural logarithm of the total assets of each bank, while bank age is measured by the number of years since the establishment of the bank (see, e.g., Hakimi et al., 2018; Baklouti, 2022). Leverage is measured by dividing total debts by total assets (see, e.g., Zouari and Taktak, 2014; Mnif and Tahari, 2021). Risk-taking is measured by the Z-score, which is calculated as the sum of ROA plus capital adequacy ratio (CAR) divided by the standard deviation of ROA (see, e.g., Mollah and Zaman, 2015; Safiullah and Shamsuddin 2018; Trinh et al., 2020). Regarding country-level control variables, GDP is measured as the annual GDP growth rate (Mezzi, 2018; Trinh et al., 2020), while the consumer price index measures the inflation rate (see, e.g., Mollah and Zaman, 2015; Nomran and Haron, 2020a). Table 4.4 summarises the measurement of study variables.

## 4.5 CONCLUSION

This chapter presented the research methodology. The study population, sample, study period, and data collection are discussed first, and then data analysis and variable measurements are discussed. The next chapter discusses the results of the statistical analysis.

Table 4.4 Summary of the Measurements of Variables

Variable	Acronym	Measure
<b>Dependent Variables:</b>		
Return on Assets	ROA	Net income divided by total assets.
Return on Equity	ROE	Net income divided by total equity.
Zakat Payment	Lnzakat	Natural logarithm of annual Zakat payment.
<b>Independent Variables:</b>		
SSB Effectiveness	SSB_SCORE	A SSB score that sums the value of six dichotomous SSB characteristics that takes a score bounded by 0-6 (i.e., SSB size, SSB cross-membership, SSB doctoral qualification, SSB reputation, SSB financial expertise, and SSB meetings) (see Table 4.2).
SSB Independence	SSB_INDP	A dummy variable, “1” if SSB is appointed by the shareholders, “0” otherwise.
SSB Remuneration	SSB_REM	A dummy variable, “1” if the annual SSB remuneration is higher than the country mean of SSB remuneration, “0” otherwise.
SSB Cross-Membership	SSB_CRMEM	Percentage of SSB members who serve on the SSBs of other IFIs.
SSB Busyness	SSB_BUSY	Percentage of SSB members who serve on the SSBs of three or more IFIs.
SSB SIZE	SSB_SIZE	The total number of SSB members at the end of each year.
SSB Financial Expertise	SSB_EXPERT	Percentage of SSB members with accounting/finance/economics expertise.

<b>Variable</b>	<b>Acronym</b>	<b>Measure</b>
SSB Reputation	SSB_REPT	Percentage of SSB members who sit on SSB of the AAOIFI.
SSB Qualification	SSB_DRQ	Percentage of SSB members with a doctoral degree.
SSB Meetings	SSB_MEET	The total number of SSB meetings held in a year.
<b>Moderating Variables:</b>		
<i>Shari'ah</i> Governance (SG) Models	CSGM Vs. DSGM	Two sub-samples: IBs in countries that adopt the CSGM versus those that embrace the DSGM (see Table 2.2).
Financial Crisis of 2008	GFC	Two sub-periods: the 2008/09 GFC period versus non-GFC periods
Covid-19 Pandemic Crisis	Covid_19	Two sub-periods: the 2020/21 COVID-19 pandemic period versus the non-Covid-19 pandemic period.
Institutional Shareholding	INST_OWN	An ordinal variable that takes “0” if the institutional shareholding is < 20%, “1” if the institutional shareholding is $\geq 20 \leq 50\%$ , and “2” if the institutional shareholding is > 50%.
<b>Control Variables:</b>		
BOD Effectiveness	BOD_INDEX	A BOD score that sums the value of four dichotomous BOD characteristics that takes a score bounded by 0-4 (i.e., BOD size, BOD independence, BOD expertise, and BOD meetings) (see Table 4.3).
Bank Size	BSIZE	Natural logarithm of total assets.
Leverage	LEV	Total debts divided by total assets.
Risk-Taking	Z-SCORE	Z-Score (ROA plus capital adequacy ratio (CAR), divided by the standard deviation of ROA).
Bank Age	BAGE	The number of years since the foundation of the bank.
GDP Growth Rate	GDP	Annual growth rate of Gross Domestic Product (GDP).
Inflation	INFL	Inflation rate

# **CHAPTER FIVE**

## **FINDINGS AND DISCUSSION**

### **5.1 INTRODUCTION**

This chapter tests the hypotheses that have been developed in chapter three. In this chapter, the study findings are presented. At first, the diagnostic tests are examined. Following this are the descriptive statistics of the study variables. In the next section, the regression results are discussed. Finally, the chapter ends with a summary and conclusion.

### **5.2 DIAGNOSTIC TESTS**

This section examines the diagnostic tests necessary before running regression analysis, namely detecting outliers, normality, linearity, multicollinearity, autocorrelation, and homoscedasticity. Consequently, these tests are tested.

#### **5.2.1 Outliers**

Univariate or multivariate outliers are values in a data set far from other data values and can distort statistical analysis. This study uses standardised values (z scores) to identify univariate outliers in continuous variables. On the other hand, multivariate outliers are detected using the BACON test, which has been proposed by Weber (2010) and is based on the methodology suggested by Billor et al. (2000).

Using standardised scores, it was found that there are univariate outliers in four variables (i.e., ROA, ROE, RISK, and LEV). To remove the effect of these univariate outliers, the variables were winsorized at the 95% level. Winsorizing outliers involves replacing the smallest and largest values of a data set with the observations closest to them, which reduces the effect of outliers by replacing them with the nearest non-outlier values.

On the other hand, multivariate outliers are detected using the BACON test. The test is run with all study variables and will show the number of BACON outliers. Using this test, no multivariate outliers were detected.

### **5.2.2 Normality**

Normality refers to the normal distribution of residuals and should follow a normal distribution. There are several methods to test the normality assumption. Graphical techniques can be utilised, such as normality plots. Also, statistical tests, such as the Kolmogorov-Smirnov and Shapiro-Wilk (Osborne and Waters, 2002), can be used. However, according to Tabachnick and Fidell (2007), graphical techniques are more efficient than numerical tests—which can yield different results—in identifying the non-normality of residuals. Therefore, the current study uses histograms with normality plots to examine the normality of residuals.

As shown in Appendix C, residuals are normally distributed. It is worth mentioning that normality plots of most models where the dependent variable is *Lnzakat* are slightly skewed. However, these are not significantly skewed, and there are no significant deviations from normality, as minor deviations in large datasets do not pose a problem (Tabachnick and Fidell, 2007). Thus, it is concluded that the data set has no serious violation of the normality assumption.

### **5.2.3 Linearity**

Multiple regression analysis assumes the relationship between dependent and independent variables is linear. Accordingly, testing linearity is essential for robust results (Tabachnick and Fidell, 2007). A statistical method based on residuals is used in this study. Hair et al. (2010) reveal that, in regression analysis, non-linearity is not an issue if the standard deviation of the residuals is less than the standard deviation of the predictor value. As shown in Table 5.1, all models' standard deviation of residuals is less than the standard deviation of dependent variables.

Table 5.1 Standard Deviation of Residuals and Performance

Model	Variable	Std. Dev		
		ROA	ROE	Lnzakat
Model (1)	Performance	2.0323	9.1244	3.5904
	Residual	0.7534	3.9546	3.4621
Model (2)	Performance	2.0323	9.1244	3.5904
	Residual	0.5356	3.4661	3.5373
Model (3)	Performance	2.0323	9.1244	3.5904
	Residual	0.7658	4.1402	3.3926
Model (4)	Performance	2.0323	9.1244	3.5904
	Residual	0.5281	4.1779	3.4623
Model (5)	Performance	2.0323	9.1244	3.5904
	Residual	0.7658	4.1402	3.3926
Model (6)	Performance	2.0323	9.1244	3.5904
	Residual	0.5175	3.9708	3.3336
Model (7)	Performance	2.0323	9.1244	3.5904
	Residual	0.6764	3.6643	3.4081

#### 5.2.4 Multicollinearity

Multicollinearity is a situation where the independent variables in a regression model are linearly dependent. Regression analysis assumes that predictor variables are not strongly correlated. This study tests multicollinearity using two methods, i.e., the Pearson correlation matrix and The Variance Inflation Factor (VIF). First, the Pearson correlation matrix is run. As a rule of thumb, the collinearity between variables is not an issue if the variables' correlation coefficients are less than 0.95 (Gujarati and Porter, 2009). Second, multicollinearity is checked using the VIF test. As a rule of thumb, if the VIF exceeds the value of 10, a variable is said to be strongly collinear (Tranmer and Elliot, 2008; Gujarati and Porter, 2009).

The bivariate correlation matrix between study variables is shown in Table 5.2. As the table suggests, multicollinearity is not a problem for the models used, as the correlation coefficients of all variables are less than 0.95. Moreover, the average VIF

values of all models were less than 10, as later shown in regression tables, indicating that multicollinearity is not a problem for the study models.

### 5.2.5 Autocorrelation

Autocorrelation or serial correlation refers to the correlation between errors over successive time intervals. In linear regression analysis, errors should be independent of each other. When errors exhibit autocorrelation, it leads to biased standard errors and weakens the results (Drukker, 2003; Hoechle, 2007). Hoffman (2010) points out autocorrelation is common in panel data studies. If there is autocorrelation, then the OLS estimator is not BLUE (best linear unbiased estimator) because of the violation of the absence of serial correlation. The current study utilises the Wooldridge test to examine autocorrelation.

The autocorrelation test is demonstrated in Table 5.3. As shown in the table, the Wooldridge test shows that almost all models exhibit autocorrelation except Models 2 and 4, where the dependent variable is *Lnzakat*. For all models except Models 2 and 4, where the dependent variable is *Lnzakat*, the null hypothesis of no first-order autocorrelation is rejected as *p*-values are less than the 0.05 significance level, indicating the presence of an autocorrelation problem.

Table 5.2 Pearson Correlation Matrix

Variable	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	
1 ROA	1																					
2 ROE	0.73 <sup>a</sup>	1																				
3 Lnzakat	0.10 <sup>b</sup>	0.08 <sup>c</sup>	1																			
4 SSB_SCORE	0.26 <sup>a</sup>	0.22 <sup>a</sup>	-0.08 <sup>c</sup>	1																		
5 SSB_INDP	0.00	-0.13 <sup>a</sup>	0.25 <sup>a</sup>	-0.13 <sup>a</sup>	1																	
6 SSB_REM	0.12 <sup>a</sup>	0.11 <sup>b</sup>	0.30 <sup>a</sup>	0.13 <sup>a</sup>	0.09 <sup>b</sup>	1																
7 SSB_BUSY	0.17 <sup>a</sup>	-0.05	0.24 <sup>a</sup>	0.13 <sup>a</sup>	0.55 <sup>a</sup>	0.11 <sup>b</sup>	1															
8 SSB_SIZE	0.19 <sup>a</sup>	0.33 <sup>a</sup>	-0.25 <sup>a</sup>	0.53 <sup>a</sup>	-0.50 <sup>a</sup>	0.10 <sup>b</sup>	-0.34 <sup>a</sup>	1														
9 SSB_CRMEM	0.20 <sup>a</sup>	-0.00	0.22 <sup>a</sup>	0.21 <sup>a</sup>	0.51 <sup>a</sup>	0.14 <sup>a</sup>	0.89 <sup>a</sup>	-0.25 <sup>a</sup>	1													
10 SSB_EXPERT	0.06 <sup>b</sup>	-0.00	0.04	0.30 <sup>a</sup>	-0.00	0.01	0.01	-0.06 <sup>b</sup>	0.02	1												
11 SSB_REPT	0.19 <sup>a</sup>	0.06 <sup>c</sup>	-0.09 <sup>b</sup>	0.41 <sup>a</sup>	0.30 <sup>a</sup>	0.14 <sup>a</sup>	0.54 <sup>a</sup>	-0.09 <sup>a</sup>	0.46 <sup>a</sup>	0.04	1											
12 SSB_DRQ	0.07 <sup>b</sup>	0.09 <sup>a</sup>	-0.19 <sup>a</sup>	0.14 <sup>a</sup>	-0.09 <sup>a</sup>	0.05	0.11 <sup>a</sup>	0.02	0.08 <sup>b</sup>	-0.14 <sup>a</sup>	0.19 <sup>a</sup>	1										
13 SSB_MEET	0.12 <sup>a</sup>	0.14 <sup>a</sup>	0.19 <sup>a</sup>	0.17 <sup>a</sup>	0.00	0.06	-0.01	0.09 <sup>b</sup>	0.02	-0.24 <sup>a</sup>	-0.34 <sup>a</sup>	0.07 <sup>c</sup>	1									
14 INST_OWN	-0.13 <sup>a</sup>	-0.05	-0.03	-0.27 <sup>a</sup>	-0.22 <sup>a</sup>	-0.03	-0.24 <sup>a</sup>	-0.09 <sup>a</sup>	-0.22 <sup>a</sup>	0.07 <sup>b</sup>	-0.35 <sup>a</sup>	-0.17 <sup>a</sup>	-0.17 <sup>a</sup>	1								
15 BOD_INDEX	-0.05	0.02	0.28 <sup>a</sup>	-0.12 <sup>a</sup>	-0.24 <sup>a</sup>	0.16 <sup>a</sup>	-0.18 <sup>a</sup>	0.06 <sup>c</sup>	-0.12 <sup>a</sup>	0.19 <sup>a</sup>	-0.42 <sup>a</sup>	-0.17 <sup>a</sup>	0.01	0.32 <sup>a</sup>	1							
16 BSIZE	0.04	0.16 <sup>a</sup>	0.87 <sup>a</sup>	-0.12 <sup>a</sup>	0.04	0.12 <sup>a</sup>	0.01	-0.13 <sup>a</sup>	0.07 <sup>b</sup>	0.08 <sup>b</sup>	-0.38 <sup>a</sup>	-0.20 <sup>a</sup>	0.29 <sup>a</sup>	0.16 <sup>a</sup>	0.45 <sup>a</sup>	1						
17 BAGE	0.07 <sup>b</sup>	0.16 <sup>a</sup>	0.00	0.16 <sup>a</sup>	0.12 <sup>a</sup>	0.14 <sup>a</sup>	-0.02	0.17 <sup>a</sup>	-0.01	-0.07 <sup>b</sup>	0.14 <sup>a</sup>	0.02	0.33 <sup>a</sup>	-0.13 <sup>a</sup>	-0.27 <sup>a</sup>	-0.10 <sup>a</sup>	1					
18 LEV	-0.03	0.22 <sup>a</sup>	-0.18 <sup>a</sup>	0.02	-0.31 <sup>a</sup>	0.01	-0.30 <sup>a</sup>	0.36 <sup>a</sup>	-0.23 <sup>a</sup>	-0.09 <sup>a</sup>	-0.15 <sup>a</sup>	0.09 <sup>a</sup>	0.01	0.15 <sup>a</sup>	0.13 <sup>a</sup>	0.19 <sup>a</sup>	0.10 <sup>a</sup>	1				
19 Z-SCORE	0.15 <sup>a</sup>	0.21 <sup>a</sup>	0.01	-0.04	-0.29 <sup>a</sup>	0.04	-0.29 <sup>a</sup>	0.28 <sup>a</sup>	-0.21 <sup>a</sup>	0.08 <sup>b</sup>	-0.26 <sup>a</sup>	0.03	-0.08 <sup>b</sup>	0.17 <sup>a</sup>	0.35 <sup>a</sup>	0.13 <sup>a</sup>	-0.10 <sup>a</sup>	0.13 <sup>a</sup>	1			
20 GDP	0.18 <sup>a</sup>	0.17 <sup>a</sup>	0.09 <sup>c</sup>	0.13 <sup>a</sup>	-0.06 <sup>c</sup>	-0.09 <sup>b</sup>	-0.00	-0.00	-0.00	0.05	0.05	-0.07 <sup>b</sup>	0.00	0.06 <sup>c</sup>	-0.01	0.06 <sup>c</sup>	0.03	-0.11 <sup>a</sup>	0.00	1		
21 INFL	0.09 <sup>a</sup>	0.07 <sup>b</sup>	0.20 <sup>a</sup>	-0.02	0.15 <sup>a</sup>	-0.04	0.04	-0.08 <sup>a</sup>	0.03	-0.02	-0.09 <sup>a</sup>	-0.12 <sup>a</sup>	0.16 <sup>a</sup>	0.04	0.06 <sup>c</sup>	0.26 <sup>a</sup>	0.01	-0.06 <sup>b</sup>	-0.00	0.42 <sup>a</sup>	1	

Notes: <sup>a</sup>, <sup>b</sup>, and <sup>c</sup> denote significance at the 1%, 5%, and 10% significance levels, respectively.

