

The impact of Shari'ah and corporate governance on Islamic banks performance: evidence from Asia

Islamic banks
performance

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Abstract

Purpose – This study aims to investigate the impact of Shari'ah and corporate governance on Islamic banks performance in Asia.

Design/methodology/approach – The study uses hand collected data set on Shari'ah and corporate governance variables of 79 Islamic banks of 19 countries of Asia, for the period of 2011-2016. Augmented Mollah *et al.* (2017) composite corporate governance index into Islamic corporate governance (ICG) index by incorporate Shari'ah board's (SBs) attributes. Two types of statistical analysis were performed; descriptive statistics, sample *t*-test and panel random effects regression. The analysis was further sub-sampled by considering the supervisory vs advisory, GCC vs non-GCC and large vs small effects of Shari'ah and corporate boards on Islamic banks performance.

Findings – The results of the baseline model reveal that Shari'ah governance-related variables are more influential in determining the financial performance of the Islamic banks. The sub-sampled data findings illustrated some interesting facts. Shari'ah supervisory vs advisory boards regression results show that the ICG index was found significant in both the models. However, when SBs are weak the general board dominates in determining the performance. GCC vs non-GCC results show a relatively good governance in non-GCC countries. While, in case of large vs small Islamic banks, banks having high total assets demonstrates sound governance characteristics.

Research limitations/implications – Independent, large and educated SB can play a significant role in removing the hurdles facing the Islamic banking industry and can also enhance stakeholders' value.

Originality/value – This study enriches the understanding on Shari'ah governance, corporate governance and financial performance of Islamic banks in Asia.

Keywords Financial performance, Asia, Islamic banks, Corporate governance, Shari'ah board

Paper type Research paper

1. Introduction

Islamic corporate governance (ICG) has received much attention in the recent years. As, the occurrence of current financial crisis raised serious questions on the corporate governance practices of conventional banking (Demirguk-Kunt *et al.*, 2013; Bitar *et al.*, 2017; Mollah and Zaman, 2015). The unprecedented amount of losses born by the world leading financial institutions brought into spotlight the concerns regarding corporate fairness, transparency and accountability. In addition, the fast increase in the interest of individuals who are religious delicate, invest as per their personal beliefs and are more incline towards banks that are Shari'ah-compliant (Ashraf *et al.*, 2015; Al-malkawi and Pillai, 2018; Hidayat *et al.*, 2017). Islamic banking has emerged as an alternative to the conventional counterpart (Aebi *et al.*, 2012; Pathan and Faff, 2013; Abdel-Baki and Leone Sciabolazza, 2014). To ensure their



continuous compliance with Shari'ah laws, an additional board composed of Islamic experts in jurisprudence with enough knowledge of contemporary finance has emerged and known as Shari'ah board (SB). Accounting and auditing organization for Islamic financial institutions describes SB as: "an independent body of specialized jurists in *Fiqh-al-Muamalat* (Islamic commercial jurisprudence) to ensure that Islamic financial institutions are in compliance with Shari'ah principle" (AAOIFI, 2015). In theory, the role of SB involves providing *fatawas* (certification on newly developed financial products), conducting Shari'ah audit (to ensure that products are in line with Shari'ah laws), calculating zakat, disposal and distribution of Shari'ah non-compliance income and guide banks on its wider social role, acting as backbone of Islamic banking. Their ultimate goal is to preserve the credibility of Islamic financial industry and enhance the confidence of stakeholders in products and activities offered by Islamic banks.

SB is considered as the most important strategic body in Islamic banking. ICG has fundamentally the same objectives as conventional corporate governance; the incorporation of Shari'ah maxims and the originating *fiqh* (Islamic laws) standards renders ICG's scope more prohibitive about the religious, ethics and social contemplations of the Islamic banking business operations. What distinct the Islamic banking from its conventional counterparts is the governance structure of Islamic banking, which pursues Shari'ah compliant characteristics and has firmly guided by the SBs (Mollah *et al.*, 2017; Bukair and Abdul Rahman, 2015). According to Chapra and Ahmed (2002) stable and sound financial system depends upon organizations that maintain the stakeholders' confidence. In case of ICG their confidence is achieved by protecting the stakeholders' interest by showing fairness with clear transparency and accountability to all the people having any direct or indirect stakes.

Corporate governance commences and stops with the board of directors (BODs). Their structures, quality and other strategic aspects determine firms' successful operations and performance. The "multi-layer" governance of Islamic banks makes BODs' work more complicated. As, Islamic banking faces distinct governance challenges such as complex governance structures, Shari'ah-compliance issues, existence of the investment account holders (IAHs)/profit and loss sharing depositors (PLS depositors), less transparency and weaker market forces. Further awareness level relating to Islamic banking, its operations and its basic terminologies (use of Arabic words) is low among people that create more hurdles (Islam and Rahman, 2017) Shari'ah non-compliance risk along with other market risks makes study of corporate governance of Islamic banking more interested.

This study has comprehensively examined the impact of "multi-layer" corporate governance on firm performance in case of Asia. Specifically, the study has focussed on SB attributes of Shari'ah board size (SBS) and education but also considered corporate board characteristics of board size (BS), board independence (BI), board meetings (BM) and ownership structure. The selection of Asian countries has based upon their contributions, which is almost 80% of Islamic financial assets of the world (IFSB report, 2015). This study contributes into the Islamic finance literature by multiple ways:

- this study has used largest handpicked data set of 79 Islamic banks of 19 countries;
- the study has augmented the composite corporate governance index (CGI) constructed by Mollah *et al.* (2017) by incorporating five additional characteristics of SB; and
- the study empirically sub-sampled the data set into Shari'ah supervisory vs advisory effects on performance, GCC vs non-GCC effects and small vs large IBs effects on performance.

