

HOW DO SHARIA SUPERVISORY BOARD AND GOOD CORPORATE GOVERNANCE RELATE TO ISLAMIC BANKS PERFORMANCE?

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ABSTRACT - This study aims to investigate the relationship between the characteristics of the Sharia Supervisory Board (SSB) and Good Corporate Governance (GCG) on the performance of Islamic Banks (IBs). Data were collected from 14 IBs listed on the Financial Services Authority (OJK) from 2013 to 2019. The multiple regression results empirically show that SSB with the academic position as professor shows a significant positive relationship on IBs performance. Meanwhile, SSB with doctoral education has no positive relationship with IBs performance. Although it is not positively correlated, doctoral education is still needed but with a background in law or sharia education, economics, including finance or accounting, and muamalah. Educational background is proven to have a significant positive relationship with IBs' performance. Meanwhile, SSB, which only has a finance or accounting background, does not positively affect IBs' performance. In addition, GCG shows a very significant positive relationship with the IBs' performance. It indicates that effective and efficient governance by the Board of Directors, Board of Commissioners, and SSB through implementing better GCG and sharia principles will improve IBs performance.

Keywords: Sharia Supervisory Board, GCG, education, Islamic banks, performance.

JEL Classification: G21, G39

ABSTRAK – Bagaimana Kaitan Dewan Pengawas Syariah dan Good Corporate Governance dengan Kinerja Bank Syariah? Penelitian ini bertujuan untuk mengetahui hubungan antara karakteristik Dewan Pengawas Syariah (DPS) dan Good Corporate Governance (GCG) terhadap kinerja Bank Syariah (BS) di Indonesia. Data dikumpulkan dari 14 BS yang terdaftar di OJK selama periode 2013-2019. Berdasarkan hasil regresi berganda secara empiris menunjukkan bahwa DPS yang memiliki jabatan akademik sebagai profesor menunjukkan hubungan positif yang signifikan dengan kinerja BS. Sedangkan DPS dengan pendidikan doktor tidak memiliki hubungan positif dengan kinerja BS. Walaupun tidak berkorelasi positif, pendidikan doktor tetap diperlukan tetapi dengan latar belakang pendidikan hukum atau syariah, ekonomi termasuk keuangan atau akuntansi, dan muamalah. Karena latar belakang pendidikan tersebut terbukti memiliki hubungan positif yang signifikan dengan kinerja BS. Sedangkan DPS yang hanya berlatar belakang keuangan atau akuntansi tidak menunjukkan hubungan positif dengan kinerja BS. Selain itu, GCG menunjukkan hubungan positif yang sangat signifikan dengan kinerja BS. Hal ini menunjukkan bahwa tata kelola yang efektif dan efisien oleh Dewan Direksi, Dewan Komisaris, dan DPS melalui penerapan prinsip-prinsip GCG dan syariah yang lebih baik akan meningkatkan kinerja BS.

Kata Kunci: Dewan Pengawas Syariah, GCG, Pendidikan, Bank Syariah, Kinerja.

INTRODUCTION

The corporate governance of Islamic banks has attracted attention recently. Islamic banks (IBs) have different corporate governance from conventional banks (CBs) called Sharia Supervisory Board (SSB). SSB and sharia compliance are the main features of Islamic bank governance (Mollah & Zaman, 2015). SSB as a control body is an additional layer that can monitor and limit the board of directors and management in aggressive lending and major risk-taking activities (Mollah & Zaman, 2015; Ahmed et al., 2013). They can approve and report IBs compliance. It is a form of moral responsibility of managers and members of the board of directors (Beekun & Badawi, 2005; Belal et al., 2015; Abdelsalam et al., 2016).

IBs must ensure that the products and daily operations comply with sharia principles so that customers remain loyal (Graiss & Pellegrini, 2006). SSB must guarantee that the operations are under sharia principles (Zulkafli et al., 2010; Ahmed et al., 2013; Alsartawi, 2019). SSB must ensure that the governance of IBs is built based on sharia governance. It is crucial because sharia governance can build stakeholder trust and contribute to financial stability and bank performance (Ismail et al., 2016; Ibrahim, 2015). Thus, the success of the IBs governance system highly depends on the effectiveness of the SSB (Nathan, 2010) which is reflected in the principles of Good Corporate Governance (GCG) including independence and transparency (Alsartawi, 2019).