To address the issue of autocorrelation presence in data sets, the Generalized Least Squares (GLS) estimation is one of the methods to be used (Kantar, 2015). Many studies utilised the GLS method to overcome the autocorrelation problem (see, e.g., Zouari and Taktak, 2012; Zouari and Taktak, 2014; Djeutcheu, 2019; Abdallah and Bahloul, 2021). The GLS estimation corrects the presence of autocorrelation in the data set (Kantar, 2015; Djeutcheu, 2019; Zouari and Taktak, 2012). With that said, the current study employs the GLS method to estimate the regression models of the study.

Table 5.3 Wooldridge Test for Autocorrelation

<b>Model</b>	<b>ROA</b>	<b>ROE</b>	<b>Lnzakat</b>
Model (1)	F (1, 52) = 44.264 Prob > F = 0.0000	F (1, 52) = 42.425 Prob > F = 0.0000	F (1, 28) = 6.188 Prob > F = 0.0191
Model (2)	F (1, 43) = 23.777 Prob > F = 0.0000	F (1, 43) = 41.299 Prob > F = 0.0000	F (1, 23) = 1.987 Prob > F = 0.1720
Model (3)	F (1, 59) = 33.825 Prob > F = 0.0000	F (1, 59) = 45.515 Prob > F = 0.0000	F (1, 34) = 4.568 Prob > F = 0.0398
Model (4)	F (1, 41) = 13.442 Prob > F = 0.0007	F (1, 41) = 29.214 Prob > F = 0.0000	F (1, 26) = 0.946 Prob > F = 0.3397
Model (5)	F (1, 59) = 33.825 Prob > F = 0.0000	F (1, 59) = 45.515 Prob > F = 0.0000	F (1, 34) = 4.568 Prob > F = 0.0398
Model (6)	F (1, 59) = 33.825 Prob > F = 0.0000	F (1, 59) = 45.515 Prob > F = 0.0000	F (1, 34) = 4.568 Prob > F = 0.0398
Model (7)	F (1, 59) = 33.825 Prob > F = 0.0000	F (1, 59) = 45.515 Prob > F = 0.0000	F (1, 34) = 4.568 Prob > F = 0.0398

**Notes:** Wooldridge Test for Autocorrelation Null Hypothesis:  
H<sub>0</sub>: no first-order autocorrelation

### 5.2.6 Homoscedasticity

Linear regression analyses presume that different continuous variables exhibit similar variance in scores. A violation of this assumption results in a heteroscedasticity problem, which “biases the standard errors and causes the results to be less efficient” (Drukker, 2003). This study employs the Breusch–Pagan/Cook–Weisberg test to examine heteroscedasticity. The heteroscedasticity test is presented in Table 5.4. As demonstrated in the table, for most regression models of the study, the null hypothesis of homoscedasticity is rejected as most models’  $p$ -values are less than 0.05 significance level, showing the presence of heteroscedasticity.

If the homoscedasticity assumption is violated (i.e., there is heteroscedasticity), the GLS estimation is one of the methods to be used (Kantar, 2015). Numerous studies used the GLS method to overcome the heteroscedasticity problem as the GLS corrects the presence of the heteroscedasticity problem (see, e.g., Zouari and Taktak, 2012; Zouari and Taktak, 2014; Djeutcheu, 2019; Abdallah and Bahloul, 2021).

Table 5.4 Breusch–Pagan/Cook–Weisberg test for Heteroscedasticity

Model		ROA	ROE	Lnzakat
Model (1)	Chi <sup>2</sup> =	17.41	42.41	0.36
	Prob > Chi <sup>2</sup> =	0.0000	0.0000	0.5479
Model (2)	Chi <sup>2</sup> =	1.26	36.19	0.00
	Prob > Chi <sup>2</sup> =	0.2625	0.0000	0.9930
Model (3)	Chi <sup>2</sup> =	12.42	45.79	1.65
	Prob > Chi <sup>2</sup> =	0.0004	0.0000	0.1989
Model (4)	Chi <sup>2</sup> =	81.98	19.29	0.95
	Prob > Chi <sup>2</sup> =	0.0000	0.0000	0.3300
Model (5)	Chi <sup>2</sup> =	12.42	45.79	1.65
	Prob > Chi <sup>2</sup> =	0.0004	0.0000	0.1989
Model (6)	Chi <sup>2</sup> =	12.42	45.79	1.65
	Prob > Chi <sup>2</sup> =	0.0004	0.0000	0.1989
Model (7)	Chi <sup>2</sup> =	12.42	45.79	1.65
	Prob > Chi <sup>2</sup> =	0.0004	0.0000	0.1989

**Notes:** Breusch–Pagan/Cook–Weisberg Test for Heteroscedasticity Null Hypothesis:  
H<sub>0</sub>: Constant Variance (Homoscedasticity)

### 5.3 DESCRIPTIVE STATISTICS

The descriptive statistics of study variables are presented in Tables 5.5 and 5.6. The former table demonstrates the descriptive statistics of deponent variables (i.e., ROA, ROE, Lnzakat) and the continuous variables, while the later table depicts the descriptive statistics of categorical variables. The current study uses the period from 2006 to 2021 based on data availability. As a result, a total number of 60 IBs and 860 firm-year observations were used.

From Table 5.5, ROA, ROE, and Lnzakat presented a minimum of (-5, -17, and 7.090) and a maximum of (5, 22, and 24.615), respectively. The reason for the negative values of ROA and ROE can be the effect of the GFC and the COVID-19 Pandemic crisis. The table also reports the mean values of dependent variables, revealing that the ROA, ROE, and Lnzakat averages are (0.733, 6.883, and 15.229), respectively. The

mean of ROA and ROE are almost consistent with the findings of Nomran and Haron (2021b), who report that the mean of ROA and ROE are 0.757 and 5.364, respectively. Moreover, as Table 5.5 depicts, the standard deviations of ROA and ROE are 2.032 and 9.124, respectively. These results are not far from the findings of Nomran and Haron (2021b), who report the standard deviation of ROA and ROE to be 1.778 and 10.451, respectively.

Furthermore, Table 5.5 demonstrates the descriptive statistics of continuous variables. The mean of SSB-SCORE indicates almost 4, showing that, on average, SSB effectiveness ranked 4 on a scale of 0 to 6. This SSB-score result of 4 reflects good SG in terms of SSB effectiveness. Similar to these results, Nomran and Haron (2019) demonstrate that the SSB score exhibited an average of 3.974 for GCC IBs and 3.284 for SEA IBs.

In Table 5.5, the mean of independent variables related to SSB individual characteristics (SSB\_BUSY, SSB\_SIZE, SSB\_CRMEM, SSB\_EXPERT, SSB\_REPT, SSB\_DRQ, and SSB\_MEET) are (0.681, 3.923, 0.757, 0.206, 0.237, 0.725, and 12.227), respectively. The average SSB busyness (SSB\_BUSY) value is 0.681, indicating that almost 68% of SSB scholars are busy. This result is consistent with earlier arguments that it is common for *Shari'ah* scholars to serve on many SSBs across several banks, countries, or even continents (Mollah and Zaman, 2015). The higher busyness rate of *Shari'ah* scholars is not surprising. Trinh et al. (2020) reported a higher busyness rate of almost 82% among SSB members in IBs. Regarding SSB size (SSB\_SIZE) for the sample IBs, SSB size reflects an average of 3.923 (nearly 4) with a minimum of 1 and a maximum of 9 members. This result is consistent with Alman (2012), Hakimi et al. (2018), and Khan and Zahid (2020), who report the average size of SSBs is 4, 3.835, and 4, respectively. Furthermore, the mean of SSB cross-membership (SSB\_CRMEM) is 0.757, suggesting that almost 76% of *Shari'ah* scholars serve more than one SSB. Similar findings have been reported by Nomran and Haron (2019), who demonstrate that *Shari'ah* scholars' average cross-membership is 75% for GCC IBs.

On average, SSB financial expertise (SSB\_EXPERT) is 0.206 (20.6%), indicating IBs in the sample have lower *Shari'ah* scholars with financial expertise. This

may not come as a surprise as the majority of *Shari'ah* scholars specialize in *fiqh* and *Shari'ah*-related fields. This result is close to the findings of Mnif and Tahari (2021) and Baklouti (2022), who found that the average financial expertise is 18% and 16%, respectively. In terms of SSB reputation (SSB\_REPT), the mean is 0.237, showing that approximately 23% of SSB members are reputable scholars. This result is consistent with Baklouti (2022), who reported the reputation of SSB members as 23%. Moreover, on average, 73% of SSB members hold doctoral qualifications (SSB\_DRQ), and similar results were found by Trinh et al. (2020). At last, the mean of SSB meetings (SSB\_MEET) is around 12, with a minimum of 2 and a maximum of 54. This result is slightly lower compared to the findings of Haddad and Souissi (2022), who found SSB meetings to be 21 with a minimum of 0 and a maximum of 43.

Finally, as shown in Table 5.5, the mean of control variables, namely BOD effectiveness (BOD\_INDEX), bank size (BSIZE), bank age (BAGE), leverage (LEV), risk-taking (Z-SCORE), economic growth rate (GDP), and inflation rate (INFL) is (2.181, 23.883, 20.668, 0.788, 19.984, 3.740, and 2.581), respectively.

Table 5.5 Descriptive Statistics for Study Variables

<b>Descriptive Statistics for Dependent Variables</b>				
Variable	Mean	Std. dev.	Minimum	Maximum
ROA	0.733	2.032	-5	5
ROE	6.883	9.124	-17	22
Lnzakat	15.229	3.590	7.090	24.615
<b>Descriptive Statistics for Continuous Variables</b>				
SSB_SCORE	4.060	0.953	1	6
SSB_BUSY	0.681	0.337	0	1
SSB_SIZE	3.923	1.452	1	9
SSB_CRMEM	0.757	0.307	0	1
SSB_EXPERT	0.206	0.212	0	1
SSB_REPT	0.237	0.293	0	1
SSB_DRQ	0.725	0.242	0	1
SSB_MEET	12.227	8.926	2	54
BOD_INDEX	2.181	1.137	0	4
BSIZE	23.883	3.342	16.308	32.474
BAGE	20.668	11.148	5	64
LEV	0.788	0.234	0.01	1.02
Z-SCORE	19.984	14.156	2.1	44.794
GDP	3.740	3.958	-9.52	26.17
INFL	2.581	2.515	-4.86	15.05

**Notes:** ROA= Return on assets; ROE= Return on equity; Lnzakat= natural logarithm of annual zakat payment; SSB\_SCORE= SSB SCORE; SSB\_BUSY= SSB busyness; SSB\_SIZE= SSB size; SSB\_CRMEM= SSB cross-membership; SSB\_EXPERT= SSB financial expertise; SSB\_REPT= SSB reputation; SSB\_DRQ= SSB doctoral qualification; SSB\_MEET= SSB meetings; BOD\_INDEX= BOD index; BSIZE= bank size; BAGE= bank age; LEV= leverage; Z-SCORE= risk-taking; GDP= gross domestic product annual growth rate; INFL= inflation rate.

Regarding the categorical variables in Table 5.6, the SSB independence (SSB\_INDP) data reveal that nearly 63% of the SSBs in the sample IBs are deemed independent. The higher independence rate of SSBs is not surprising. Alsartawi (2019) reported a notably higher independence rate of approximately 97% among SSBs in GCC-based IBs. Regarding remuneration, 38% of the SSBs received compensation above the average total remuneration, while the remaining 62% received less than the

average. When examining *Shari'ah* Governance models (CSGM vs. DSGM), a significant majority, or about 74%, of the sampled IBs follow the CSGM, with the remaining 26% adopting the DSGM. Lastly, the data on institutional shareholding/ownership (INST\_OWN) indicate that most of the sampled IBs, or 76%, are subsidiaries with substantial institutional ownership that constitutes a control. Meanwhile, IBs with institutional ownership between 20% and 50% constitute roughly 12.33%, and those with less than 20% ownership comprise 11.63%.