2. Literature review and formulation of hypotheses

Theoretically Islamic banks are adherent to social justice, their existence and functioning is different from the conventional counterparts. Islamic banks are supposed to follow the Islamic principles of “fair and just” earnings (i.e. PLS model), impartially distributing the earnings and prohibiting *riba* (interest). Therefore, to ensure the continuous compliance with these principles they put in place the SBs, as the backers and promoters of Islamic banking (Mollah and Zaman, 2015). In the Islamic banking literature many researchers compared the Islamic and conventional banks on the grounds of stability, efficiency, profitability and their business orientations to find out the differences and similarities among them (Hutapea and Kasri, 2010; Mollah and Karim, 2011; Wasiuzzaman and Gunasegavan, 2013; Grassa and Matoussi, 2015; Bitar *et al.*, 2017 Khan *et al.*, 2017 etc.). This study has exclusively focussed on the impact of distinct governance structure of Islamic banking on their performance.

2.1 Islamic corporate governance index

For measuring the effectiveness of SB, Ajili and Bouri (2018) incorporated four features of SB i.e. existence, size, experience and education in an index and found that its effect on performance is marginal. On the other hand, to find-out the accumulative effect of corporate governance-related items on firm performance Mollah *et al.* (2017) constructed a composite CGI based upon 12 board room characteristics using data of 52 Islamic banks and 104 conventional banks. The result of *t*-test shows that Islamic banks compared to conventional banks gain desirable CGI scores indicating that corporate governance structure of Islamic banks have relatively superior to their counterparts. Moreover, consistent with the study of (Cihak and Hesse, 2010) they also found that CGI of Islamic banks is positively affecting the Z-score, suggesting Islamic banks have underneath insolvency risk. They also found the effect of CGI on small and large banks and concluded that large banks are better capitalized to handle the risk. However, our study constructs an ICG index on 12 characteristics of boardroom and it is hypothesizing that:

H1. There is a positive association between ICG index and bank performance.

2.2 Shari'ah board size

Shari'ah governance, on which Islamic banking rests, is referred as the system that provides conformity for commercial transactions in all activities of Islamic banks. Their significance is procured from religious, social, economic and legal resources. Keeping in view the complexity of the working of SBs many authors found positive association between SBS and Islamic banks performance (Grassa and Matoussi, 2014; Khan *et al.*, 2018; Mollah and Zaman, 2015; Almutairi and Quttainah, 2017 and Nomran *et al.*, 2018). However, there are contradictory findings in the literature that support small size SBs and found them more efficient in developing consensus, reduce agency cost, better in communications and have good control and decision-making (Mollah and Zaman, 2015; Quttainah *et al.*, 2013). However, Hamza (2016) argued that large SBs involve members having different expertise and abilities related to the various schools of *fiqh*, therefore; large SB prompt a superior understanding of products and services leading towards the improved performance. Additionally, larger board having multiple experiences brings forth immediate review of corporate reporting (Amalina Wan Abdullah *et al.*, 2013).

H2. There is a positive association between large SBS and bank performance.

2.3 Shari'ah board education

Ownership over applicable information and aptitude empower the members to comprehend the nature and ramifications of submitted product(s) for certification, guidance and *fatawas*. Shari'ah understanding along with financial and accounting knowledge helps SB to be free for taking decision. [Kakabadse et al. \(2010\)](#) stated that important element that reflects the quality of board is their education. Therefore, education positively impacts the banks' performance ([Haniffa and Cooke, 2002](#); [Cheng et al., 2010](#)). Further, they enhance banks' competitiveness ([Gabrielsson and Huse, 2005](#)). According to [Musibah and Alfattani \(2014\)](#) highly qualified members of SB contribute towards higher profits in a recent study [Nomran et al. \(2018\)](#) found a very interesting result regarding SB education and firm performance. They found negatively significant effect of *SBE* on banks of Malaysia. In their detailed discussion of the results they realized that the variables they constructed for *SBE* was their Ph.D. degree holding in any subject, which is not perfectly related to the nature and scope of banking industry. They explained the result by describing that this result could change if the variable constructed by just taking in to account the Ph.D. degree in accounting or finance. [Khan and Khan \(2017\)](#) found that SB members having knowledge of accounting and finance in addition to the knowledge of Shari'ah is positively and significantly associated with the banks' performance. Indicating that profitability of banks is increased by SB members having background of accounting and finance. [Ghayad \(2008\)](#) and [Kolsi and Grassa \(2017\)](#) also find the similar results. Moreover, results of regression analysis revealed that SB members having education of business/economics are aware about the current issues hence; contribute towards improved performance ([Farook et al., 2011](#)).

H3. There is a positive association between *SBE* and bank performance.

2.4 Board size

In the context of Islamic banking for avoiding communication hurdles and improving performance, it is preferred to have reasonable size of board ([Ghayad, 2008](#)). According to [Andres and Vallelado \(2008\)](#) BS is expected to be large in case of banks because of the complexity of business, asymmetric information and changing behaviour of the market as it exercises better monitoring and advising. However, there are contradictory findings that supports smaller size boards have improved performance ([Adusei, 2011](#); [Belkhir, 2009](#)). Moreover, board having smaller size will give positive results and will increase the performance of the organization ([Malik and Makhdoom, 2016](#)). In case of Islamic banking no consensus have found regarding the BS and firm performance e.g. [Grassa and Matoussi \(2014\)](#), [Quttainah \(2013\)](#) and [Shahzad Bukhari et al. \(2013\)](#) found positive relationship between BS and performance and [Mollah and Zaman, \(2015\)](#), [Bukair and Rahman \(2015\)](#) found negative relationship, whereas [Grassa et al. \(2010\)](#) and [Juras and Hinson \(2008\)](#) found no association.