The SSB and GCG of IBs guarantee more for stakeholders that IBs are managed under sharia principles. It can maintain the credibility of the Islamic finance industry and increase stakeholder confidence in the products and activities offered by IBs (Khan & Zahid, 2020; Maulana, 2014). The question is, "Do the public or consumers feel guaranteed or believe in SSB and GCG at this time?" The indicator is how much the community entrusts their funds to be managed by IBs or utilizing funds distributed by IBs.

The number of Muslims in Indonesia is 229 million people, or 87.2 percent of the total population of Indonesia (Barus, 2020). With this vast potential, IBs should grow faster and more extensively than conventional banks (CBs) because there are opportunities and Muslim trust in IBs. Based on OJK (financial services authority) data as of December 2020, the market share ratio between IBs and CBs is 6.51: 93.49 percent (OJK, 2020). It is not comparable to the number of Muslims in Indonesia. In addition, from 2016 to 2020, IBs



tend to decline in terms of assets, disbursed financing (PYD), and third-party funds (DPK) (see Table 1). It indicates that the involvement of Muslims in IBs is still not maximized.

Table 1. Asset Growth, PYD, and DPK

Name	2016	2017	2018	2019	2020
ASSET	20.28%	18.97%	12.57%	9.93%	13.11%
PYD	16.41%	15.27%	12.17%	10.89%	8.08%
DPK	20.84%	19.89%	11.14%	11.93%	11.88%

Source: OJK (2020)

As mentioned above, the critical role played by the SSB is still questionable, whether or not the members of the SSB can carry out their functions effectively. It indeed depends on the characteristics of the SSB members themselves. Previous studies have investigated the relationship between SSB characteristics (such as SSB members, educational qualifications, expertise, reputation, double SSB, and meetings) and Islamic bank performance (Rahman & Bukair, 2013; Mollah & Zaman, 2015; Almutairi & Quttainah, 2017; Nurkhin et al., 2018; Nomran et al., 2018). These characteristics can be grouped into four main variables: the number of SSB members, educational background (education qualifications, expertise), double positions (reputation, double SSB), and the number of meetings.

In this study, the educational background becomes the focus variable in the research because education is the starting point and the primary strategy to build quality human beings (Yusuf, 2018). Second, higher education has better analytical skills (Almutairi & Quttainah, 2017) and is rich in experience (Rahman & Bukair, 2013). Therefore, this study will further explore SSB education from the level of education and type of education.

In addition to the role of SSB, the IBs' performance is influenced by other boards, such as the Board of Directors, Board of Commissioners, and Audit Committee. This role is captured through GCG because it reflects the effectiveness of the boards in managing IBs. If GCG is appropriately implemented, the decision-making process will be optimal and efficient, and create a healthy work culture to impact company performance (Dwiridotjahjono, 2009). Based on the problems of IBs, the market share is smaller than conventional banks (Nadia, Ibrahim, & Jalilah, 2019); and performance tends to decline (see Table 1). This study aims to investigate the



effectiveness of SSB, particularly the educational characteristics of SSB and GCG, on the performance of Islamic banks.

LITERATURE REVIEW

SSB Educational Qualifications and the Performance of Islamic Banks

Education is a basic human need for self-development. The higher the level of education, the easier it is to accept and develop knowledge and technology that can increase productivity. Educational qualifications board members with a good level of education can handle each new act in a good way (Hambrick & Mason, 1984). Thus the educational qualification reflects the quality of the board (Kakabadse et al., 2010), which will increase the company's competitiveness (Gabrielsson & Huse, 2005). Accordingly, SSB qualifications are essential for decision making, where higher education has better analytical skills and is rich with innovative ideas and policy development (Almutairi & Quttainah, 2017).