Table 5.6 Descriptive Statistics for Categorical Variables

Variable	Coding	Frequency	Percent
SSB_INDP	“1” if SSB is appointed by the shareholders, “0” otherwise.		
	1	525	63.41 %
	0	303	36.59 %
SSB_REM	“1” if the annual SSB remuneration is higher than the country mean of SSB remuneration, “0” otherwise.		
	1	181	38.43 %
	0	290	61.57 %
CSGM vs DSGM	Two sub-samples are IBs in countries that adopt the CSGM and those that embrace the DSGM.		
	CSGM	636	73.95 %
	DSGM	224	26.05 %
INST_OWN	Three categories of institutional shareholding.		
	0 if INST_OWN is < 20%	100	11.63 %
	1 if INST_OWN is $\geq 20 \leq 50\%$	106	12.33 %
	2 if INST_OWN is > 50%	654	76.05 %

**Notes:** SSB\_INDP= SSB independence; SSB\_REM= SSB remuneration; CSGM vs DSGM= IBs in countries that adopt CSGM versus IBs in countries that embrace the DSGM; INST\_OWN= Institutional shareholding.

#### 5.4 REGRESSION ANALYSIS RESULTS

Tables 5.7, 5.8, 5.9, 5.10, 5.11, 5.12, 5.13, and 5.14 set forth the hypotheses testing results based on the Generalized Least Squares (GLS) regression estimation. The diagnostic tests in these tables show that study models are well-fitted. The Wald test

statistics are significant ( $p < 0.05$ ), implying the overall significance of the models used. Moreover, the mean VIF of all models is less than 10, showing that multicollinearity is not a problem in the study's models.

#### **5.4.1 *Shari'ah* Supervisory Board Independence, Busyness, and Performance**

Table 5.7 presents the GLS regression results assessing the effect of SSB independence and busyness on the performance of IBs measured by three measurements (ROA, ROE, and Lnzakat). The diagnostics tests in Table 5.7 show that the Wald test overall significance of regression models is fit as the significance levels are less than 5% for the three measurements (i.e., ROA, ROE, Lnzakat) ( $p = 0.000, 0.000, 0.000$ ), respectively. Furthermore, the mean VIF for all models shows no sign of multicollinearity.

SSB independence has a significant and a negative effect on ROA and ROE ( $p = 0.000, 0.000$ ), respectively, while it has a positive but insignificant impact on Islamic social performance (Lnzakat). Thus, hypothesis H<sub>1</sub>(a) is not supported for all three performance measurements. This result is consistent with the findings of Alsartawi (2019), who found a significant negative association between SSB independence and the financial performance of GCC IBs. There are two possible explanations for this result. First, SSBs may not be independent in conducting their functions, especially since shareholders and management suggest their rewards (Grais and Pellegrini, 2006a; Grassa, 2013a; Bouheni and Ammi, 2015) and nominate them (Garas, 2012). These SSBs may have an advisory rather than a supervisory role, which diminishes their effectiveness and influence on IBs. Assigning SSBs an advisory role only can reduce the level of *Shari'ah*-compliance in IFIs because management is not obligated to enforce SSB decisions regarding compliance with its products and services (Alkhamees, 2013). Second, this adverse relationship between SSB independence and financial performance metrics aligns with the stewardship theory. This theory suggests that non-independent executive directors are better informed, have more information on daily operations, are better positioned to make good decisions, and have more details than independent non-executive directors (Donaldson and Davis, 1991). However, SSB members' independence can be compromised if they take executive roles. The reason

is that working in such a post may require them to have supportive views regarding management actions and decisions (Alkhamees, 2013), thereby putting *Sharī'ah*-compliance at risk. Thus, contrary to the suggestions of stewardship theory, appointing SSB members as executive directors is impractical.

An important implication of this adverse effect between SSB independence and the performance of IBs is that although appointing SSBs by shareholders is thought to raise SSB independence, it may not necessarily imply that they are independent. This is because, according to Alkhamees (2013), BOD recommends the appointment of certain *Sharī'ah* scholars at their general meetings, a process typically met with approval without objection. He further adds that BOD recommendations, in turn, tend to be influenced by management views. So, it is questionable to assume that management will have no authority in selecting SSB members. Even when shareholders directly make the selections, the decisions of the annual general meeting can be influenced by a few individuals who control the majority of the company's shares (Bakar, 2002).

Lack of independence may prompt SSBs to align with the shareholders and BODs (and likely with the management) if they aim to be re-elected to secure their position on the board (Alman, 2012). Alman (2012) contends that SSB members are influenced by the conflict of interest between *Sharī'ah* governance and the bank's economic success, as achieving economic success often requires SSB members to be more permissive than restrictive. He highlights that when shareholders and managers have similar interests, the decisions of less independent SSBs may come in line with their interests, thereby affecting the effectiveness of SSBs in monitoring managerial actions. It is, therefore, unrealistic to assert that the shareholders' selection of SSB members is sufficient to ensure SSB autonomy (Alkhamees, 2013).

Regarding SSB busyness, the busyness of SSBs positively and significantly affects all three performance measurements (i.e., ROA, ROE, and Ln<sub>z</sub>akat) ( $p = 0.000$ ,  $0.000$ ,  $0.044$ ), respectively. Hence, hypothesis H<sub>1</sub>(b) is not supported for all three performance measurements, which aligns with the "*Reputation hypothesis*" and the RDT. This result suggests that busy SSB members are reputable, high-quality scholars with extensive experience who offer better *Sharī'ah* advisory and supervisory functions. Their reputation may attract customers, depositors, and investors into IBs,

subsequently enhancing the performance of these banks. Moreover, from the RDT perspective, such scholars bring external resources, knowledge, experience, and new connections to the bank. Subsequently, these factors enhance the performance of IBs. For Islamic social performance, to preserve their reputation within Muslim society, these members may urge IBs to pay Zakat, thereby increasing the Islamic social performance of these banks. The finding of this study is in contrast with the findings of Trinh et al. (2020), who found a significant negative relationship between SSB busyness and the performance of IBs. However, this result is consistent with various studies that found a positive association between BOD busyness and bank performance (see, e.g., Elyasiani and Zhang, 2015; Trinh et al., 2020).

In addition, Table 5.7 shows the results of control variables (i.e., BOD effectiveness, bank size, bank age, leverage, risk-taking, GDP growth, and inflation). BOD effectiveness (BOD\_INDEX) has a negative and significant impact on all three performance measurements (i.e., ROA, ROE, and Lnzakat) ( $p = 0.003, 0.000, 0.052$ ), respectively. This result is in contrast with the study's expectation that BOD effectiveness would enhance the performance of IBs, implying that high BOD effectiveness diminishes IB's performance. Furthermore, the BOD, as shown in Table 5.7, negatively influences Islamic social performance as measured by Zakat payment, suggesting that BODs dominate the decision of Zakat payments in IBs as their effect on Lnzakat is significant and may not favour contributing Zakat funds. According to Nomran and Haron (2019), BODs may not endorse Zakat deductions; thus, SSBs must urge the BoD to prioritize Zakat payments within IBs. Notably, these results are consistent with the findings of Mollah and Zaman (2015) and Nomran and Haron (2019), who found a negative association between BOD and the performance of IBs. As Ajili and Bouri (2018a) contend, directors in IBs may lack sufficient knowledge in both banking and *Shari'ah*, which undermines their oversight function and subsequently decreases the performance of IBs.

Bank size (BSIZE) positively impacts all three performance measurements (ROA, ROE, and Lnzakat). However, its effect is statistically significant only on (ROE and Lnzakat) ( $p = 0.001$  and  $0.000$ ), respectively. This result is in line with the findings of Alsartawi (2019), Aslam and Haron (2020), and Nomran and Haron (2021b), who documented a positive association between bank size and the performance of IBs. In

terms of bank age (BAGE), no relationship was found between bank age and all three performance measurements (ROA, ROE, and Lnzakat) ( $p = 0.334, 0.182, 0.994$ ), respectively, in line with the findings of Nomran and Haron (2019). Leverage (LEV) has a significant positive impact on ROE ( $p = 0.000$ ), in line with Hakimi et al. (2018). Furthermore, a significant positive relationship is found between risk-taking (Z-SCORE) and performance (ROA and ROE) ( $p = 0.000, 0.000$ ), respectively, in line with Mollah and Zaman (2015).

Finally, as expected, economic growth (GDP) has a significant positive impact on all three performance measurements (ROA, ROE, and Lnzakat) ( $p = 0.000, 0.000, 0.006$ ), respectively, in line with the findings of Zouari and Taktak (2014) and Aslam and Haron (2020). Moreover, a positive but insignificant relationship is found between inflation (INFL) and financial performance, and a negative significant relationship between inflation and (Lnzakat) ( $p = 0.005$ ), indicating that as inflation rises, Zakat payments decline. As prices of goods and services hike, customer deposits and demand for financing may decrease, adversely affecting the performance of IBs and thus leading these banks to lower the amount of Zakat that is payable. This result is consistent with Saadillah et al. (2019), who found a negative link between the inflation rate and Zakat.

Table 5.7 SSB Independence, busyness, and Performance: GLS Regression Results

Model	1	1	1
Variables	ROA	ROE	Lnzakat
SSB_INDP	-0.790*** (0.000)	-4.534*** (0.000)	0.386 (0.127)
SSB_BUSY	1.934*** (0.000)	4.232*** (0.000)	0.759** (0.044)
BOD_INDEX	-0.249*** (0.003)	-1.391*** (0.000)	-0.202* (0.052)
BSIZE	0.018 (0.474)	0.354*** (0.001)	1.022*** (0.000)
BAGE	-0.007 (0.334)	0.043 (0.182)	0.006 (0.994)
LEV	0.255 (0.445)	6.335*** (0.000)	-0.760 (0.136)
Z-SCORE	0.028*** (0.000)	0.132*** (0.000)	0.002 (0.714)
GDP	0.095*** (0.000)	0.432*** (0.000)	0.067*** (0.006)
INFL	0.021 (0.510)	0.018 (0.898)	-0.121*** (0.005)
Cons_	-0.977 (0.113)	-8.653*** (0.001)	-9.196*** (0.000)
Wald Chi <sup>2</sup>	110.92*** (0.000)	167.37*** (0.000)	1755.82*** (0.000)
Mean VIF	1.44	1.44	1.72

**Notes:** Figures in the parenthesis are the *p*-values of regression coefficients. \*\*\*, \*\*, \* denote significance at the 1%, 5%, and 10% levels, respectively. Wald Chi<sup>2</sup>= The Wald Test (Wald Chi-Squared Test) for overall model significance. Mean VIF= Mean Variance Inflation Factor (VIF) test for Multicollinearity.

#### 5.4.2 Shari'ah Supervisory Board Remuneration and Performance

Table 5.8 presents the GLS regression results examining the effect of SSB remuneration on the performance of IBs measured by three measurements (ROA, ROE, and Lnzakat). The diagnostics tests in Table 5.8 show that the Wald test overall significance of regression models is fit as the significance levels are less than 5% for the three measurements (i.e., ROA, ROE, Lnzakat) ( $p = 0.000, 0.000, 0.000$ ), respectively. Furthermore, the mean VIF for all models exhibits no multi-collinearity issue.

As shown in Table 5.8, SSB remuneration (SSB\_REM) has a positive effect on all three performance measurements but only has a statistically significant impact on

ROA and ROE ( $p = 0.002, 0.006$ ), respectively. Therefore, hypothesis H<sub>1(c)</sub> is supported for ROA and ROE, which is in line with the AGT. The findings of this study infer that ample incentives in the form of high remuneration motivate SSB members to enhance the performance of IBs. High remuneration provided to the SSB members may augment their diligence, thereby elevating the quality of their work. This result is in contrast to the findings of Haron et al. (2021a), who found a negative impact of SSB remuneration on the performance of IBs in Malaysia.

However, this finding aligns with numerous prior studies showing a positive relationship between directors' remuneration and firm performance (see, e.g., Becher et al., 2005; Lee and Isa, 2015; Oziegbe and Cy, 2021). These studies suggest that appealing compensation serves as a motivation for directors and helps sustain efforts to enhance firm performance. In the context of SSBs, this result is consistent with the research of Mnif and Tahari (2021), who identified a positive association between SSB remuneration and the compliance performance of IBs across nine different countries. Hence, this study concludes that high remuneration is indispensable for attracting and retaining high-quality *Shari'ah* scholars, thereby linked with enhanced bank performance.

Table 5.8 SSB Remuneration and Performance: GLS Regression Results

Model	2	2	2
Variables	ROA	ROE	Lnzakat
SSB_REM	0.541*** (0.002)	2.087*** (0.006)	0.283 (0.199)
BOD_INDEX	-0.299*** (0.001)	-1.274*** (0.001)	-0.031 (0.789)
BSIZE	0.011 (0.683)	0.274** (0.025)	1.029*** (0.000)
BAGE	0.021** (0.027)	0.069 (0.110)	0.038*** (0.002)
LEV	-0.319 (0.347)	7.218*** (0.000)	-1.586*** (0.007)
Z-SCORE	0.020*** (0.001)	0.139*** (0.000)	-0.007 (0.361)
GDP	0.068*** (0.005)	0.374*** (0.000)	-0.002 (0.995)
INFL	0.013 (0.779)	0.061 (0.781)	0.068 (0.333)
Cons_	0.054 (0.934)	-9.392*** (0.001)	-9.737*** (0.000)
Wald Chi <sup>2</sup>	44.78*** (0.000)	95.18*** (0.000)	1482.72*** (0.000)
Mean VIF	1.30	1.30	1.47

**Notes:** Figures in the parenthesis are the *p*-values of regression coefficients. \*\*\*, \*\*, \* denote significance at the 1%, 5%, and 10% levels, respectively. Wald Chi<sup>2</sup>= The Wald Test (Wald Chi-Squared Test) for overall model significance. Mean VIF= Mean Variance Inflation Factor (VIF) test for Multicollinearity.

### 5.4.3 *Shari'ah* Supervisory Board Effectiveness and Performance

Table 5.9 depicts the GLS regression results investigating the effect of SSB effectiveness (captured by a SSB score) on the performance of IBs measured by three measurements (ROA, ROE, and Lnzakat). The diagnostics tests in Table 5.9 show that the Wald test overall significance of regression models is fit as the significance levels are less than 5% for the three measurements (i.e., ROA, ROE, Lnzakat) ( $p = 0.000$ , 0.000, 0.000), respectively. Furthermore, the mean VIF for all models suggests that multi-collinearity is not a problem in this model.

SSB effectiveness (SSB\_SCORE) is observed to positively impact all three performance measurements (ROA, ROE, and LnZakat), but it only exhibits a statistically significant influence on ROA and ROE ( $p = 0.000, 0.000$ ), respectively. Therefore, hypothesis H<sub>2</sub>(a) is supported for ROA and ROE, which is consistent with the AGT, RDT, and STK. This finding suggests that an enhancement in the effectiveness of SSBs is associated with an improvement in the financial performance of IBs and is in line with the conclusions of some previous studies, such as Nomran and Haron (2019) and Rahman and Bukair (2013), who discovered that SSB effectiveness (measured by a SSB score) enhances financial performance and CSR disclosure performance, respectively. Notably, this result validates the argument that effective SSBs enhance supervision quality (Farook et al., 2011; Rahman and Bukair, 2013), thereby affirming that SSBs offer an extra possible reduction in agency costs within IBs (Abdelsalam et al., 2016). Thus, the current study concludes that effective SSBs are essential for the financial performance of IBs and for fostering the credibility and confidence of IBs in the eyes of customers and other stakeholders.