BS significantly defines the level that organizations are holding in terms of disclosure and transparency ([Hussain and Mallin, 2003](#)). As it is argued that the level of disclosure is increased with the increase of BS ([Hussain and Mallin, 2003](#)).

H4. There is a positive association between large BS and bank performance.

2.5 Board independence

BODs referred as the body that significantly upholds the interest of all the stakeholders involved. To gain and further strengthen of stakeholders' interest, it is important to take

executive as well as non-executive members on the board. However, it is argued that non-executive directors should be able to perform their assigned tasks effectively when they are working as independent board members; otherwise they will not be able to yield and impart unbiased decisions (Fuji *et al.*, 2016; Andres and Vallelado, 2008). Shareholders are represented on the board by independent directors that help to mitigate and overcome the agency issues. Additionally, it is suggested by the code of corporate governance and other key regulators to have independent directors on the board so that the functioning of the board becomes effective.

Independent directors have fewer conflicts of interest while performing their duties of monitoring, advising and to avoiding conflict of interest with the regulator. Hence, a positive link between the independent directors and bank value is expected. Owning independent members not only contributes towards improved performance rather more appropriate and well-advised governance (Fuji *et al.*, 2016; Malik and Makhdoom, 2016; O'Connor and Byrne, 2015). There is a positive association between BI and banks performance (Fuji *et al.*, 2016; Bukair and Rahman, 2015; Quttainah, 2013; Shahzad Bukhari *et al.*, 2013).

H5. There is a positive association between independent directors and bank performance.

2.6 Board activities

The frequency of BM is most important to understand the working of the board. High frequency of meetings gives the board members the opportunity to meet, resolve the outstanding issues, exchange ideas and give productive advices to the management (Vafeas, 1999). Frequencies of the BM signal both proactive and reactive meanings. However, regular meetings are not good for firm as it will put negative effect on the firm and decrease the performance of the company (Malik and Makhdoom, 2016; Mayur and Saravanan, 2017). We hypothesized the relationship between board activities and firm performance as follow:

H6. There is a positive association between BM and bank performance.

2.7 Ownership structure

To examine the relationship between ownership structure and performance, especially to identify the block holders, which are institutional, family, foreign and state, Ben SlamaZouari and BoulilaTaktak (2014) found that banks having institutional and foreign shareholders have negative relationship consistent with the study of (Al-Saidi and Al-Shammari, 2013). On the other hand, positive relationship between ownership structure and Islamic banks performance has been found by (Juras and Hinson, 2008; Al-Saidi and Al-Shammari, 2013) However, Rachdi and Ameer (2011) and Belkhir (2009) found no bond at all.

H7. There is a positive association between ownership structure and bank performance.

3. Data and methodology

This study uses unique hand collected data set on corporate governance variables. It is the largest handpicked data set on Islamic banking in Asia. The selection of Asian countries has based upon their contributions, which is almost 80% of Islamic financial assets of the world (IFSB report, 2015). Corporate governance variables information could readily be available

from data bases such as Bankscope, Bloomberg, Thomson and router. However, because of the missing values and accuracy issues, this study prefers to use hand collected data, which was though a tedious task to conduct. As many Islamic banks' reports were not on standardized format, annual reports format has even changed within the banks and country. Secondly, a few Islamic banks' are publishing their annual reports in their native languages. Thirdly, the web links of many Islamic banks were inactive as reported in the directories of their central banks. Fourthly, as annual reports are considered the most accurate and genuine documents to collect information, but in many cases of Middle and Central Asia publish only financial statements, which do not contained corporate governance-related information.

Initially all the countries of Asia were taken as sample, where Islamic banking operations exist. However, due to the non-availability of corporate governance-related data the final sample of the study consists of 79 Islamic banks from 19 countries, which make 553 firms-year observations. The banks of our sample come from Bahrain, Bangladesh, Brunei, Indonesia, Jordan, Kuwait, Lebanon, Malaysia, Maldives, Oman, Pakistan, Qatar, Saudi Arabia, Sri Lanka, Syria, Thailand, Turkey, United Arab Emirates and Yemen for the periods 2010 to 2016. Table 1 shows the list of countries, number of banks and percentage of observation from each country.

3.1 Variables

To analyse the impact of Shari'ah supervision on firm performance we applied panel random effects model (REM). as, the nature and extend of corporate governance-related variables do not change frequently (Mollah *et al.*, 2017; Mollah and Zaman, 2015; Pathan, 2009). REM is a best technique to examine the relationship. Three performance measures were used as dependent variable, namely, return on Assets (ROA), return on equity (ROE)

Countries	Islamic banks	Observations	(%)
Bahrain	6	42	7.59
Bangladesh	4	28	5.06
Brunei	1	7	1.27
Indonesia	12	84	15.19
Jordan	3	21	3.79
Kuwait	5	35	6.33
Lebanon	4	28	5.06
Malaysia	13	91	16.46
Maldives	1	7	1.27
Oman	2	14	2.53
Pakistan	5	35	6.33
Qatar	4	28	5.06
Saudi Arabia	4	28	5.06
Sri Lanka	1	7	1.27
Syria	3	21	3.79
Thailand	1	7	1.27
Turkey	2	14	2.53
United Arab Emirates	6	42	7.59
Yemen	2	14	2.53
<i>Total</i>	<i>79</i>	<i>553</i>	<i>100</i>

Table 1.
Sample distribution

Notes: Table 1 provides country-wise distribution of the banks, observations and percentage share of each country. The study considers 79 Islamic banks in 19 countries for the period from 2010 to 2016

and Tobin's Q. These ratios were widely used in previous studies (such as [Musibah and Alfattani, 2014](#); [Nomran et al., 2018](#); [Grassa and Matoussi, 2014](#)).