Previous studies have shown that the level of education is positively correlated with a person's ability to impact company performance (Wardana, 2016; Ratnasari, 2018). In the banking sector, it also shows that the education and performance of IBs are positively correlated (Almutairi & Quttainah, 2017). SSB members with doctoral degrees are expected to have more experience in Islamic banking finance (Farook et al., 2011; Rahman & Bukair, 2013; Nomran et al., 2018). Likewise, SSB members with the position of professor will be more experienced because they must at least have a doctoral education. Thus, a higher level of SSB education leads to higher profitability (Musibah & Alfattani, 2014). The proposed hypotheses are as follows:

H_{1a}: There is a positive relationship between SSB with doctoral education and the performance of Islamic banks.

H_{1b}: There is a positive relationship between SSB with the academic position as a professor and the performance of Islamic banks.

SSB Educational Background and the Performance of Islamic Banks

SSB's educational background is essential for their knowledge and competence in IBs, so they effectively carry out their duties as sharia supervisors. According to Harel & Baruch (1993), different types of education and training can



influence some individual outcomes to the organization. It shows that if an individual's type of education and training is under the requirements of Islamic banking, then the individual is valuable for banking.

Universities with graduates in finance and banking completed by fiqh, economics, management, and accounting will be well accepted in the job environment (Hasan, 2008; Suryanti, Ibrahim, & Ayumiati, 2019). It can happen because those fields of study are closely related to the Islamic banking sector. Likewise, SSB members must have adequate education and knowledge in the area of Sharia and Islamic banking to carry out their duties effectively (Salin et al., 2012). Supervising the Islamic banking industry requires Islamic law, economics, finance, and accounting practices. Moreover, SSB members with financial knowledge and experience are more effective in their performance than those without this ability (Rahman & Bukair, 2013).

The reality is that not all SSB members have accounting, banking, economic and financial expertise (Abdullah et al., 2014); thus, it can affect their credibility related to financial products and activities (Ginena & Hamid, 2015). However, the knowledge of SSB members in this field is beneficial for them in dealing with IBs problems. Several studies have shown that SSB members with expertise in accounting, finance, and Sharia law can improve the performance of IBs (Matoussi & Grassa, 2012; Grassa, 2015; Nomran et al., 2018). Therefore, based on the above reasoning, the following are proposed hypotheses:

H_{2a}: There is a positive relationship between SSB with expertise in finance or accounting and the performance of Islamic banks.

H_{2b}: There is a positive relationship between SSB with background academic in law, economics, *muamalah* education, and the performance of Islamic banks.

Good Corporate Governance and the Performance of Islamic Banks

GCG is a process of supervision and control to ensure that company management acts in line with the interests of shareholders (Parkinson, 1995; Solomon et al., 2002). Meanwhile, Syakhroza (2002) suggested that GCG is a system used by the board to direct, control, and supervise the management of organizational resources efficiently and effectively under the principles of transparency, accountability, responsibility, independence, and fairness.



GCG practices are more unique in the banking industry than in other sectors. In general, the GCG mechanism aligns shareholders and managers, but in banking, managers manage and secure funds provided by various parties, including depositors (Darmadi, 2013). Sharia GCG assures sharia compliance (Elamer et al., 2020), which is carried out by the Sharia Supervisory Board (SSB) (Alnasser & Muhammed, 2012). SSB can advise the Board of Directors to ensure that operational activities are under sharia principles.

In agency theory, an effective SSB can reduce agency conflicts and information asymmetry between management and shareholders by providing valuable and independent oversight of sharia-compliant products and operations (Safieddine, 2009). Minimizing conflict will encourage healthier banking management, increasing the trust of shareholders, customers, and other stakeholders. Additionally, it leads to better performance improvements. It aligns with GCG objectives, namely to increase added value, improve financial performance, and better stakeholder perceptions of future performance (Maradita, 2014). Therefore, management must apply the principles of GCG to create an effective and efficient performance (Indra & Yustiavandana, 2008) to positively impact company performance (Riandi & Siregar, 2011).

Several previous studies have shown a positive relationship between GCG and the performance of Islamic banks. Ausat (2018) proved that GCG with board size and CEO duality affects the performance of Islamic banks. Helmi & Mulyany (2019) demonstrated that SSB and the Board of Directors, as representatives of Islamic GCG, affect the Islamic banks' performance. Darwanto & Chariri (2019) used SSB, Board of Directors, and Board of Commissioners for CG, which shows a positive influence on the performance of Islamic banks. Maulidar & Majid (2020) found that GCG, as measured by 11 indicators of Indonesian banks, has a positive effect on the Islamic banks' performance. Based on the various proxies for measuring corporate governance, GCG generally shows a positive relationship with IBs' performance. Therefore, the third hypothesis is as follows:

H₃: There is a positive relationship between good corporate governance and the performance of Islamic banks.