However, SSB effectiveness does not seem to affect Islamic social performance, although enhancing IBs' commitment to paying Zakat is one of the responsibilities of SSBs. This result may be because BODs dominate the decision of IBs more than the SSB, including in the area of Zakat payments. This is evident as Table 5.9 shows that the coefficient of BOD (BOD\_INDEX) on Zakat payments is higher and significant, while the coefficient of SSB\_SCORE is much lower and insignificant. BODs may not support Zakat deductions (Nomran and Haron, 2019). Hence, since it is the responsibility of SSBs to improve Islamic social performance in IBs, SSBs should urge BODs to pay Zakat. However, this requires real SSB independence and assigning them supervisory rather than advisory roles for them to be able to enhance the Islamic social performance of IBs.

Table 5.9 SSB Effectiveness and Performance: GLS Regression Results

Model	3	3	3
Variables	ROA	ROE	Lnzakat
SSB_SCORE	0.539*** (0.000)	1.912*** (0.000)	0.056 (0.514)
BOD_INDEX	-0.231*** (0.001)	-0.844*** (0.005)	-0.362*** (0.000)
BSIZE	0.066*** (0.004)	0.501*** (0.000)	1.090*** (0.000)
BAGE	0.005 (0.351)	0.100*** (0.000)	0.027*** (0.000)
LEV	-0.561* (0.053)	6.745*** (0.000)	-2.964*** (0.000)
Z-SCORE	0.030*** (0.000)	0.145*** (0.000)	0.011* (0.069)
GDP	0.061*** (0.001)	0.349*** (0.000)	0.002 (0.999)
INFL	0.021 (0.472)	-0.075 (0.550)	-0.028 (0.519)
Cons_	-3.117*** (0.000)	-22.464*** (0.000)	-9.045*** (0.000)
Wald Chi <sup>2</sup>	141.07*** (0.000)	222.92*** (0.000)	1589.57*** (0.000)
Mean VIF	1.25	1.25	1.25

**Notes:** Figures in the parenthesis are the  $p$ -values of regression coefficients. \*\*\*, \*\*, \* denote significance at the 1%, 5%, and 10% levels, respectively. Wald Chi<sup>2</sup>= The Wald Test (Wald Chi-Squared Test) for overall model significance. Mean VIF= Mean Variance Inflation Factor (VIF) test for Multicollinearity.

#### 5.4.4 *Shari'ah* Supervisory Board Score Characteristics and Performance

Table 5.10 demonstrates the GLS regression results inspecting the effect of SSB Score individual characteristics (i.e., cross-membership, size, financial expertise, reputation, educational qualification, and meetings) on the performance of IBs measured by three measurements (ROA, ROE, and Lnzakat). The diagnostics tests in Table 5.10 show that the Wald test overall significance of regression models is fit as the significance levels are less than 5% for the three measurements (i.e., ROA, ROE, Lnzakat) ( $p = 0.000, 0.000, 0.000$ ), respectively. In addition, the mean VIF for all models reveals that multicollinearity is not an issue in this model.

From Table 5.10, SSB cross-membership (SSB\_CRMEM) negatively affects all three performance measurements, but it only shows a statistically significant influence on ROE ( $p = 0.002$ ). Hence, hypothesis H<sub>2</sub>(b) provides some evidence supporting the “*busyness hypothesis*” and the AGT. These findings imply that SSB members serving more than one SSB (cross-members) are associated with decreased financial performance in IBs. Hence, this result is consistent with earlier arguments that SSB cross-membership is associated with lower effectiveness in terms of commitment and attendance, as well as conflict of interest, as they have access to confidential information. This result is in line with Baklouti (2022), who found an adverse relationship between SSB cross-membership and the financial performance of IBs across the Middle East, North Africa, and some non-Islamic countries.

SSB size (SSB\_SIZE) is found to have a positive impact on all three performance measurements, but it only illustrates a statistically significant influence on ROA and ROE ( $p = 0.015, 0.000$ ), respectively. Thus, hypothesis H<sub>2</sub>(c) is supported for ROA and ROE, which is in line with the RDT and the STK, as these theories assume that larger boards are better than small boards in terms of the extent of external resources they bring and higher stakeholder representation. This result infers that larger SSBs are better than smaller boards, and an increase in their size enhances bank performance. This finding is consistent with numerous studies that show a positive relationship between SSB size and the performance of IBs (see, e.g., Mollah and Zaman, 2015; Nomran et al., 2018; Hakimi et al., 2018; Baklouti, 2022).

Furthermore, the financial expertise of the SSB (SSB\_EXPERT) only negatively impacts Islamic social performance, as indicated by Lnzakat ( $p = 0.004$ ). Consequently, hypothesis H<sub>2</sub>(d) does not hold across all three performance measurements. This negative result between Islamic social performance as measured by Zakat contributions and SSB financial expertise is consistent with the findings of Nomran and Haron (2019), who documented a negative but weak relationship between the financial expertise of SSB members and Islamic social performance of IBs in the GCC and SEA regions.

The logic behind this result can be that improving IBs’ commitment to paying Zakat is more closely associated with SSBs that contain more scholars with *Shari’ah*

and law backgrounds, whereas increasing profits is more linked to members with financial expertise (Nomran and Haron, 2019), hence the negative influence of SSB financial expertise on Islamic social performance. However, it appears that SSB's financial expertise does not influence the financial performance metrics (i.e., ROA and ROE) either. This may not come as a surprise as Table 5.5 demonstrates that the average SSB financial expertise is only almost 21%. A possible explanation is that most scholars on SSBs have specializations in *Sharī'ah* and *fiqh al-mu'amalat* (Islamic commercial law), resulting in a scarcity of scholars who possess financial expertise. Therefore, it is crucial to balance the number of SSB members with experience in the fields of *Sharī'ah*, law, and financial expertise (Nomran and Haron, 2019).

Regarding SSB reputation, it is found that reputable SSBs are significantly and positively related to all three performance measurements (ROA, ROE, and Lnzakat) ( $p = 0.072, 0.001, 0.000$ ), respectively. Thus, hypothesis H<sub>2</sub>(e) is supported, which aligns with the RDT, suggesting that corporate boards provide essential resources to firms, such as reputation enhancing their performance (Nomran et al., 2018). The reason for this outcome is that reputable *Sharī'ah* scholars represent industry knowledge (Farook et al., 2011) and are regarded as the best *Sharī'ah* minds of both the Islamic world and Islamic Finance (Bakar, 2016). These findings align with those of Nomran et al. (2018) and Haron et al. (2021a), who show that SSB reputation enhances the performance of IBs in Malaysia.

SSB educational qualifications (SSB\_DRQ), measured by members holding doctoral degrees, positively affect financial performance measurements. However, this effect only significantly impacts ROE ( $p = 0.003$ ) while exhibiting a significant adverse effect on Islamic social performance, as captured by Zakat payments ( $p = 0.036$ ). Hence, hypothesis H<sub>2</sub>(f) provides some evidence supporting the RDT concerning the influence of SSB education qualification on financial performance metrics, while it is not supported for Islamic social performance measurement (i.e., Lnzakat). Prior literature documented mixed results between SSB education qualifications and the financial performance of IBs. Musibah and Alfattani (2014), Nomran and Haron (2019), and Haron et al. (2021a) documented a positive relationship between SSB doctoral qualifications and the performance of IBs, while Nomran et al. (2018) found a negative relationship.

Surprisingly, the results show that the SSB doctoral qualification is linked with lower Islamic social performance as measured by Zakat payments (Lnzakat), which is in contrast with the study's expectation that SSB members with PhDs would enhance the social performance of IBs. A possible explanation for this result is that most SSB members with doctoral degrees specialize in *Sharī'ah* and Islamic commercial law, while members with PhDs in different fields, namely in accounting and finance, are scarce. Logically, enhancing IBs' dedication to paying Zakat is more associated with SSB scholars specializing in *Sharī'ah* and law fields, while increasing profits is more associated with members possessing financial expertise (Nomran and Haron, 2019). However, it is vital to note that the financial expertise of SSB members is also crucial for Zakat payment, as having financial knowledge helps *Sharī'ah* scholars accurately calculate the Zakat amount due. SSB members must understand the financial data, which comprises assets, liabilities, and their related allocations on which Zakatable and non-Zakatable assets will be based.

This negative impact indicates a need for SSB scholars to possess PhDs in fields such as accounting and finance. As Table 5.5 demonstrates, the average SSB financial expertise is almost 21%. This shows that, on average, only 21% of the scholars in these SSBs have knowledge in accounting, finance, and other related fields, and not all of them hold PhD degrees. In fact, the majority of SSB scholars with doctoral qualifications specialize in *Sharī'ah* and *fiqh al-mu'amalat* (Islamic commercial law), leading to a shortage of scholars with financial proficiency. Therefore, it is crucial to balance the number of SSB members with experience in the fields of *Sharī'ah*, law, accounting, and finance (Nomran and Haron, 2019).

Finally, the variable SSB meetings (SSB\_MEET) does not affect all three performance measurements, as the *p*-values of ROA, ROE, and Lnzakat are insignificant. This suggests that the frequency of SSB meetings does not influence the financial and social performance of IBs. Thus, hypothesis H<sub>2</sub>(g) is not supported for all performance measurements. This result contradicts several previous studies, which found a significant effect with this variable (see, e.g., Alsartawi, 2019; Baklouti, 2022; Haddad and Souissi, 2022).

Table 5.10 SSB-SCORE Characteristics and Performance: GLS Regression Results

<b>Model</b>	<b>4</b>	<b>4</b>	<b>4</b>
<b>Variables</b>	<b>ROA</b>	<b>ROE</b>	<b>Lnzakat</b>
SSB_CRMEM	-0.087 (0.673)	-2.566** (0.012)	-0.178 (0.561)
SSB_SIZE	0.122** (0.015)	1.459*** (0.000)	0.003 (0.958)
SSB_EXPERT	0.062 (0.838)	-2.307 (0.121)	-1.180*** (0.009)
SSB_REPT	0.645* (0.072)	5.743*** (0.001)	2.947*** (0.000)
SSB_DRQ	0.187 (0.464)	3.781*** (0.003)	-0.808** (0.036)
SSB_MEET	0.008 (0.342)	0.017 (0.665)	-0.006 (0.556)
BOD_INDEX	-0.195*** (0.005)	-0.931*** (0.006)	-0.189* (0.078)
BSIZE	0.104*** (0.000)	1.138*** (0.000)	1.160*** (0.000)
BAGE	0.015** (0.012)	0.046 (0.129)	0.031*** (0.000)
LEV	0.783** (0.021)	6.975*** (0.000)	-1.550** (0.013)
Z-SCORE	0.020*** (0.000)	0.071*** (0.001)	0.021*** (0.003)
GDP	0.005 (0.847)	0.091 (0.542)	-0.035 (0.419)
INFL	0.057 (0.185)	-0.512** (0.015)	0.015 (0.817)
Cons_	-3.434*** (0.000)	-31.802*** (0.000)	-12.018*** (0.000)
Wald Chi <sup>2</sup>	116.05*** (0.000)	252.50*** (0.000)	1675.99*** (0.000)
Mean VIF	1.57	1.57	1.57

**Notes:** Figures in the parenthesis are the *p*-values of regression coefficients. \*\*\*, \*\*, \* denote significance at the 1%, 5%, and 10% levels, respectively. Wald Chi<sup>2</sup>= The Wald Test (Wald Chi-Squared Test) for overall model significance. Mean VIF= Mean Variance Inflation Factor (VIF) test for Multicollinearity.

## 5.4.5 The 2008 GFC and the COVID-19 Pandemic

### 5.4.5.1 The Moderating Effect of SSB Effectiveness During the 2008 GFC Period

Table 5.11 depicts the GLS regression results exploring the effect of SSB effectiveness, captured by a SSB score, on the performance of IBs during the 2008 global financial crisis (GFC) period versus non-2008 crisis periods. The diagnostics tests in Table 5.11 reveal that the Wald test overall significance of regression models of both crisis and non-crisis periods is fit as the significance levels are less than 5% for the three measurements (i.e., ROA, ROE, Lnzakat) (Non-crisis period:  $p = 0.000, 0.000, 0.000$ ; 2008 Crisis period:  $p = 0.000, 0.000, 0.000$ ), respectively. Moreover, the mean VIF for all models portrays that multi-collinearity is not an issue in this model.

In non-2008 crisis periods, SSB effectiveness (SSB\_SCORE) has a significant positive effect on financial performance measurements (i.e., ROA and ROE) (Non-crisis period:  $p = 0.000, 0.000$ ), respectively, while there is no significant impact on Islamic social performance as measured by Zakat payments (Lnzakat). In contrast, SSB effectiveness (SSB\_SCORE) during the 2008 GFC has a significant positive impact on all three performance measurements (i.e., ROA, ROE, and Lnzakat) (Crisis period:  $p = 0.000, 0.000, 0.000$ ), respectively.

This finding suggests that during the 2008 financial crisis, effective SSBs enhanced the social performance of IBs, as they strengthened the dedication of IBs to pay Zakat during the crisis. The coefficient of SSB\_SCORE on Lnzakat during the 2008 GFC is significant ( $p = 0.000$ ), while it is insignificant in non-crisis periods, implying that effective SSBs enhanced Islamic social performance during the 2008 financial crisis. Hence, hypothesis H<sub>3</sub>(a) is supported only for Lnzakat. Regarding ROA and ROE, the results imply that effective SSBs did not strengthen the financial performance of IBs, as the coefficients of SSB\_SCORE on ROA and ROE for both periods are almost the same.

This study concludes that effective SSBs boosted the Islamic social performance of IBs during the 2008 global financial crisis. Enhancing Islamic social performance regarding Zakat payments is one of the responsibilities of SSBs. This result infers that

effective SSBs strengthened the commitment of IBs to paying Zakat during the 2008 GFC by distributing Zakat funds to the poor and individuals affected by this crisis.