This study uses both the market and accounting-based measures to investigate the impact of Shari'ah supervision and corporate governance on bank performance. Consistent with the study of [Hutchinson and Gul \(2004\)](#), [Gani and Jermias \(2006\)](#), [Andres and Vallelado \(2008\)](#), [Abdel-Baki and Leone Sciabolazza \(2014\)](#), [Mollah and Zaman \(2015\)](#) and [Mollah et al. \(2017\)](#) this study uses ROA and ROE as accounting-based measures. Where market-based measure Tobin's Q is used consistent with the study of [Yermack \(1996\)](#), [Weir et al. \(2002\)](#), [Andres and Vallelado \(2008\)](#), [Abdel-Baki and Leone Sciabolazza \(2014\)](#), [Mollah and Zaman \(2015\)](#) and [Mollah et al. \(2017\)](#). It reflects the true picture towards the market performance as it includes the tangible and intangibles assets ([Pathan and Faff, 2013](#)).

The ICG index is constructed based on 12 boardroom characteristics. Our index though nestled upon the work of [Mollah et al. \(2017\)](#) but also considers five SB attributes that were not incorporate by them. The 12 characteristics are:

- (1) BS; coded one if the BS is smaller than the median value of the BS, zero otherwise.
- (2) Independent directors; coded one if the BI is larger than the median value of BI, zero otherwise.
- (3) Female director; coded one for female directorship on the board, zero otherwise.
- (4) BM; coded one if the BM are larger than the median value of the BM held in a year, zero otherwise.
- (5) Board attendance; coded one if the board attendance is larger than 75% of BM held in a year, otherwise zero.
- (6) Board committees; coded one if the number of board committees are larger than the median value of board committees, zero otherwise.
- (7) CEO chair; coded one if the chairman and CEO is not the same person, zero otherwise.
- (8) SBS; coded one if the SB size is smaller than the median value of the SB size, zero otherwise.
- (9) Female member of the SB; coded one if female member exists in SB, zero otherwise.
- (10) SB supervisory/advisory; coded one for supervisory role, zero otherwise.
- (11) Shari'ah BM; coded one if the SB meetings are larger than the median value of the SB meetings held in a year, zero otherwise.
- (12) SBE; coded one if the SB members have knowledge of accounting, finance, economics and commerce, zero otherwise.

We found in the existing literature a set of control variables significantly affecting bank performance. In line with the literature, this study have used three company specific control variables that includes:

- (1) Z score that measures the distance to default and is widely used in literature to check the stability of a firm ([Mollah et al., 2017](#); [Mollah and Zaman, 2015](#));
- (2) Equity to total assets (EQTA) is a level of protection affordable to the bank by equity; and
- (3) (3) Net loans to total assets (NLTA) an indicator of the proportion of assets that are tied up in loans.

The details of all variables include independent variables, control variables and dependent variables are given in [Table 2](#).

3.2 Model

To analyse the impact of Shari'ah and corporate governance on Islamic banks performance, we have applied panel REM as statistical technique to estimate the proposed model. As, the nature and extend of corporate governance-related variables do not change frequently ([Mollah et al., 2017](#); [Mollah and Zaman, 2015](#); [Pathan, 2009](#)). REM is a best technique to examine the relationship.

$$performance_{it} = \beta_0 + \beta_1 ICG_{it} + \beta_4 X_{it} + e_{it} \quad (1)$$

$$performance_{it} = \beta_0 + \beta_1 ICG_{it} + \beta_2 SB_{it} + \beta_3 X_{it} + e_{it} \quad (2)$$

$$performance_{it} = \beta_0 + \beta_1 ICG_{it} + \beta_2 SB_{it} + \beta_3 CG_{it} + \beta_3 X_{it} + e_{it} \quad (3)$$

Where, i go from bank 1 to bank 79 and t takes the values of the years from 2010 to 2016. β parameters are estimated coefficients for each of the explanatory variables. ICG_{it} is the CGI index of Islamic banks, SB_{it} is the matrix of Shari'ah governance variables such as SBS and SBE , CG_{it} represents matrix of board structure variables such as BS , BM and independent directors and X_{it} is the matrix of control variables. Then, e_{it} is the error term. While, bank performance is measured using accounting measures such as ROA_{it} , ROE_{it} and market measure such as Tobins' Q_{it} .

4. Results and discussion

4.1 Descriptive statistics

[Table 3](#) presents the descriptive statistics of the variables used in this study. The level of ICG index is average around 50% with the minimum value of 17% and maximum value of 92%, respectively. The comparison of the ICG index between the GCC and non-GCC countries found negatively significant, which means that non-GCC countries have better corporate governance relative to the GCC countries. The performance variables used in the analysis are ROA , ROE and Tobins' Q having mean value of 0.95%, 7.4% and 10%, respectively. The minimum values of performance variables are negative that reflects crisis period effects as the data set of the country starts from 2010, which is the initial period of recovery from global financial crisis. The comparison of GCC and non-GCC countries of the performance variables shows that non-GCC countries perform relatively better than GCC countries.