METHODOLOGY

Sample

This study uses a sample of all Islamic commercial banks in Indonesia from 2013 to 2019. Until 2019 there were 14 banks listed on the Financial Services Authority (OJK). The year 2013 was used as the initial period of observation because, since 2013, Islamic commercial banks' regulatory and supervisory functions have shifted from Bank Indonesia to OJK. The year 2019 is used as the final observation period because there has not been a Covid-19 pandemic crisis. Covid-19 pandemic becomes a factor outside the variables of this study, which possibly dominate the impact on the performance of Islamic banks. The total data are 98 banks based on panel data over seven years. Sharia bank annual report data is obtained from the website of each Islamic bank.

Measurement Variables

Measurement of the Islamic banks' performance in this study used Return on Assets (ROA) because it is considered the most common measure of company performance (Schendel et al., 1991; Alsartawi, 2019). Meanwhile, the independent variable used SSB and GCG characters. SSB character is mainly related to SSB educational qualifications and background. Academic qualifications use the number of Doctors (Nomran et al., 2018), whereas Professors are development variables in this study because previous researchers have not observed these variables. The educational background used the number of SSB members with finance or accounting backgrounds and law, economics, muamalah (Matoussi & Grassa, 2012; Grassa, 2015; Nomran et al., 2018). Furthermore, GCG used self-assessment analysis (Nugroho & Bararah, 2018). Overall measurement of independent, dependent, and control variables can be seen in Table 2.

Control Variables

The control variable is designed to control the company's characteristics that can affect the dependent variable. This study used firm size, leverage, and age variables as control variables. Firm size is in accordance with previous studies (Al-Saidi & Al-Sammari, 2013; Hadriche, 2015; Nomran et al., 2017; Alsartawi, 2019). Large Islamic banks can invest financial resources in various instruments to diversify risks based on sharia principles to offer products and services at lower costs and higher profits (Bukair & Rahman, 2015). Second,



leverage follows the study of Bukair & Rahman (2015) dan Alsartawi (2019). IBs with significant assets tend to use internal resources to finance their investments before using external funds. Therefore, IBs that have many assets and low debt will increase investment, which will impact their performance (Bukair, 2013). Third, firm age, the longer the age of the IBs, the more experience they have in managing the IBs (Aulia, Ibrahim, & Tarigan, 2020). Accordingly, their performance is getting better. Meanwhile, the firm age measurement follows Matoussi & Grassa (2012), Hamza (2016), and Nomran et al. (2018).

Table 2. Measurement of Variables

Name of Variables	Operational	Measurement
Dependent Variables:		
IBs Performance	IBs Performance (ROA)	Net profit / total assets
Independent Variables:		
SSB Characters:		
DR	SSB members with Doctoral education	The proportion of Doctoral from SSB members
PROF	SSB members with the academic title Professor	The proportion of Professors from SSB members
FA	SSB members with expertise in finance or accounting	The proportion of SSB members with finance or accounting education
HEMA	SSB members with expertise in law/ sharia, economics including finance/ accounting, muamalah.	The proportion of SSB members having law education/ sharia, economics including finance/ accounting, muamalah.
GCG	GCG uses self-assessment analysis based on the provisions of 62 PBI No. 11/33/PBI/2009.	Using score: Excellent (rating 1) = 5; Very good (rank 2) = 4; Good (rank 3) = 3; Fair (rank 4) = 2; Poor (rank 5) = 1
Control Variables:		
LEV	Leverage	Total Debt / Total Assets
FSIZE	Firm Size	Ln of Total Assets
FAGE	Firm Age	Year _t – Year ₀

Model and Estimation

This study used a multiple regression model, which was developed to investigate the relationship between the characteristics of SSB education and GCG with the Islamic banks' performance. The following is the model used to test the hypotheses.