Table 5.11 SSB Effectiveness During the 2008 GFC: GLS Regression Results

Model	5(A)	5(A)	5(A)	5(B)	5(B)	5(B)
	Non-Crisis Period			The 2008 GFC Period		
Variables	ROA	ROE	Lnzakat	ROA	ROE	Lnzakat
SSB_SCORE	0.172*** (0.000)	1.227*** (0.000)	0.003 (0.952)	0.563*** (0.000)	0.808** (0.019)	0.682*** (0.000)
BOD_INDEX	-0.201*** (0.000)	-0.828*** (0.000)	-0.463*** (0.000)	-0.079 (0.353)	-1.111*** (0.003)	0.219 (0.163)
BSIZE	0.009 (0.511)	0.475*** (0.000)	1.145*** (0.000)	0.019 (0.688)	0.659*** (0.001)	1.087*** (0.000)
BAGE	0.019*** (0.000)	0.141*** (0.000)	0.032*** (0.000)	0.019 (0.110)	0.153*** (0.000)	0.049*** (0.007)
LEV	-0.248 (0.403)	10.181*** (0.000)	-1.904*** (0.000)	-0.887 (0.323)	8.630*** (0.000)	-5.245*** (0.000)
Z-SCORE	0.017*** (0.000)	0.098*** (0.000)	0.003 (0.405)	0.036*** (0.000)	0.182*** (0.000)	0.050*** (0.000)
GDP	0.051*** (0.000)	0.323*** (0.000)	0.032** (0.045)	0.098*** (0.000)	0.612*** (0.000)	-0.005 (0.922)
INFL	0.007 (0.741)	-0.082 (0.512)	-0.097** (0.011)	-0.030 (0.306)	-0.210** (0.032)	-0.048 (0.458)
Cons_	-0.379 (0.411)	-20.806*** (0.000)	-10.421*** (0.000)	-2.076* (0.095)	-23.967*** (0.000)	-11.889*** (0.000)
Wald Chi <sup>2</sup>	126.89*** (0.000)	311.89*** (0.0000)	3015.53*** (0.000)	180.07*** (0.000)	465.13*** (0.000)	307.31*** (0.000)
Mean VIF	1.35	1.35	1.98	1.35	1.35	1.98

**Notes:** Figures in the parenthesis are the *p*-values of regression coefficients. \*\*\*, \*\*, \* denote significance at the 1%, 5%, and 10% levels, respectively. Wald Chi<sup>2</sup>= The Wald Test (Wald Chi-Squared Test) for overall model significance. Mean VIF= Mean Variance Inflation Factor (VIF) test for Multicollinearity.

#### 5.4.5.2 The Moderating Effect of SSB Effectiveness During the COVID-19 Period

Table 5.12 presents the GLS regression results examining the effect of SSB effectiveness, captured by a SSB score, on the performance of IBs during the COVID-19 Pandemic period versus non-COVID-19 Pandemic periods. The diagnostics tests in Table 5.12 indicate that the Wald test overall significance of regression models of both crisis and non-crisis periods is fit as the significance levels are less than 5% for the three measurements (i.e., ROA, ROE, Lnzakat) (Non-crisis period:  $p = 0.000, 0.000, 0.000$ ; COVID crisis period:  $p = 0.000, 0.000, 0.000$ ), respectively. Moreover, the mean VIF for all models demonstrates that multi-collinearity is not a problem in this model.

In both non-COVID-19 Pandemic periods and the COVID-19 Pandemic period, SSB effectiveness (SSB\_SCORE) has a significant positive impact on financial performance measurements (i.e., ROA and ROE) (Non-crisis period:  $p = 0.000, 0.000$ ) (Crisis period:  $p = 0.000, 0.000$ ), respectively while no significant effect is found with regards to Islamic social performance metric (i.e., Lnzakat) in both periods. This result suggests that effective SSBs enhanced the financial performance of IBs during the COVID-19 pandemic as the coefficients of SSB\_SCORE of ROA and ROE during the COVID-19 pandemic period (0.320, 1.756) are greater than the coefficients of SSB\_SCORE in non-COVID-19 Pandemic periods (0.213, 1.226).

Hence, hypothesis H<sub>3</sub>(b) provides evidence that effective SSBs enhanced the financial performance of IBs during the COVID-19 pandemic. *Shari'ah* Supervision in crisis periods mitigates the adverse effects of excessive risk-taking and contributes to better performance of IBs (Mollah and Zaman, 2015). Effective SSBs are expected to be more responsive in periods of crisis and, thereby, better able to respond to emerging risks, helping IBs to be more stable. It is therefore concluded that SSB effectiveness strengthened the financial performance of IBs amid the COVID-19 pandemic crisis.

Table 5.12 SSB Effectiveness During the COVID-19 Pandemic Crisis: GLS Regression Results

Model	5(C)	5(C)	5(C)	5(D)	5(D)	5(D)
	Non-Crisis Period			The COVID-19 Pandemic Crisis Period		
Variables	ROA	ROE	Lnzakat	ROA	ROE	Lnzakat
SSB_SCORE	0.213*** (0.000)	1.226*** (0.000)	0.001 (0.968)	0.320*** (0.000)	1.756*** (0.000)	0.224 (0.139)
BOD_INDEX	-0.181*** (0.000)	-0.684*** (0.002)	-0.393*** (0.000)	-0.155** (0.011)	-0.967** (0.018)	-0.794*** (0.000)
B_SIZE	-0.005 (0.734)	0.447*** (0.000)	1.128*** (0.000)	0.044** (0.017)	0.578*** (0.000)	1.241*** (0.000)
BAGE	0.025*** (0.000)	0.152*** (0.000)	0.034*** (0.000)	0.014*** (0.002)	0.169*** (0.000)	0.015* (0.076)
LEV	-0.569* (0.069)	9.889*** (0.000)	-2.742*** (0.000)	-1.083 (0.190)	5.283*** (0.008)	0.017 (0.983)
Z-SCORE	0.020*** (0.000)	0.109*** (0.000)	0.003 (0.456)	0.013*** (0.000)	0.070*** (0.007)	0.015* (0.075)
GDP	0.069*** (0.000)	0.320*** (0.000)	-0.016 (0.419)	-0.001 (0.889)	0.161*** (0.001)	0.088*** (0.000)
INFL	0.009 (0.607)	-0.102 (0.277)	-0.085*** (0.004)	0.053 (0.108)	0.377** (0.019)	-0.139** (0.018)
Cons_	-0.216 (0.650)	-20.470*** (0.000)	-9.296*** (0.000)	-1.228 (0.181)	-22.412*** (0.000)	-14.662*** (0.000)
Wald Chi <sup>2</sup>	175.92*** (0.000)	314.40*** (0.000)	2677.04*** (0.000)	115.29*** (0.000)	187.27*** (0.000)	1871.57*** (0.000)
Mean VIF	1.43	1.43	1.63	1.43	1.43	1.63

Notes: Figures in the parenthesis are the *p*-values of regression coefficients. \*\*\*, \*\*, \* denote significance at the 1%, 5%, and 10% levels, respectively. Wald Chi<sup>2</sup>= The Wald Test (Wald Chi-Squared Test) for overall model significance. Mean VIF= Mean Variance Inflation Factor (VIF) test for Multicollinearity.

#### 5.4.5.3 The Moderating Effect of *Sharī'ah* Governance Models (CSGM VS. DSGM)

Table 5.13 shows the GLS regression results assessing the moderating impact of *Sharī'ah* Governance (SG) models (CSGM vs. DSGM) on the relationship between SSB effectiveness, captured by a SSB score, and the performance of IBs. The diagnostics tests in Table 5.13 indicate that the Wald test overall significance of regression models of both groups is fit as the significance levels are less than 5% for the three measurements (i.e., ROA, ROE, Lnzakat) (CSGM:  $p = 0.000, 0.000, 0.000$ ; DSGM:  $p = 0.000, 0.000, 0.000$ ), respectively. Additionally, the mean VIF for all models shows no sign of multi-collinearity in this model.

Under the CSGM, SSB effectiveness (SSB\_SCORE) has a significant positive impact on ROA and ROE ( $p = 0.018, 0.000$ ), respectively, while it exerts a negative but insignificant effect on Islamic social performance as measured by Zakat payments (Lnzakat). In contrast, SSB effectiveness (SSB\_SCORE), under the DSGM, has a significant positive effect on ROA and ROE ( $p = 0.000, 0.012$ ), respectively, while it has a positive but insignificant influence on Zakat payments. This result suggests that there is insufficient evidence to support the idea that SG models influence the relationship between SSB effectiveness and performance, as the coefficients of SSB\_SCORE on ROA and ROE are nearly identical under both the CSGM (0.210, 1.362) and the DSGM (0.629, 1.376). Thus, hypothesis (H<sub>4</sub>) is not supported.

These results suggest that the centralised *Sharī'ah* governance structure does not influence SSB effectiveness, which is in contrast with the expectation of this study that SSB effectiveness in IBs located in jurisdictions that follow the CSGM is expected to show better bank performance than those that operate under the DSGM. A possible explanation for this result is that the role of central authorities in enhancing the SG in IBs is still weak. According to Hasan (2011), most countries embracing Islamic finance have weak SG practices, and improvements in the regulatory framework, independence, and competence of SSBs are needed. Moreover, SSBs have largely advisory rather than supervisory roles (Mollah and Zaman, 2015), adversely affecting their effectiveness. Therefore, these factors indicate that the role of regulatory authorities in enhancing SG in IBs is still limited.

Table 5.13 The Moderating Effect of SG Models on SSB Effectiveness: GLS Regression Results

Model	6(A)	6(A)	6(A)	6(B)	6(B)	6(B)
	Centralised <i>Shari'ah</i> Governance Model (CSGM)			Decentralised <i>Shari'ah</i> Governance Model (DSGM)		
Variables	ROA	ROE	Lnzakat	ROA	ROE	Lnzakat
SSB_SCORE	0.210** (0.018)	1.362*** (0.000)	-0.113 (0.305)	0.629*** (0.000)	1.376** (0.012)	0.148 (0.300)
BOD_INDEX	-0.161* (0.051)	-0.232 (0.520)	-0.270** (0.013)	-0.468** (0.021)	-1.840** (0.038)	-0.387 (0.105)
BSIZE	0.013 (0.616)	0.294** (0.011)	1.044*** (0.000)	0.423*** (0.000)	1.818*** (0.000)	1.364*** (0.000)
BAGE	0.015* (0.096)	0.117*** (0.005)	0.036*** (0.001)	-0.009 (0.244)	0.028 (0.430)	0.005 (0.958)
LEV	-0.545* (0.074)	4.596*** (0.001)	-1.781*** (0.001)	0.383 (0.655)	18.266*** (0.000)	-10.104*** (0.000)
Z-SCORE	0.020*** (0.000)	0.150*** (0.000)	0.006 (0.932)	0.090*** (0.000)	0.237*** (0.000)	0.021 (0.178)
GDP	0.059** (0.044)	0.557*** (0.000)	-0.044 (0.237)	0.065*** (0.006)	0.340*** (0.001)	0.010 (0.757)
INFL	0.020 (0.649)	-0.149 (0.454)	0.044 (0.500)	0.037 (0.356)	0.042 (0.808)	-0.103 (0.122)
Cons_	-0.674 (0.349)	-16.435*** (0.000)	-8.410*** (0.000)	-12.859*** (0.000)	-58.233*** (0.000)	-8.922*** (0.002)
Wald Chi <sup>2</sup>	37.30*** (0.000)	134.95*** (0.000)	1348.28*** (0.000)	202.19*** (0.000)	149.47*** (0.000)	461.86*** (0.000)
Mean VIF	1.41	1.41	1.44	1.41	1.41	1.44

**Notes:** Figures in the parenthesis are the *p*-values of regression coefficients. \*\*\*, \*\*, \* denote significance at the 1%, 5%, and 10% levels, respectively. Wald Chi<sup>2</sup>= The Wald Test (Wald Chi-Squared Test) for overall model significance. Mean VIF= Mean Variance Inflation Factor (VIF) test for Multicollinearity.

#### 5.4.5.4 The Moderating Effect of Institutional Shareholding

Table 5.14 demonstrates the GLS regression results exploring the moderating effect of institutional shareholding on the relationship between SSB effectiveness, captured by a SSB score, and the performance of IBs. The diagnostics tests in Table 5.14 indicate that the Wald test overall significance of regression models of the three groups is fit as the significance levels are less than 5% for the three measurements (i.e., ROA, ROE, Lnzakat) (Institutional shareholding <20%:  $p = 0.000, 0.000, 0.000$ ; Institutional shareholding  $\geq 20 \leq 50\%$ :  $p = 0.000, 0.000, 0.000$ ; Institutional shareholding > 50%:  $p = 0.000, 0.000, 0.000$ ), respectively. Moreover, the mean VIF for all models indicates that multi-collinearity is not a concern in this model.

As shown in Table 5.14, when institutional shareholding is less than 20% and between  $\geq 20 \leq 50\%$ , SSB effectiveness (SSB\_SCORE) does not exert any significant effect on all three performance measurements (i.e., ROA, ROE, and Lnzakat). However, when institutional shareholding is more than 50%, which constitutes a control, Institutional shareholding has a significant positive impact on financial performance metrics (ROA and ROE) ( $p = 0.000, 0.000$ ), respectively, and a significant negative effect on Islamic social performance measurement (Lnzakat) ( $p = 0.046$ ). Hence, hypothesis (H<sub>5</sub>) is supported for ROA and ROE, which is consistent with the AGT, *efficient-monitoring hypothesis*, and the performance-improvement argument, while it is not supported for Lnzakat. This result implies that controlling institutional shareholders positively moderate the relationship between effective SSBs and the performance of IBs in terms of ROA and ROE and negatively in terms of Islamic social performance (Lnzakat).

The positive impact suggests that the presence of controlling institutional shareholders strengthens the role of effective SSBs in enhancing the performance of IBs in terms of ROA and ROE. These shareholders enable SSBs to fulfil their supervisory and advisory roles more effectively, thereby escalating the profitability of IBs. Large Institutional shareholders have the incentive to gather information and monitor managerial actions due to the greater benefits they reap than smaller shareholders from monitoring the firm (Shleifer and Vishny, 1986; Shleifer and Vishny, 1997). Such shareholders represent sophisticated, knowledgeable market participants, generally

have fiduciary responsibilities, and are expected to be active monitors (Hardin et al., 2005). Regarding SSBs, controlling institutional shareholders may enable SSBs to conduct their supervisory and advisory tasks in two ways. First, they may strengthen the role of SSBs in mitigating *Shari'ah* non-compliance risk, which is part of operational risks. Second, such shareholders may enhance the duty of SSBs in developing *Shari'ah*-compliant products, increasing the profits of IBs.