The SB structure variables statistics are telling us an interesting story. SBS was found four members on average with the minimum value of 1 and maximum 13. A deep look into the SBS shows that the countries in South Asia have larger SB membership on average and a few of the banks of Bangladesh inflate the overall average of South Asian countries, for example, Islami bank of Bangladesh have on average 13 members in the board. While, the rest of the banks analysed have on average three to five members. The comparison of GCC and non-GCC countries SBS shows that the non-GCC countries have more SB members on average than GCC. SB members university education of finance-related is 94% with the minimum value of 0 and maximum value of 75% in case of Hong Leong IB Malaysia. The comparison of GCC and non-GCC countries SB members university education of finance-related shows that SB members of non-GCC countries have more knowledge of accounting

Variables	Abbreviations	Definitions and coding
<i>Independent variables</i>		
<i>ICG index</i>	ICG index	Index is constructed based on 12 boardroom characteristics
<i>SBS</i>	SBS	Total members of SB
<i>SBE</i>	SBE	Percentage of the members of SB having university degree/certificate of accounting, finance, economics and commerce
<i>SB role as supervisory/advisory</i>	SB S/A	Dummy variable set equal to 1 if the SB has a supervisory role, 0 otherwise
<i>BS</i>	BS	Total members of the BODs
<i>BI</i>	BI	Proportion of independent non-executives on the board
<i>BM</i>	BM	Number of meetings held by the board during a year
<i>Institutional block holders</i>	IO	Percentage of institutional block holding i.e. block holders of 5% ownership level
<i>Control variables</i>		
<i>Z Score</i>	Z Score	Z-score measures the distance to default. In addition, has estimated as, ROA plus capital to assets ratio divided by SD of ROA
<i>EQTA</i>	EQTA	EQTA is a measure of level of protection afforded to the bank by the equity
<i>NLTA</i>	NLTA	NLTA are an indicator of the proportion of assets that are tied up in loans
<i>Dependent variables</i>		
<i>ROA</i>	ROA	Net profit to total assets
<i>ROE</i>	ROE	Net profit to total equity
<i>Tobins' Q</i>	Tobins' Q	Market value of equity plus book value of liabilities divided by book value of assets

Table 2.
Description of variables

and finance as compared to GCC countries. On average 66% of IBs were found having supervisory role of SB. Majority of banks fall in GCC countries.

BS was found eight members on average with the minimum value of 3 as in the case of Mega Bank Syariah Indonesia and maximum value of 20 as in case of Islamic bank of Bangladesh. The comparison of GCC and non-GCC countries BS shows that the two regions are not different in terms of BS. BOD independence was found 43% with the minimum value of 0 in case of Meezan bank of Pakistan and maximum value of 91% in case of Bank Al Salam Bahrain, which shows that GCC countries have more independent directors. However, the comparison of GCC and non-GCC countries BI shows the same level of independence. Average BM were found around 6% with the minimum 3 meetings in a year and maximum 52 meetings held in case of bank Syariah BRI Indonesia.

Majority of the ownership of Islamic banks in Asia is institutional ownership (IO) and the difference between GCC and non-GCC was negatively significant, which means that non-GCC countries have more IO than the GCC countries. A deeper analysis of the ownership structure shows that IO of the non-GCC countries is acquired by the petrol rich GCC countries institutions.

4.2 Regression results

Tables 4 and 5 presents the empirical results of the study. For empirical estimation we have adopted an incremental methodology, starting from the impact of ICG index, then adding SB attributes and finally board characteristics on performance variables for all the three dependent variables as proposed in Section 3.2 model of the study. While, Table 5 estimated

Table 3.
Descriptive statistics

	N	Full sample			Max.	Skew.	Kurt.	Pl	P99	GGC		Non-GCC		Sample t-test
		Mean	S.D.	Min.						sample mean	sample mean	sample mean	t-test	
ROA	513	0.0095	0.0937	-0.90	1.3	1.0912	110.58	-0.1062	0.0737	-0.0061	0.0117	0.0117	-2.0312**	
ROE	513	0.0745	0.0979	-0.39	0.5798	-0.2843	6.9233	-0.2339	0.326	0.0670	0.7823	0.7823	-1.2121	
Tobins'Q	457	1.0116	0.6752	0.1235	10.02	6.5657	75.663	0.2602	3.71	0.9332	1.0568	1.0568	-1.8898**	
ICG index	536	0.4861	0.1491	0.17	0.92	-0.2956	2.5338	0.17	0.83	0.4259	0.5463	0.5463	-9.4811***	
SBS	534	4	1.5581	1	13	1.8497	10.879	1	10	3.9820	4.0530	4.0530	-1.1229	
SBE	536	0.0845	0.1607	0	0.75	1.5709	4.6952	0	0.67	0.0563	0.1128	0.1128	-3.8701***	
SB supervisory/advisory (SBS/A)	531	0.6365	0.4814	0	1	-0.5677	1.3223	0	1	0.5284	0.6901	0.6901	-3.6869***	
BS	531	8.3822	2.8613	3	20	1.1005	5.6105	4	20	8.9942	8.0865	8.0865	3.4610***	
BI	531	0.4315	0.2392	0	0.91	-0.2494	2.4611	0	0.9	0.4543	0.4205	0.4205	1.5305*	
BM	441	8.8072	5.5874	3	52	2.6028	13.9068	4	30	6.9302	9.5833	9.5833	-4.6409***	
Institutional block holders (IO)	528	63.2015	21.3191	5.33	100	-0.2162	1.7604	7.62	100	56.5984	66.5027	66.5027	-3.7013***	
EQTA	513	0.1918	0.6072	-0.2038	13.14	19.1291	405.05	0	1.4845	0.1709	0.2019	0.2019	-0.5415	
NLTA	509	0.6882	3.8240	-0.8376	84.8742	21.138	463.749	0	2.7204	1.2965	0.3938	0.3938	2.5095***	
Z-score	514	2.3314	5.1017	-10.962	80.0598	9.2062	123.854	-1.6792	14.3777	1.5327	2.7158	2.7158	-2.4745***	
Log-TA	513	7.5188	1.1441	4.4428	11.4795	1.0630	5.1513	5.2857	11.1178	7.1426	7.7004	7.7004	-5.3095***	