$$\text{Perf_IBS}_{i,t} = \beta_0 + \beta_1 \text{Char_E}_{i,t} + \beta_2 \text{GCG}_{i,t} + \beta_3 \text{Control}_{i,t} + \varepsilon_{i,t}$$

Where,

Perf_IBS_{i,t} = performance of Islamic banks *i* at time *t*;

Char_E_{i,t} = SSB character with qualifications and educational background (DR, PROF, FA, HEM) at IBs *i* at time *t*;

GCG_{i,t} = good corporate governance rating at IBs *i* at time *t*;

Control_{i,t} = LEV, FSIZE, FAGE at IBs *i* at time *t*;

ε_{i,t} = error term;

β₀ = constant;

β₁, β₂, β₃ = vectors of coefficient estimates.

RESULT AND DISCUSSION

Descriptive Statistics

The results of descriptive statistics for the variables are shown in Table 3. The dependent variable of the average ROA of Islamic banks is 1.12 percent, which ranges from -0.20 to 0.14 percent. This result is relatively low compared to conventional banks, 2.47 percent (OJK, 2019). Several studies in Indonesia show that Islamic banks' performance (ROA) is lower than conventional banks (Rosiana & Triaryati, 2016; Thayib et al., 2017; Rinawati & Santoso, 2019; Prihatin, 2019; Rachman et al., 2019). It might be caused by regulations that limit IBs, where high cash savings characterize IBs due to a more conservative investment decision-making approach (Alsartawi, 2019). Furthermore, the average number of SSB members with doctoral education (DR) is 51.7 percent, and Professor (PROF) 34.3 percent. The average number of SSB members with expertise in finance or accounting (FA) is 14.7 percent. In the fields of law, economics, muamalah (HEMA), the average is 43.3 percent.

Table 3. Descriptive Statistics

Variable	N	Min.	Max.	Mean	Std. dev
ROA	98	-0.20	0.14	0.0112	0.04139
DR	98	0.00	1.00	0.5167	0.29790
PROF	98	0.00	1.00	0.3432	0.35654
FA	98	0.00	0.50	0.1472	0.20083
HEMA	98	0.00	1.00	0.4332	0.33165
GCG	98	3.00	5.00	3.9694	0.59990
LEV	98	0.10	0.97	0.8255	0.15414



FSIZE	98	12.61	18.54	16.0704	1.24316
FAGE	98	0.00	27.00	8.8571	5.92043

Source: Processed data (2020)

In comparison, Islamic banks' GCG has a minimum score of 3 percent and a maximum of 5, with an average of 3.97. It explains that the assessment of governance or GCG of this Islamic bank is good.

Correlation

Table 4 presents the Pearson correlation coefficients between the independent variables. The highest correlation is between FSIZE and FAGE ($r = 0.670$), while the lowest correlation is between FSIZE and HEMA ($r = -0.003$). DR shows significant correlation with PROF, HEMA, FAGE ($\rho = 0.01$) and Lev ($\rho = 0.05$). PROF is significantly correlated with HEMA ($\rho = 0.01$). FA is significantly correlated with HEMA and FAGE ($\rho = 0.05$). LEV is significantly correlated with FSIZE and FAGE ($\rho = 0.01$). Subsequently, FSIZE is significantly correlated with FAGE ($\rho = 0.01$).

Table 4. Correlation Pearson

Independent Variable	DR	PROF	FA	HEMA	GCG	LEV	FSIZE	FAGE
DR	1							
PROF	0.695**	1						
FA	-0.072	-0.062	1					
HEMA	0.578**	0.492**	0.249*	1				
GCG	0.111	-0.038	0.153	0.030	1			
LEV	0.212*	0.174	-0.049	-0.053	-0.027	1		
FSIZE	0.096	-0.045	0.169	-0.003	0.067	0.478**	1	
FAGE	0.279**	0.107	0.206*	0.198	-0.085	0.275**	0.670**	1

* The correlation is significant at the 0.05 level (2-tailed), ** significant at the 0.01 level (2-tailed)

Source: Processed data (2020)

Based on table 4, no correlation coefficient exceeds 0.90; therefore, collinearity between variables is not a problem (Hair, 2009; Tabachnick et al., 2001). The multicollinearity and inflation variance (VIF) as the indicator of multicollinearity was checked to diagnose the collinearity problems. Based on table 5, there is no multicollinearity problem between variables because the VIF of the variables does not exceed 10 (Gujarati & Porter, 2009). Thus, all independent variables were included in the regression model.