Nonetheless, concerning the negative impact on *Lanzakat*, it can be concluded that controlling institutional shareholders with effective SSBs decreases the Islamic social performance of IBs in terms of Zakat payments. This result implies that controlling shareholders do not favour CSR activities concerning Zakat payments as CSR<sup>22</sup>. There are two possible explanations for this result. First, according to Peng and Yang (2014), when a single shareholder holds majority ownership rights, they exercise more discretionary power and may tend to be more self-interested. This motivates the controlling shareholder to entrench him or herself at the expense of minority shareholders (Claessens et al. 2000). In this manner, the controlling shareholders with higher control rights would bear a minor financial loss while engaging in value-damaging CSR activities (Ting and Yin, 2018). Consequently, the ability and incentive of the controlling shareholder to obtain information to control corporate policies may lead them not to favour Zakat distribution policies, which, in turn, may adversely affect decisions in the area of CSR. This result suggests that CSR activities regarding Zakat payments benefit IBs with dispersed ownership structures.

Second, because the sample IBs in the study are located in developing countries in the GCC and SEA regions where there is a lack of strict regulations on CSR engagements, controlling institutional shareholders may not prioritize Zakat payments as part of CSR. It has been argued that CSR is context-dependent, and distinct institutional structures and business systems found in developing countries may result in different expressions of CSR (Jamali and Neville, 2011). Hence, the influence of

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<sup>22</sup> Zakat distribution has been used by many studies as a proxy for Corporate Social Responsibility (CSR) (See, e.g., Rosman et al., 2019; Ali et al., 2023).

ownership structure on CSR may differ between developing and developed countries due to variations in, for instance, regulations and practices.

This result is consistent with prior studies that found that ownership concentration and controlling shareholders negatively moderate the relationship between CSR and firm performance (e.g., Peng and Yang, 2014; Ting and Yin, 2018; Akben-Selcuk, 2019).

## **5.5 CONCLUSION**

This chapter presented the findings of this study. The chapter is divided into three sections. The first section discusses the diagnostic tests necessary before analysing the data. This is followed by the second section, which demonstrates the descriptive statistics. The last section focused on hypothesis testing based on the GLS regression method.

Table 5.14 The Moderating Effect of Institutional Shareholding on SSB Effectiveness: GLS Regression Results

Model	(7A)	(7A)	(7A)	(7B)	(7B)	(7B)	(7C)	(7C)	(7C)
	Institutional Shareholding <20%			Institutional Shareholding ≥20< 50%			Institutional Shareholding > 50%		
Variables	ROA	ROE	Lnzakat	ROA	ROE	Lnzakat	ROA	ROE	Lnzakat
SSB_SCORE	0.510 (0.284)	2.350 (0.160)	-0.496 (0.311)	-0.058 (0.660)	-0.549 (0.295)	-0.031 (0.879)	0.517*** (0.000)	1.893*** (0.000)	-0.207** (0.046)
BOD_INDEX	-0.277 (0.307)	0.374 (0.695)	-0.015 (0.957)	-0.245 (0.123)	-0.968 (0.126)	0.378 (0.281)	-0.099 (0.209)	-0.619* (0.087)	-0.236** (0.025)
BSIZE	0.296 (0.133)	1.909*** (0.006)	1.014*** (0.000)	0.386*** (0.000)	1.749*** (0.000)	1.748*** (0.000)	0.028 (0.251)	0.338*** (0.003)	1.053*** (0.000)
BAGE	0.034* (0.077)	0.179*** (0.010)	0.016 (0.388)	-0.004 (0.967)	0.080* (0.086)	-0.053*** (0.000)	-0.011 (0.137)	0.023 (0.511)	0.043*** (0.000)
LEV	-5.272*** (0.000)	-9.988* (0.054)	-0.039 (0.982)	1.360* (0.084)	7.688** (0.014)	-5.495*** (0.000)	-0.328 (0.283)	7.065*** (0.000)	-1.823*** (0.002)
Z-SCORE	0.078** (0.011)	0.275** (0.011)	0.005 (0.998)	-0.002 (0.810)	-0.033 (0.467)	-0.002 (0.920)	0.025*** (0.000)	0.131*** (0.000)	0.012* (0.058)
GDP	0.172** (0.016)	0.871*** (0.001)	0.011 (0.897)	0.066*** (0.005)	0.332*** (0.000)	0.013 (0.679)	0.064*** (0.004)	0.351*** (0.001)	-0.033 (0.282)
INFL	0.196* (0.052)	0.463 (0.191)	-0.008 (0.938)	0.085* (0.052)	-0.092 (0.595)	0.056 (0.429)	-0.004 (0.897)	-0.106 (0.514)	0.041 (0.454)
Cons_	-6.925* (0.053)	-53.454*** (0.000)	-5.828 (0.200)	-8.407*** (0.000)	-35.501*** (0.000)	-21.006*** (0.000)	-2.196*** (0.001)	-17.698*** (0.000)	-8.891*** (0.000)
Wald Chi <sup>2</sup>	66.55*** (0.000)	115.19*** (0.000)	135.56*** (0.000)	86.75*** (0.000)	122.61*** (0.000)	474.47*** (0.000)	97.86*** (0.000)	138.63*** (0.000)	1488.39*** (0.000)
Mean VIF	1.33	1.33	1.36	1.33	1.33	1.36	1.33	1.33	1.36

**Notes:** Figures in the parenthesis are the *p*-values of regression coefficients. \*\*\*, \*\*, \* denote significance at the 1%, 5%, and 10% levels, respectively. Wald Chi<sup>2</sup>= The Wald Test (Wald Chi-Squared Test) for overall model significance. Mean VIF= Mean Variance Inflation Factor (VIF) test for Multicollinearity.

## CHAPTER SIX

### SUMMARY AND CONCLUSION

#### 6.1 INTRODUCTION

This chapter finalizes this study and presents the summary of the findings and conclusions of this research. This chapter consists of five sections. The first section summarises the empirical findings of the study. The second section discusses the study's theoretical and practical implications. The third and fourth sections scrutinise the study's limitations and recommendations for future research, respectively. The fifth and last section sets forth the conclusion of this chapter.

#### 6.2 SUMMARY OF RESEARCH FINDINGS

This study presents a piece of vital empirical evidence concerning the notion that *Sharī'ah* governance (SG), as represented by the SSB, influences the performance of IBs. The current study utilises a multi-theoretical framework that contains theories, namely the agency theory (AGT), resource dependence theory (RDT), and stakeholder theory (STK), to investigate the effect of SSB as an extra monitoring mechanism besides the BOD on the performance of IBs. In this study, the performance is categorized into two measures (i.e., financial and social performance). ROA and ROE gauge financial performance, while social performance is captured by Zakat payments (Lanzakat). Based on the GLS regression analysis, various important findings emerge.

First, findings show that independent SSBs harm the financial performance of IBs, while they do not influence the Islamic social performance measured by Zakat payments. Therefore, SSBs may not be independent in conducting their functions, especially since shareholders suggest their rewards and appoints them. These SSBs may have an advisory rather than a supervisory role, which diminishes their influence on IBs.

Second, the results also show that busy SSBs enhance both the financial and Islamic social performance of IBs across the GCC and SEA regions. This result infers that busy *Sharī'ah* scholars are reputable, high-quality scholars with extensive experience who offer better *Sharī'ah* advisory and supervisory functions. Their reputation attracts customers, depositors, and investors into IBs, subsequently enhancing the performance of these banks. Moreover, to preserve their reputation within the Muslim society, these reputable SSB scholars may encourage IBs to pay Zakat, subsequently raising the Islamic social performance of these banks.

Third, the regression outputs demonstrate that high SSB remuneration increases the financial performance of IBs as measured by ROA and ROE while not affecting Islamic social performance as measured by LnZakat. This suggests that substantial incentives, such as high remuneration, motivate SSB members to improve the financial performance of IBs. High remuneration provided to the SSB members may augment their diligence, thereby elevating the quality of their work.

Fourth, findings show that SSB effectiveness (captured by a SSB score) enhances the financial performance of IBs while they do not have a significant influence on Islamic social performance. This result implies that effective SSBs improve the profitability of IBs while not impacting Zakat payments. As stated above, a possible reason that effective SSBs do not influence Islamic social performance is that BODs control the overall decisions of IBs, including Zakat payments. This is evident as the coefficient of BOD (BOD\_INDEX) on Zakat payments is higher while the coefficient of SSB\_SCORE is much lower and insignificant.

Fifth, the results show that an increase in the SSB size and reputation leads to high bank performance. Furthermore, the results reveal that an increase in SSB cross-membership and financial expertise harms bank performance. Educational qualification of SSBs enhances financial performance while it diminishes Islamic social performance. Lastly, SSB meetings have no significant impact on financial and social performance.

Sixth, when it comes to the moderating impact of SSB during crises, the findings suggest that effective SSBs only enhanced the Islamic social performance of IBs amid

the 2008 GFC. Enhancing Islamic social performance regarding Zakat payments is one of the responsibilities of SSBs in IBs. This result suggests that effective SSBs strengthened the commitment of IBs to paying Zakat during the 2008 GFC by distributing Zakat funds to people experiencing poverty and individuals affected by this crisis. Moreover, in the recent COVID-19 pandemic crisis, effective SSBs enhanced the financial performance of IBs.

Seventh, the empirical results show that SG models (CSGM and DSGM) do not moderate the relationship between SSB effectiveness and the performance of IBs. In other words, there is not enough evidence that SG models influence the link between effective SSBs and the performance of IBs.

Finally, the study discovered that controlling institutional shareholding positively moderates the relationship between SSB effectiveness and the financial performance of IBs measured by ROA and ROE, implying that such shareholders support SSBs in performing their duties effectively, enhancing financial performance. Moreover, findings show that controlling institutional shareholding negatively moderates the link between SSB effectiveness and the social performance of IBs as measured by Zakat payments, suggesting that such shareholders do not enable effective SSBs to achieve better Islamic social performance in terms of Zakat payments. Expressly, the ability and incentive of the controlling shareholder to obtain information to control corporate policies may lead them not to favour Zakat distribution policies, which, in turn, may adversely affect decisions in the area of CSR. Moreover, because sample IBs are located in developing countries where there is a lack of strict regulations on CSR engagements, controlling institutional shareholders may not prioritize Zakat payments as part of CSR. Notably, this result suggests that CSR activities regarding Zakat payments benefit IBs with dispersed ownership structures.

To sum up, it is concluded that there are weaknesses in the role of SSBs in IBs as SSBs do not seem independent. These SSBs may not be independent in conducting their functions, especially since shareholders and management suggest their rewards (Grais and Pellegrini, 2006a; Grassa, 2013a; Bouheni and Ammi, 2015) and nominate them (Garas, 2012). Moreover, these SSBs may have advisory rather than supervisory roles. Assigning SSBs an advisory role only can reduce the level of *Shari'ah-*

compliance in IFIs because management is not obligated to enforce SSB decisions regarding compliance with its products and services (Alkhamees, 2013). Further, dependent SSBs may approve suspicious operations to ensure their position on the board (Grassa, 2013b), harming performance and increasing *Sharī'ah* non-compliance risk, which is part of operational risks. *Sharī'ah* non-compliance can lead to financial, legal, and reputational losses (AAOIFI, 2018). Lastly, SSBs' influence on Islamic social performance regarding Zakat payment is also weak, implying that BODs control and dominate decisions regarding Zakat distributions. Hence, it is vital that SSBs are highly independent so that they can perform their duties effectively, subsequently enhancing IBs' performance.

## **6.3 THEORETICAL AND PRACTICAL IMPLICATIONS**

### **6.3.1 Theoretical Implications**

The study has important implications for theory and research in the areas of *Sharī'ah* and corporate governance, corporate finance, and Islamic banking and finance. The findings of this study contribute to the body of knowledge by demonstrating how the *Sharī'ah* governance mechanism, as represented by SSBs, influences the performance of IBs. Notably, this study has several contributions to the existing literature.

First, although recently, many studies have assessed the role of SSB characteristics from different perspectives, such as financial performance, CSR, risk-taking, efficiency, compliance, and disclosure levels, some attributes of SSBs have not been adequately addressed. Therefore, the current study contributes to how SSB independence, remuneration, and busyness impact the financial and social performance of IBs. Moreover, this study contributes to the literature by employing a composite measure, which sums up six important SSB characteristics to reflect on the overall effectiveness of SSBs.

Therefore, academic research may benefit from the attempt of this study to demonstrate how some theories, including AGT, RDT, and STK, can be used to study how SSB characteristics can affect and improve the effectiveness of SSBs and, thereafter, enhance the performance of IBs. Notably, unlike previous studies, this study

primarily focuses on how STK can explain the relationship between some SSB characteristics and the performance of IBs. Most researchers utilise theories such as the AGT, RDT, and stewardship theory to understand the impact of SSB on the performance of IBs. Therefore, this study suggests that the STK needs to be employed more often to understand SSB's role in IBs, as *Sharī'ah* endorses a stakeholder-oriented model of CG.

Third, in terms of methodology, the study uses Zakat payments to gauge Islamic social performance and can also measure the CSR of IBs. The studies that used Zakat distributions as a performance measurement are minimal. Hence, this study highlights the importance of using performance measurements that reflect the nature of IBs as *Sharī'ah*-compliant banks. *Sharī'ah* expresses that Zakat payment is an obligation towards society.

Fourth, the current study contributes by assessing how effective SSBs influence the performance of IBs in crisis and non-crisis periods. Very few studies have investigated how the role of SSBs differs in different periods. Hence, this study examined how effective SSBs functioned during the 2008 financial crisis and the recent COVID-19 pandemic crisis.

Fifth, this study complements the literature by scrutinizing the effect of SG models (CSGM and DSGM) on SSB effectiveness. Assessing the impact of different SG models is vital, as SG mechanisms in different jurisdictions have implications for the performance of IBs. Hence, distinct SG models affect the way SSBs perform their duties and responsibilities, which in turn can influence the performance of IBs.

Finally, the current study considered the moderating effect of ownership structure (institutional shareholding) on the relationship between SSB effectiveness and the performance of IBs. No prior research has investigated this relationship. This investigation is vital as it would add to the literature by understanding the role of large institutional shareholders in affecting the role of SSBs in IBs and, after that, affecting the financial and social performance of IBs.