Notes: *Significant at 10%; **Significant at 5%; ***Significant at 1%

Variables	ROA			ROE			Tobins' Q		
	1	2	3	1	2	3	1	2	3
<i>ICG index</i>	0.0598 (0.0546)	0.0475 (0.0384)	0.0548 (0.0518)	0.0708 (0.0576)	0.0007 (-0.0064)	0.0446*** (0.0073)	0.0362*** (0.0117)	0.3180** (0.1355)	0.3554 (0.3127)
<i>SBS</i>		0.0029 (0.0029)	0.0027 (0.0037)		0.0088*** (0.0030)	0.0069* (0.0040)		0.0328* (0.0185)	0.0331 (0.0401)
<i>SBE</i>		0.0256*** (0.0081)	0.1719*** (0.0417)		-0.0064 (0.0319)	0.0090 (0.0236)		0.1125 (0.1902)	0.0039 (0.0239)
<i>BS</i>			-0.0363 (0.1051)			0.0028 (0.0050)			0.7003*** (0.0604)
<i>BI</i>			-0.0612 (0.1320)			0.2343 (0.1541)			0.0683 (0.2106)
<i>BSID</i>			0.0019 (0.1459)			0.2910** (0.1154)			0.0116 (0.1011)
<i>BM</i>			0.0004 (0.0009)			-0.0011 (0.0011)			3.6334 (2.9546)
<i>IO</i>			0.4629 (0.2968)			0.0166 (0.0374)			-0.0018 (0.0016)
<i>Z Score</i>	0.0950* (0.0598)	0.0672 (0.0454)	0.0893 (0.0559)	-0.0002 (0.0081)	-0.0030 (0.0085)	0.0032 (0.0103)	0.0661 (0.0445)	0.2375** (0.1145)	0.3199* (0.1915)
<i>EGTA</i>	0.0066 (0.0038)	0.0019 (0.0023)	-0.0169 (0.0184)	0.0044 (0.0038)	0.0032 (0.0038)	-0.0688*** (0.0272)	0.0031 (0.0021)	0.0447 (0.0311)	0.7575 (0.4786)
<i>NLTA</i>	0.0001 (0.0006)	0.0003 (0.0005)	0.0001 (31.100)	0.0006 (0.0006)	0.0006 (0.0040)	0.0014 (0.0013)	0.0043 (0.0051)	0.0073*** (0.0006)	0.0053** (0.0022)
<i>LnTA</i>	0.0245 (0.0161)	0.0033 (0.0067)	0.0035 (0.0058)	0.0145** (0.0072)	0.0133* (0.0071)	0.0142* (0.0075)	0.0028 (0.0069)	0.1692 (0.8000)	0.2088* (0.1251)
<i>Constant</i>	-0.1605 (0.1128)	-0.0213 (0.0489)	0.0032 (0.1077)	-0.0339 (0.0571)	-0.0631 (0.0582)	-0.0216 (0.0804)	0.0086 (0.0487)	2.0830*** (0.7187)	0.0029* (0.0018)
<i>Observations</i>	502	499	411	502	499	380	502	451	375
<i>Overall R²</i>	0.14	0.18	0.56	0.22	0.16	0.14	0.29	0.28	0.32
<i>Wald X²</i>	7.38 (0.0000)	5.63 (0.6891)	21.93 (0.0801)	124.45 (0.0000)	140.87 (0.0000)	71.42 (0.0000)	2.90 (0.007)	186.68 (0.0000)	86.23 (0.0000)

Notes: Table 4 presents the results of baseline model for the Shaif'ah and corporate boards effects on performance for the period of 2010-2016. The standard errors are in parentheses. *Significant at 10%; **Significant at 5%; ***Significant at 1%.

Table 4. Baseline model (panel random effects regression results)

Table 5.
Panel random effects
regression results
(supervisory/
advisory, GCC/non-
GCC and large/small;
with the dependent
variable of tobin's Q)