Hypothesis Testing



Table 5 presents the regression analysis of the research model. These results indicate that the value is less than 5 percent. This finding statistically supports the significance of the regression model. Furthermore, the regression results show that PROF, HEMA, and GCG are significantly positively related to the performance of Islamic banks ($\rho = 0.05; 0.05; 0.01$) so that H1b, H2b, and H3 are supported. Meanwhile, DR and FA are negatively related to the performance of Islamic banks ($\rho = 0.01$), so that H1a and H2a are rejected.

This study found that SSB members who have the academic position of Professor (PROF) have a significant positive relationship with the performance of IBs (ROA). Professors are believed to have influence, fame, experience, and extensive knowledge so that they are able to supervise effectively, which has a positive impact on the IBs' performance. On the other hand, SSB members with Doctoral education (DR) are negatively related to the IBs' performance. This is in contrast to H1a, which is expected to have a positive relationship. This study is in accordance with Nomran et al. (2017) and Nomran et al. (2018) that Doctoral education qualifications are negatively related to Islamic banks in Malaysia and Indonesia.

Table 5. Multiple Regression

Variables	Beta	t-test	Significance	VIF
DR	-0.092	-4.492	0.000***	2.794
PROF	0.030	1.998	0.049**	2.127
FA	-0.056	-2.713	0.008***	1.289
HEMA	0.038	2.426	0.017**	1.896
GCG	0.023	3.483	0.001***	1.158
LEV	-0.033	-1.132	0.261	1.479
FSIZE	0.010	2.278	0.025**	2.437
FAGE	-0.001	-0.865	0.390	2.217
R^2	0.307			
F	4.939			
Sig (F)	0.000			

*Significant at 10%; **significant at 5%; ***significant at 1%

Source: data processed (2020)

According to Nomran et al. (2017), doctoral education is still important for SSB members, but certain education is required, such as law or sharia, economics, including finance or accounting, and muamalah. A study shows that SSB with a background in law or sharia, muamalah, economics, including finance or



accounting (HEMA), have a significant positive relationship with the performance of IBs. Meanwhile, SSB, which only has a finance or accounting (FA) background, does not have a positive relationship. From this finding, it is not enough for SSB to only know about finance or accounting. They must complement other fields, including Islamic law and economics. Rahman & Bukair (2013) demonstrated that SSB must have adequate knowledge and skills in banking, such as Islamic law, economics, finance, and accounting practices.

Furthermore, this study determines a significant positive relationship between GCG and the IBs' performance. Based on table 3, the average GCG is 3.97, or close to point 4 with a good score (see table 2). It indicates that if IBs are managed by implementing better GCG and sharia principles, the IBs' performance will be better, and vice versa. These results are consistent with the studies of Ausat (2018), Helmi & Mulyany (2019), Darwanto & Chariri (2019), and Maulidar & Majid (2020).

CONCLUSIONS

This study aims to investigate the relationship between SSB characteristics, particularly regarding the education of SSB members, and good corporate governance with the performance of Islamic banks. This study found that SSB members with the academic position of professor show a significant positive relationship with the IBs' performance. On the other hand, SSB members with doctoral education do not positively correlate with the IBs' performance. Furthermore, SSB members with a law or sharia educational background, economics including finance or accounting, and muamalah positively correlate with the IBs performance. On the other hand, SSB, which only has a finance or accounting background, does not positively affect the IBs' performance. Finally, good corporate governance (GCG) shows a significant positive relationship with the IBs' performance. In other words, the Islamic banks' performance improves if they are managed effectively and efficiently by the board of directors, commissioners, and SSB by implementing better GCG and sharia principles.

Based on these findings, it is suggested that SSB members should have adequate knowledge in banking, not only finance or accounting but also knowledge in the fields of law or sharia, economics, and muamalah. Thus, this knowledge can strengthen SSB's insight into supervising good corporate



governance, and sharia carried out by the board of directors and commissioners of IBs.

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