### 6.3.2 Practical Implications

The findings of this study have important practical implications for policymakers, regulators, IBs, and researchers concerning the *Sharī'ah* and corporate governance practices of IBs in the GCC and SEA regions. Hence, the study sets forth some important practical implications, which are as follows:

1. The independence of SSBs should be improved to enhance their functions, which ideally encompass advisory and supervisory tasks. The findings of this study provide evidence for regulators to take charge of appointing SSB members to ensure that SSBs are highly independent. SSB may not be fully independent, especially since shareholders appoint them and suggest their rewards. Moreover, SSBs may have an advisory rather than a supervisory role, which diminishes their effectiveness and influence on IBs. Hence, it is recommended that a higher regulatory body approve the appointment and dismissal of SSB members. This requirement for a central authority to endorse every appointment and dismissal of SSB members would provide robust safeguards for the board to act independently as they would be able to raise any issues concerning IFI's policies and operations without 'fear' or 'favour' of the threat of dismissal (Sori et al., 2015). Countries like Malaysia, Sudan, and Pakistan are the only countries that benefit from such an advantage (Baklouti, 2022). Indeed, a good example is the case of IBs in Malaysia, where IBs are required to submit the names of SSB candidates to the supreme *Sharī'ah* board in the central bank for final approval, as this would ensure the selection of competent members and high independence. Malaysia has a stronger SG framework than the GCC countries (Hasan, 2011).

The recommendation of this study is consistent with the calls of several studies, including those by Hamza (2013), Alkhamees (2013), and Grassa (2013b) suggesting that regulatory bodies oversee and approve the appointment of SSB members as this should provide an additional layer of protection for SSB independence from shareholders, BODs, or management, ensuring greater objectivity in selecting SSB members.

In addition to the appointment and dismissal of SSB members, financial independence is another critical dimension of SSB independence. This is because the employment status of the SSB generates an economic stake (remuneration and renewal) in the bank, which may compromise the SSB's independence (Bouheni and Ammi, 2015). Consequently, Grassa (2013b) and Hamza (2013) proposed that the remuneration of SSBs should also be done by a higher authority, such as a Central Bank. However, this approach may not be practical because IFIs would still indirectly compensate SSB members. Hence, Mannai and Ahmed (2019) suggest that regulators disassociate SSB remuneration from the IFI to ensure SSB independence. The authors recommend establishing and assigning an independent organisation to provide this service, which could be funded by the membership fees that IFIs pay annually in return for such service.

Therefore, this study presents empirical evidence for regulators to administer the appointment and dismissal of SSB members and to disassociate their remuneration from IBs. Regulators should play a proactive role in guaranteeing SSB independence.

2. SSBs also have to be granted real independence in terms of their influence on Islamic social performance regarding Zakat payments, as findings show that BODs control and dominate Zakat distribution decisions. Findings indicate that BODs do not favour Zakat payments as their effect on Zakat is negative. Hence, high SSB independence permits SSBs to urge BODs to discharge the Zakat amount due, thereby enhancing the Islamic social performance of IBs.
3. Regarding busy *Sharī'ah* scholars, the study offers guidance to IBs and regulators when appointing SSB members. It is recommended that IBs consider appointing some *Sharī'ah* scholars who serve multiple boards to their SSBs as these scholars bring experience and reputation, which subsequently can enhance their performance. Moreover, it is recommended that regulators do not view busy scholars negatively. Instead, they should

encourage IBs to include certain *Sharī'ah* scholars with multiple SSB appointments in their SSBs.

However, it is essential to note that due to the time and cognitive abilities of individuals that can be limited, serving many SSBs can also restrict the time, commitment, and attention of SSB members to each IB, which can adversely affect performance. Therefore, this study suggests that SSBs should contain a mixture of members who hold multiple SSB seats together with other members who serve fewer SSBs. This way, the SSB will consist of both highly experienced members and members who are more available than the busy *Sharī'ah* scholars. The former group will bring high competence and experience, while the latter will offer fresh perspectives and be more available. This recommendation is consistent with IFSB (2009; p.8), which proposes that IBs should have SSBs with different lengths of experience.

According to IFSB (2009), more experienced *Sharī'ah* scholars, due to their strong reputation and experience, will usually have a lot of other commitments, such as serving various SSBs, and therefore, in terms of time allocation, it is likely that the less experienced members (i.e., those scholars usually without various appointments and are available) can dedicate more time to studying the issues and proposals for deliberation at the SSB, thereby enabling an efficient and effective learning process between the two. Combining the two groups would foster a better balance between experience and fresh ideas, which, in turn, is more likely to facilitate innovation and harmonization throughout the SSB's deliberations (IFSB, 2009; p.8). This way, reputable and experienced *Sharī'ah* scholars will mentor the less experienced scholars, allowing them to acquire relevant competence and experience.

4. IBs should enhance the compensation schemes provided to SSB members as ample incentives in the form of high remuneration motivate SSB members to enhance performance. High remuneration provided to the SSB members augments their diligence, elevating their work quality. Therefore,

high remuneration is important to attract and retain high-quality *Sharī'ah* scholars.

5. Researchers may benefit from this study's findings by being informed about the effect of various SSB attributes on the performance of IBs. More specifically, the current study suggests that when measuring the overall influence of SSBs in IBs, composite measurement should be considered to capture their overall effect. This is shown in the empirical results of this study as the effect of SSB score, which contains six SSB characteristics, positively influences the performance of IBs. In contrast, individual SSB score attributes show different results, as some of them exert an insignificant effect on the performance of IBs. This is consistent with some researchers arguing that CG characteristics can be complementary and should be combined.
6. The study furnishes empirical evidence for IBs and regulators to help understand the role of effective SSBs in crisis periods and how IBs can adopt an appropriate SSB structure to improve performance. Findings suggest that effective SSBs support IBs to maintain stability during crises. It is vital to note that the role of SSB means that the products of IBs are likely to be less risky because of *Sharī'ah*-compliance. Therefore, SSB may be helpful to IBs in maintaining their performance during crisis periods. With that said, regulators and IBs should strive to improve the independence of SSBs, which can be very helpful in times of crisis.
7. Cornering SG models, it is concluded that neither model (CSGM or DSGM) influences the relationship between SSB effectiveness and the performance of IBs. This result suggests that the role of central authorities in enhancing the SG in IBs is still weak. The absence of the role of regulators in improving the SG in IBs is evident, as the findings of the present study suggest that SSBs may not be independent. Accordingly, it is recommended that policymakers and regulators should put in place a robust SG framework and improve the independence of SSBs. A sound SG framework is an essential indicator of the extent of SSB effectiveness, and appropriate

controls will preserve stakeholders' confidence in IBs. Therefore, regulators should play a proactive role in ensuring a sound and good SG.

8. Finally, the ownership structure (large institutional shareholding) has vital implications for IBs and regulators. At first, when IBs have controlling institutional shareholders, SSBs' effectiveness in conducting their advisory and supervisory roles increases, enhancing the financial performance of IBs. The exception, however, is that controlling institutional shareholders does not enable SSBs to achieve better Islamic social performance as measured by Zakat payments. The ability and incentive of the controlling shareholder to obtain information to control corporate policies may lead them not to favour Zakat distribution policies, which, in turn, may adversely affect decisions in the area of Islamic social performance (or CSR). Furthermore, because the sample IBs in the study are located in developing countries in the GCC and SEA regions where there is a lack of strict regulations on CSR engagements, controlling institutional shareholders may not prioritize Zakat payments as part of CSR. Thus, this finding can help policymakers and regulators identify how controlling institutional shareholding, prevalent in emerging markets such as the GCC and SEA countries, affects Islamic social performance or CSR activities. Regulators can investigate the effectiveness of Zakat payment initiatives in IBs with controlling institutional shareholders, as Zakat disbursement is mandatory in some of the sample countries, such as Malaysia, Saudi Arabia, Kuwait, and Qatar. Moreover, it recommended that policymakers and regulators improve regulations around the CSR initiatives of IBs, especially those related to Zakat payments.

Finally, it is recommended that IBs who aim to boost their Islamic social performance have low institutional shareholding, as this structure may facilitate SSBs to perform better in their efforts to enhance Islamic social performance. On the other hand, it is recommended that IBs have high institutional shareholding if their focus is boosting financial performance.

9. Finally, this study recommends that IBs, especially those in the GCC region, improve their disclosure and reporting practices. The researcher faced challenges in obtaining SSB and other corporate governance information from annual reports, resulting in significant time spent searching for these details across various online sources.

#### **6.4 LIMITATIONS OF THE STUDY**

This study has several limitations that require due consideration. First, the current study used a dummy variable that takes the value of “1” if shareholders appoint SSBs and “0” otherwise. Hence, this measure may not be enough to capture the independence of SSBs in IBs. Second, the SSB remuneration variable is limited to some IBs in the sample, as not all banks disclose remuneration in their annual reports. This reduces the sample IBs to 44 from 60.

Third, the Islamic social performance measurement is limited to some IBs in the sample as not all IBs disclose Zakat payments in their annual reports. This narrows the sample of IBs to 38 from 60. Fourth, this research assessed financial performance proxied by bank ROA and ROE. Other performance metrics were excluded. Fifth, the study neglected to examine whether the legal environment moderates the effect of SSB on the performance of IBs, as some countries have strong corporate and *Sharī'ah* governance legal frameworks while others lack them. Sixth, the sample IBs used in this study are confined to the IBs in the GCC and SEA regions while neglecting IBs in other jurisdictions that embrace Islamic banking.

Finally, another limitation is related to the ownership structure, as the moderating effect of institutional shareholding on the SSB-performance relationship is examined. Therefore, the moderating effect of institutional shareholders can vary based on the identity of the institutional shareholders, such as pension funds, mutual funds, banking institutions, sovereign wealth funds, insurance companies, and endowment funds are not considered in this study.

## 6.5 RECOMMENDATIONS FOR FUTURE RESEARCH

Considering the limitations mentioned above, this study sets forth some recommendations and avenues for future research, which are as follows:

1. The current study recommends that SSB independence be measured using a different measurement to reflect SSB independence better. Future studies should measure SSB independence by metrics such as whether the central authorities approve their appointment and dismissal.
2. There is a need to examine the maximum SSB appointments that *Sharī'ah* scholars can occupy without harming the performance of IBs. As argued earlier, due to the time and cognitive abilities of individuals that can be limited, extreme busyness by *Sharī'ah* scholars may restrict their time commitment and attention to each IFI, which can adversely affect the performance of IBs. Therefore, future studies should assess the maximum number of seats SSB members can serve without compromising their effectiveness in terms of availability and attention to each IB.
3. The SSB remuneration variable in this study is limited to 44 IBs, and therefore, future studies should extend the number of banks and include other jurisdictions, such as the MENA, South Asia, and Africa regions.
4. Zakat, a social performance measurement, is also limited to only 38 IBs in the GCC and SEA regions; hence, future research should extend the number of IBs to include other countries that embrace Islamic finance.
5. In terms of performance measurements, future research should consider not only financial performance metrics but also market performance of listed IBs. However, since most IBs are not listed, future studies should increase the number of countries to attain a good sample size for regression analysis.
6. Future studies should scrutinise the moderating effect of the legal environment on SSB effectiveness. The effectiveness and efficiency of SSBs may differ between regulated and unregulated jurisdictions.

7. There is a need for empirical studies to examine whether the identity of institutional shareholders, such as pension funds, mutual funds, banking institutions, sovereign wealth funds, insurance companies, and endowment funds, moderates the SSB-performance relationship.
8. Finally, the sample IBs used in this study are limited to the IBs in the GCC and SEA regions while neglecting IBs in other jurisdictions that embrace Islamic banking, especially in the MENA and South Asia regions. Thus, future research should extend the number of IBs and countries.

## 6.6 CONCLUSION

This chapter provided the conclusion of the study. It summarised the empirical findings of the study. The chapter presented the study's theoretical and practical implications. Finally, the chapter discussed limitations and provided recommendations and avenues for future research.

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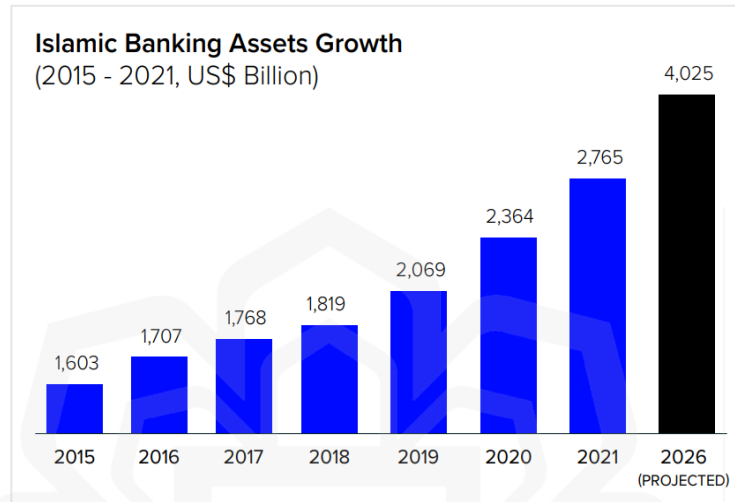
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## APPENDIX A

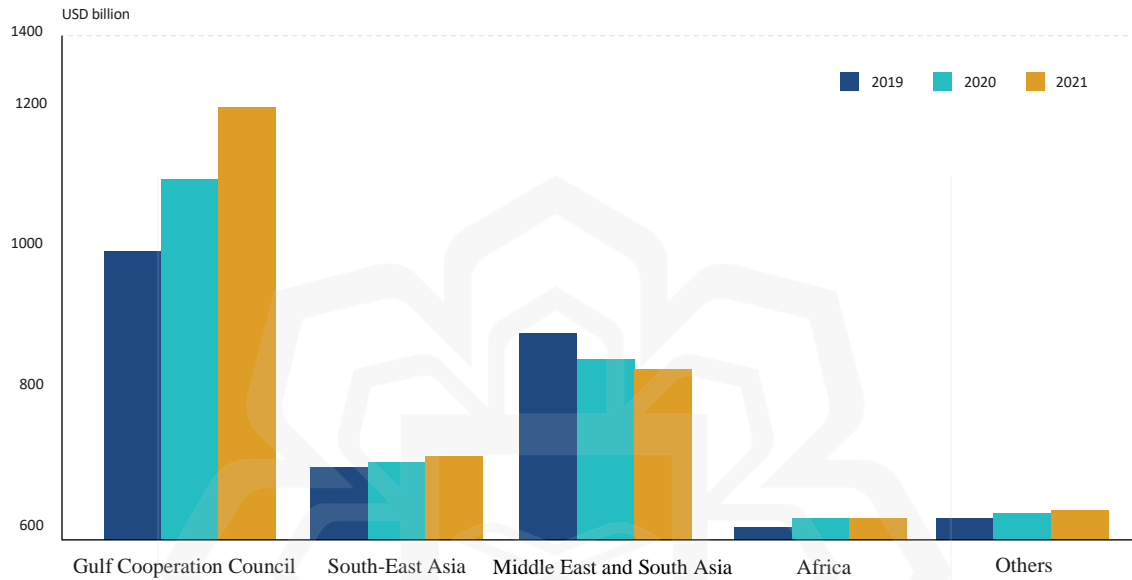
### ISLAMIC BANKING ASSETS GROWTH OVER THE 2015-2021 PERIOD



Source: Islamic Development Bank (IsDB) Group and Refinitiv (2022)