Variables	Supervisory/advisory		GCC/non-GCC		Large/small	
	1	2	1	2	1	2
<i>ICG index</i>	0.0994** (0.0504)	0.0525*** (0.0072)	0.2449 (0.3688)	0.7533*** (0.2539)	0.2346* (0.1294)	0.70298 (0.4615)
<i>SBS</i>	-0.0016 (0.0035)	0.0151** (0.0062)	0.1277 (0.0868)	0.0900 (0.0605)	0.0535 (0.0466)	-0.0405 (0.0558)
<i>SBE</i>	0.0701* (0.0404)	0.0003 (0.0448)	1.7221** (0.7150)	0.2152 (0.4686)	0.1300 (0.2897)	-0.3102 (0.3658)
<i>BS</i>	0.0046 (0.0058)	-0.0493 (0.1619)	-0.9605 (2.1514)	1.9808** (1.0244)	1.9893* (1.1601)	3.3663 (3.3081)
<i>BI</i>	0.0425 (0.1478)	-0.1405 (0.2618)	-2.1129 (3.2256)	3.2803 (2.2192)	3.6690** (1.7724)	2.8762 (3.8121)
<i>BSID</i>	-0.1293 (0.1537)	0.1417 (0.3076)	2.7964 (3.6941)	-2.8787 (2.4205)	-3.7656* (1.9203)	-3.4407 (4.2334)
<i>BM</i>	0.0007 (0.0011)	0.1472 (0.0934)	-0.0213 (0.0191)	0.0031 (0.0170)	0.4629 (0.2968)	0.0126 (0.0114)
<i>IO</i>	0.0052*** (0.0006)	0.0010 (0.0790)	0.0010 (0.0790)	0.0114 (0.0652)	-0.0734 (0.0567)	0.0128 (0.0649)
<i>Z Score</i>	0.1079 (0.0764)	-0.0670*** (0.0204)	1.0086*** (0.3588)	-0.0852 (0.1590)	0.3142* (0.1693)	0.1145 (0.1755)
<i>EQTA</i>	0.0006 (0.0181)	0.1670** (0.0792)	-1.4874** (0.6928)	-1.6394*** (0.2837)	-0.0352*** (0.0117)	-1.0104 (0.9222)
<i>NLTA</i>	-0.0345 (0.0001)	0.0003 (0.0036)	-0.0042*** (0.0009)	0.3081 (0.3062)	-0.0064*** (0.0004)	0.2754 (0.2237)
<i>LnTA</i>	0.0068 (0.0113)	-0.0662*** (0.0236)	-0.6630 (0.5402)	-0.8467*** (0.1193)	-0.0661 (0.0682)	-0.3523 (0.24463)
<i>Constant</i>	-0.0546 (0.1087)	1.4124*** (0.2207)	6.8920* (3.9582)	6.1457*** (1.5704)	-0.8281 (1.2728)	0.6756 (0.9959)
<i>Observations</i>	261	257	125	257	234	219
<i>Overall R²</i>	0.21	0.36	0.59	0.41	0.50	0.67
<i>Wald X²</i>	19.08 (0.1620)	9.08 (0.0000)	8.73 (0.0000)	6.23 (0.0000)	9.53 (0.0000)	7.33 (0.0000)

Notes: Standard errors are in parentheses. * Significant at 10%; significant at 5%; ***Significant at 1%

equation (3) of the model for comparison of Shari'ah supervisory vs advisory, GCC vs non-GCC and large vs small using Tobin's Q as dependent variable.

4.2.1 Estimation results of baseline model. The baseline model estimation takes into consideration the whole sample of the study. Table 4 presents the results of the baseline model and shows that ICG index is found significant for Tobin's Q and ROE, while ICG index was found insignificant with ROA. The result of our estimation was found consistent with the study of (Mollah *et al.*, 2017). ICG index results reveals that CG structure of IBs is relatively superior and is better capitalized to handle the risk. Hence, *H1* is accepted.

SBS is found positively significant in case of ROE however; were insignificant in case of ROA and Tobin's. The significance of the SBS was consistent with the work of (Mollah and Zaman, 2015; Quttainah *et al.*, 2013), which illustrates that the larger SBS is influential in enhancing the overall financial performance of the IBs. The larger SBS having diverse experience and expertise could be more beneficial for value enhancing of the firm. As, the complexity of the work of the SB is high as they not only take care of the Shari'ah compliance of the newly developed products and services but also involve in Shari'ah audit, disposal and distribution of income to IAHS and answered the issues and quarries raised by the stakeholders and general public at large. Keeping in view the rapid growth of IBs and its initial stage into the banking business, as majority of the IBs have age less than 10 years, the larger SBS could be required to handle all these challenges especially the challenge of immature *fatawas* that could cause products withdrawals and Shari'ah non adherence that lead to customer mistreat on IBs. Thus, *H2* is accepted. SBE is found significant in case of ROA and consistent with the study of (Cheng *et al.*, 2010; Farook *et al.*, 2011; Ghayad, 2008; Kolsi and Grassa, 2017; Khan and Khan, 2017; Musibah and Alfattani, 2014), which shows that knowledge of university education in addition to knowledge of Shari'ah of the members of the SB have a positive impact on banks' performance. As they could be able to understand complicated financial products designs submitted for providing *fatawas* with more confidence and clarity by understanding its future implications. An additional benefit of SB university education is that they cannot be deceived or cheated by the banks' staff and been able to give their independent opinion. However, SBE was not found significant in case of two other performance variables i.e. ROA and Tobin's Q, which is consistent with the work of (Nomran *et al.*, 2018). Thus, *H3* is accepted if we consider the accounting base bank performance criteria otherwise rejected.

Keeping in view the complexity of banking business relatively larger BS is the common practice in the industry. After the financial global crisis of 2007-2008 not only the BS matters but also its independence is more pushed by the regulators. The result reveals that the interaction term of BS and independence (BSID) was found insignificant, which may reflect that, as both BS and BI individually were not found significant, their interaction has also been ineffective to influence performance. Thus, rejects our *H4* and *H5*. The BM variable was found insignificant, which is consistent with the studies of (Khan and Khan, 2017; Malik and Makhdoom, 2016; Mayur and Saravanan, 2017). This could imply that more frequent meetings may have negative effect on financial performance as they signal reactive. Thus, *H6* is also rejected. The ownership structure was measure through IO and variable was found insignificant, rejecting *H8*. Concentrated IO structure as being already exist in case of Islamic banking is negatively impacting the performance of firms, more diffused ownership structure could benefit as in case of the conventional banking system. The result of our study was consistent to the work of (Ben SlamaZouari and BoulilaTaktak, 2014) pointed out that IO effect the performance negatively. The overall results reveal that in case of Islamic banking existence of SB overshadows the influence of conventional governance structure.

The results of the control variables like EQTA is a measure of the level of protection afforded to the banks by the equity was found significant only in case of ROE while the NLTA, which is the measure of protection of assets that are tied up in loans was significant in case of Tobin's Q. Throughout Z-score, which is a measure of the stability of the firm was consistently found significant in the final equation of baseline model, which shows that the more stable firms been able to perform better.