## APPENDIX B

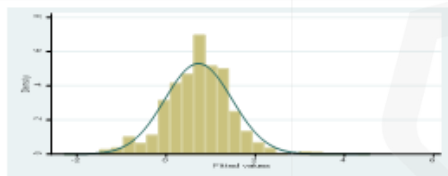
### GLOBAL ISLAMIC BANKING ASSETS BY REGION OVER THE 2019–2021 PERIOD



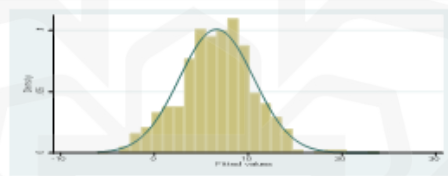
Source: Islamic Financial Services Board (2022)

## APPENDIX C

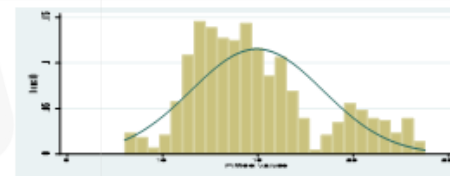
### NORMALITY PLOTS



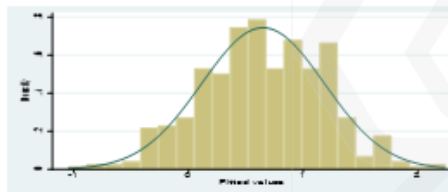
Graph 1A: Normality Plot for Model 1 (Dependent Variable is ROA)



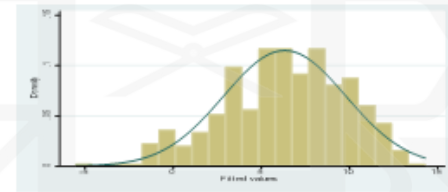
Graph 1B: Normality Plot for Model 1 (Dependent Variable is ROE)



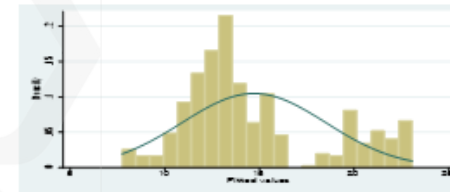
Graph 1C: Normality Plot for Model 1 (Dependent Variable is Lnzakat)



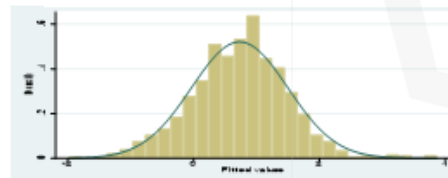
Graph 2A: Normality Plot for Model 2 (Dependent Variable is ROA)



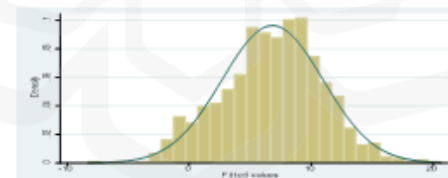
Graph 2B: Normality Plot for Model 2 (Dependent Variable is ROE)



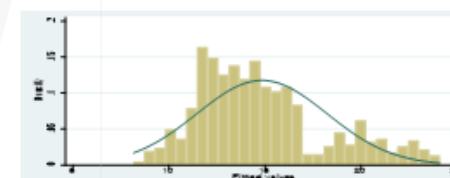
Graph 2C: Normality Plot for Model 2 (Dependent variable is Lnzakat)



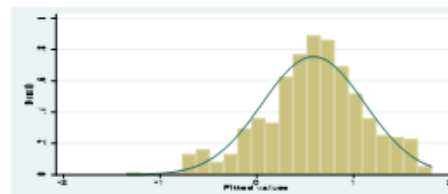
Graph 3A: Normality Plot for Model 3 (Dependent Variable is ROA)



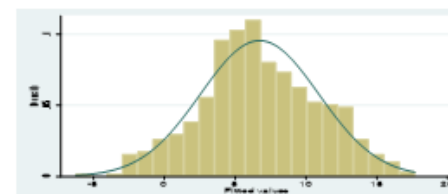
Graph 3B: Normality Plot for Model 3 (Dependent Variable is ROE)



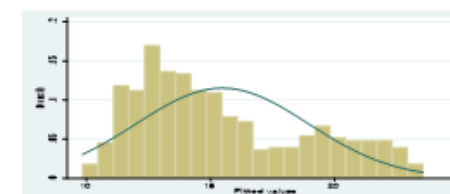
Graph 3C: Normality Plot for Model 3 (Dependent Variable is Lnzakat)



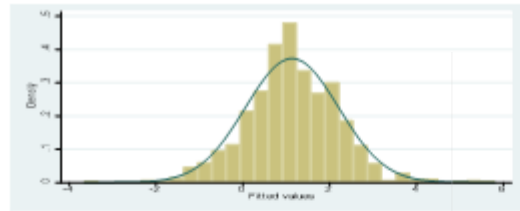
Graph 4A: Normality Plot for Model 4 (Dependent Variable is ROA)



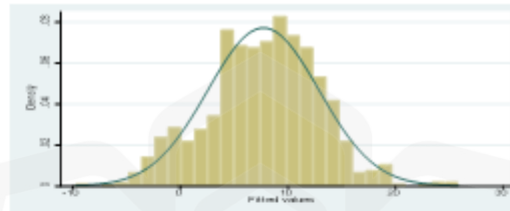
Graph 4B: Normality Plot for Model 4 (Dependent Variable is ROE)



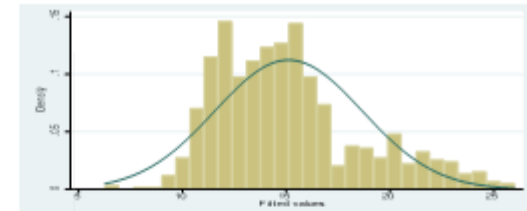
Graph 4C: Normality Plot for Model 4 (Dependent Variable is Lnzakat)



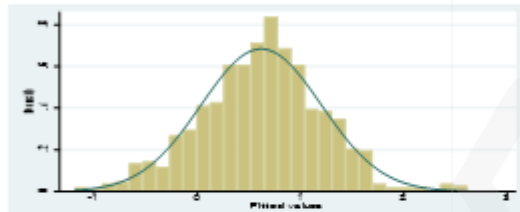
Graph 5A: Normality Plot for Model 5(a) (Dependent Variable is ROA)



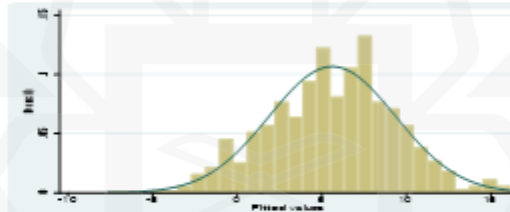
Graph 5B: Normality Plot for Model 5(a) (Dependent Variable is ROE)



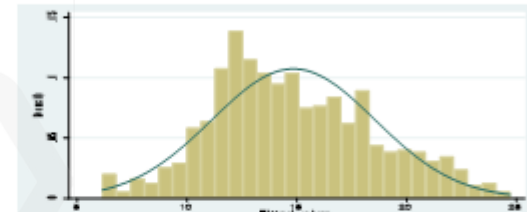
Graph 5C: Normality Plot for Model 5 (a) (Dependent Variable is Lnzakat)



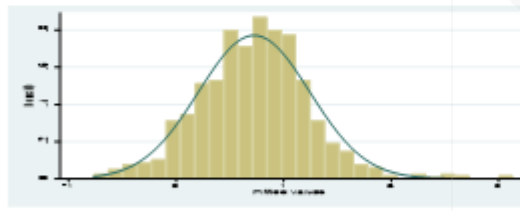
Graph 5D: Normality Plot for Model 5(b) (Dependent Variable is ROA)



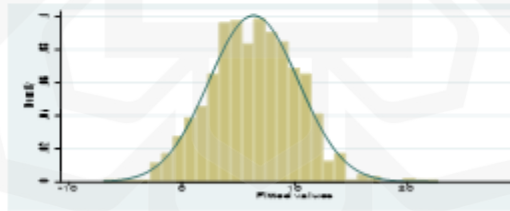
Graph 5E: Normality Plot for Model 5(b) (Dependent Variable is ROE)



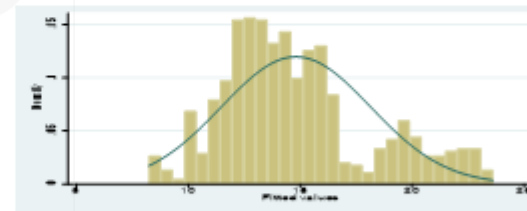
Graph 5F: Normality Plot for Model 5(b) (Dependent Variable is Lnzakat)



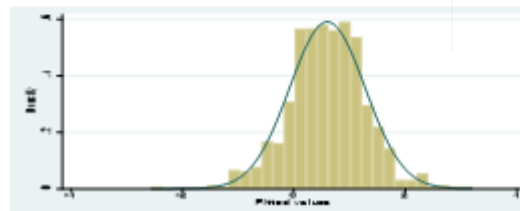
Graph 6A: Normality Plot for Model 6 (Dependent Variable is ROA)



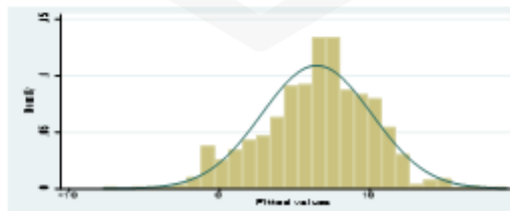
Graph 6B: Normality Plot for Model 6 (Dependent Variable is ROE)



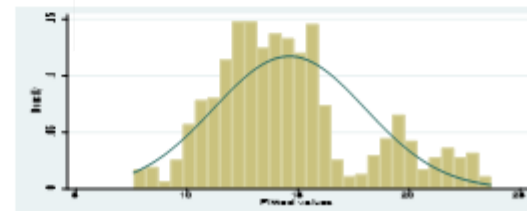
Graph 6C: Normality Plot for Model 6 (Dependent Variable is Lnzakat)



Graph 7A: Normality Plot for Model 7 (Dependent Variable is ROA)



Graph 7B: Normality Plot for Model 7 (Dependent Variable is ROE)



Graph 7C: Normality Plot for Model 7 (Dependent Variable is Lnzakat)

## APPENDIX D

### LIST OF ISLAMIC BANKS IN THE SAMPLE

No.	Islamic Bank Name	Country
1.	Bank Islam Brunei Darussalam Berhad	Brunei Darussalam
2.	Islamic Bank of Thailand	Thailand
3.	Al-Amanah Islamic Investment Bank of the Philippines	Philippines
4.	Alliance Islamic Bank Berhad	Malaysia
5.	Affin Islamic Bank Berhad	Malaysia
6.	Al Rajhi Banking & Investment Corporation (Malaysia)	Malaysia
7.	AmBank Islamic Berhad	Malaysia
8.	Bank Islam Malaysia Berhad	Malaysia
9.	Bank Kerjasama Rakyat Malaysia Berhad	Malaysia
10.	Bank Muamalat Malaysia Berhad	Malaysia
11.	CIMB Islamic Bank Berhad	Malaysia
12.	HSBC Amanah Malaysia Berhad	Malaysia
13.	Hong Leong Islamic Bank Berhad	Malaysia
14.	Kuwait Finance House Berhad (Malaysia)	Malaysia
15.	Maybank Islamic Berhad	Malaysia
16.	OCBC Al-Amin Bank Berhad	Malaysia
17.	Public Islamic Bank Berhad	Malaysia
18.	RHB Islamic Bank Berhad	Malaysia
19.	Standard Chartered Saadiq Berhad	Malaysia
20.	PT Bank BCA Syariah	Indonesia
21.	PT Bank BNI Syariah	Indonesia
22.	PT Bank BRI Syariah	Indonesia
23.	PT Bank BTPN Syariah Tbk	Indonesia
24.	PT Bank Jabar Banten Syariah	Indonesia
25.	PT Bank Maybank Syariah Indonesia	Indonesia
26.	PT Bank Mega Syariah	Indonesia
27.	PT Bank Muamalat Indonesia Tbk	Indonesia
28.	PT Bank Panin Dubai Syariah	Indonesia

<b>No.</b>	<b>Islamic Bank Name</b>	<b>Country</b>
29.	PT Bank Syariah Bukopin	Indonesia
30.	PT Bank Syariah Mandiri	Indonesia
31.	PT Bank Victoria Syariah	Indonesia
32.	ABC Islamic Bank (E.C.)	Bahrain
33.	Al Baraka Islamic Bank B.S.C. (c)	Bahrain
34.	Al Salam Bank B.S.C	Bahrain
35.	Bahrain Islamic Bank B.S.C.	Bahrain
36.	Citi Islamic Investment Bank E.C.	Bahrain
37.	GFH Financial Group BSC	Bahrain
38.	Ithmaar Bank B.S.C.	Bahrain
39.	Khaleeji Commercial Bank B.S.C.	Bahrain
40.	Kuwait Finance House (Bahrain) B.S.C. (c)	Bahrain
41.	Liquidity Management Centre B.S.C.(c)	Bahrain
42.	Venture Capital Bank B.S.C. (c)	Bahrain
43.	Ahli United Bank K.S.C.P.	Kuwait
44.	Boubyan Bank K.S.C.P.	Kuwait
45.	Kuwait Finance House (K.S.C.P.)	Kuwait
46.	Kuwait International Bank K.S.C.P.	Kuwait
47.	WARBA Bank K.S.C.P.	Kuwait
48.	Alizz Islamic Bank SAOC	Oman
49.	Bank Nizwa SAOG	Oman
50.	Masraf Al Rayan (Q.P.S.C.)	Qatar
51.	Qatar First Bank L.L.C (Public)	Qatar
52.	Qatar International Islamic Bank (Q.P.S.C.)	Qatar
53.	Qatar Islamic Bank (Q.P.S.C)	Qatar
54.	Al Rajhi Banking and Investment Corporation	Saudi Arabia
55.	Alinma Bank	Saudi Arabia
56.	Bank Albilad	Saudi Arabia
57.	Bank Aljazira	Saudi Arabia
58.	Abu Dhabi Islamic Bank PJSC	United Arab Emirates
59.	Al Hilal Bank PJSC	United Arab Emirates
60.	Emirates Islamic Bank PJSC	United Arab Emirates