The overall sample of the study is divided into sub samples such as supervisory vs advisory, GCC vs non-GCC, large vs small to access a deep understanding of the corporate governance impact on banks' performance.

4.2.2 Estimation results of supervisory/advisory, GCC vs non-GCC and large vs small. Table 5 reports the results of the supervisory vs advisory role of the SB, GCC vs non-GCC and large vs small IBs and their impact on bank performance. As descriptive statistics shows that majority of the Shari'ah governance structure follows supervisory mode. Model 1 of Table 5 shows the results of SB supervisory. ICG index was found significant and positive. The SB variables such as SBS and SBE were also found significant. However, the level of significance has increased compared to the baseline model. One contradictory result compare to the baseline model is the negative sign of the BS and insignificant BI, which may be interpreted as that in case of supervisory role of the SB, the general characteristics of the corporate governance were influence the firm performance marginally. These results are consistent with the findings of (Mollah and Zaman, 2015; Mollah *et al.*, 2017). Model 2 reports the results of the advisory role of the SB and its impact on banks' performance. The results of the ICG index were also found significant indicating that SB existence matters not nature.

The logic behind dividing data set into GCC and non-GCC division was that majority of the Islamic banks were in GCC countries and in majority of the GCC countries they enjoy no competitors. Secondly, GCCs' Islamic banks were owned by the companies or individuals were also owned the major shares of the Islamic banks of non-GCC countries. Thirdly, majority of the GCC Islamic banks are fall into the category of large banks as they hold the largest assets of the Islamic financial assets. Models 3 and 4 demonstrate the results of the estimation of Shari'ah governance effect on performance regarding GCC and non-GCC, respectively. Model 3 reports that ICG Index was found positively significant in case of ROE. Among the Shari'ah variables SBE was insignificant as the same is indicated by the sample t-test as the mean of SBE of the GCC countries shows that only the 5% of the members of the Islamic banks are university educated. For non-GCC countries ICG is found more powerful and influential in determining the value of the firm and SBS was positively significant but the SBE was found insignificant. The GCC and non-GCC comparison of the corporate governance variables shows an interesting picture that CG variables in case of both regions were found insignificant except ownership structure. As majority owners of the both regions banks are the same institutions. Therefore, their impact on financial performance was found significant. As for the control variables Z-score was found consistently insignificant in case of GCC countries while the same was significant in case of non-GCC countries, which is consistent with the figures of the descriptive statistics. As, the sample t-test value is negatively significant in case of Z-score indicating that non-GCC Islamic banks were more stable.

The whole sample is further divided into the large and small IBs. The division between the small and large Islamic banks was based on their total assets. Those Islamic banks whose total assets were larger than the average total assets of the sample were categorized as large IBs otherwise small. Then, it was observed that majority of the large Islamic banks located in GCC countries. Models 5 and 6 of Table 5 reports the results of the regression

analysis and it was found that large Islamic banks were more profitable and have sound corporate governance characteristics. Their Shari'ah governance structures were also found influential in determining financial performance having larger SBS and SBE as compared to the small size Islamic banks.

5. Conclusions

The main objective of this study was to examine that whether Shari'ah governance, which is the most inspired source of ICG and represents multi-layer governance mechanism, helps increase Islamic banks performance in Asia and creates stakeholder value. Despite rapid growth of Islamic finance over the past three decades, roles and the responsibilities of Shari'ah supervisors are unexplored and little has been known on these issues. Poor governance of Islamic banking may negatively impact their performance and stakeholders' value. This consideration has motivated us to explore the possible effects of Shari'ah and corporate boards on Islamic banks' performance of Asian countries. As they are the largest contributor into the world Islamic financial industry and their largest number is also exists in Asia mainly because most of the Muslim population lives in Asia. Our analysis of governance-performance nexus reveals that ICG index is low and statistically insignificant with performance. As, majority of the SBs have supervisory role and can veto any Shari'ah non-compliant products, processes or understandings etc., therefore their high monitoring ability is positively associated with Islamic banks performance and protects the interests of stakeholders. In addition, the existence of SB overshadows the impact of conventional corporate board in bank performance. Thus, we concluded that SB is an important body in case of Islamic banks that influence their performance.

Panel REM was applied to the data set and the results of the baseline model, which considered the whole sample, reveal that Shari'ah governance-related variables are more influential in determining the financial performance of the Islamic banks, while the corporate governance variables are not found that much effective. It could be drives from these results that in case of Islamic banks' performance Shari'ah governance-related factors are the significant determinants. The results of the sub-sampled analysis illustrate some interesting findings. The Shari'ah supervisory vs advisory board regression results show that the ICG index was found significant in both the models. The result of the ICG index in case of Shari'ah advisory board was found highly significant with a significant BS, which may implies that when the SB is weak the general board dominates in determining the performance. GCC vs non-GCC results reveals that ICG index was found significant in case of non-GCC with a significant BS indicating relatively good governance in non-GCC countries. In general, corporate governance variables were insignificant in case of both the regions. In case of large vs small, the large Islamic banks have sound corporate governance characteristics.

The findings of this study have imparted policy implications for regulatory bodies and financial institutions in Asia. As the focus of the ICG is "stakeholders-centric", sound Shari'ah governance is a pre-condition for the good health and protection of Islamic banking. Independent, large and diligent SB can play a significant role in removing the hurdles facing the Islamic banking industry especially in dual banking system and can enhance stakeholders' value. The future research can extend our findings by adding scholars' interviews, central banks regulations and demographic institutions to measure the independence and effectiveness governance mechanisms.

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Further reading

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