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Performance of Islamic banks

Do the frequency of Sharīʿah supervisory board meetings and independence matter?

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Abstract

Purpose – This paper aims to investigate the relationship between the composition of Sharīʿah supervisory boards (independence and frequency of meetings) and the performance of Islamic banks in the Gulf Cooperation Council (GCC) countries.

Design/methodology/approach – The study developed a multiple linear regression model, and data were collected from the annual reports of 48 standalone Islamic banks listed in the GCC countries covering the period between 2013 and 2017.

Findings – The results showed a statistically significant and negative relationship between the composition of the Sharīʿah supervisory boards and the performance of Islamic banks.

Research limitations/implications – As the current study used only one indicator, that is Return on Assets to measure performance, it is recommended to expand the framework of this study, through the addition of market-based performance indicators such as Tobin's Q.

Practical implications – This study recommends the GCC countries to follow a more proactive Sharīʿah governance model to strengthen their frameworks from both regulatory and non-regulatory aspects.

Originality/value – The study contributes to the Sharīʿah governance and Islamic banking literature relating to the GCC countries as previous studies gave no attention to the composition of Sharīʿah supervisory boards.

Keywords Sharīʿah governance, Sharīʿah supervisory board independence, Sharīʿah supervisory board frequency of meetings, Performance, Islamic banking

Paper type Research paper

Introduction

Despite the dire necessity of a proper corporate governance system, Islamic banks (IBs) have the responsibility to ensure compliance with the Sharīʿah (Islamic law) principles in their operations and practices. In conventional finance, the term "governance" normally refers to corporate governance; yet in Islamic finance "governance" could also refer to Sharīʿah governance. This means that IBs need to conform to both regulatory and Sharīʿah requirements depending on the type of bank (window, subsidiaries or standalone). Sharīʿah governance, which is exclusive to Islamic banks, can be defined as the processes and frameworks that assure compliance of business operations with the Sharīʿah so as to build

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the confidence of stakeholders and contribute to the financial stability and performance of the banks (Ismail *et al.*, 2016). This study refers to this unique system of governance implemented by IBs as the dual governance model.

The Sharīʿah supervisory board (SSB) is one of the most important governance mechanisms employed by IBs as a legitimate control body for ensuring compliance with the Sharīʿah; it has both supervisory and consultative responsibilities (Ahmed *et al.*, 2013). The main function of the SSB is to undertake independent audits and monitor (ex-post) the bank's operations and attest (ex-ante) that they are free from any actions that are prohibited by the Sharīʿah (Ahmed *et al.*, 2013). In the case of IBs, the board of directors (BODs) is subjected to the SSB's opinions and decisions (Musibah and Alfattani, 2014) as they are part of a bank's corporate governance mechanism framework (Grais and Pellegrini, 2006). As a result, effective SSBs should reflect the principles of corporate governance including independence and transparency. According to Mollah and Zaman (2015), SSBs provide an extra level of governance in addition to the BODs, thus modifying the governance structures of IBs from single-level governance structures as in conventional banks to multi-level governance structures.

Karim (1990), however, perceives SSBs as auditor units that usually act as internal control bodies, thus improving the credibility of IBs to investors and bolstering their Islamic credentials, leading to better performance. Similarly, Nomran *et al.* (2018) believes that by being Sharīʿah-compliant, banks can gain the trust and confidence of customers, especially Muslim customers, and ensure their loyalty, which in turn increases bank profitability and leads to higher market shares.

However, to be effective, members of the SSB must be both Sharīʿah scholars and financial experts, and this is a rare combination of expertise. As this combination of expertise is in high demand, many scholars sit on the SSBs of several banks simultaneously (Haniffa and Cooke, 2002; Nathan, 2010). This leads to an independency issue and gives rise to conflicts of interest among SSB members, as they are able to obtain exclusive and critical financial information from multiple banks (Grassa, 2016; Samra, 2016). Yet Grassa (2016) argues that this helps in attracting potential investors, thereby enhancing the productivity, efficiency and eventually the performance of IBs.

Understanding the attributes of SSBs and their influence on management decisions is a very critical research question in the literature. One of the main functions of the SSB is deciding whether to introduce a new financial instrument based on its compliance with Sharīʿah requirements (Warde, 1998). Another important function of SSBs is to issue opinions in final form when the BOD does not have a second opinion on the issue. Based on Banaga *et al.* (1994), SSBs have the power to disapprove all transactions and dealings which contradict Sharīʿah principles. As all these major decisions are in the hands of the SSB, it can be argued that Sharīʿah advisors have a profound impact on the performance of IBs since no one, not even managers, can override or disregard their decisions (BNM, 2010).

From a conventional banking point of view, several previous studies have focused on the relationship between board composition including board independence, and the frequency of annual board meetings, and firm performance (Baysinger *et al.*, 1991; Ntim *et al.*, 2017; Rashid, 2018). Nevertheless, based on Nomran *et al.* (2018), research on Sharīʿah supervision is almost negligible, especially with regards to the impact of Sharīʿah governance on the performance of IBs. As the effectiveness of SSBs has become a matter of concern for IBs across countries that have different regulatory environments, it would be interesting to investigate the relationship between the structure of SSBs and bank performance across different regulatory environments in the Gulf Cooperation Council (GCC) countries.

Therefore, this research paper aims to address the following questions: What is the level of SSB independence in IBs in the GCC? How many meetings are held annually by IBs in the GCC? Finally, what is the impact of the independence of SSBs and frequency of meetings on the performance of IBs in the GCC? Although a study by Nomran *et al.* (2018) was conducted to investigate this relationship, their study focused on Sharīʿah board size, Sharīʿah board qualification, Sharīʿah board reputation and change in its composition. This study, on the other hand, focuses on SSB independence and frequency of meetings. This adds a new contribution to the literature in the area of Islamic banking in the GCC.

The GCC region is the focus of this study for several reasons, mainly due to its unique environment in relation to the Islamic banking industry. The GCC is at the core of the Islamic world and it is thus expected that the GCC countries would be at the heart of the fast-growing Islamic finance industry, which includes retail and investment banking, insurance, and the issuance and trading of *ṣukūk* (Sharīʿah-compliant securities) (Wilson, 2009). In the GCC, Sharīʿah-compliant assets represent a large portion of the total banking assets (Basu *et al.*, 2018). Moreover, the GCC countries have adopted a set of standards including the corporate governance standards aimed at protecting the rights of investors and encouraging investment in various economic sectors, including the Islamic banking sector.

Moreover, as the economies of the GCC countries are characterized by family-owned businesses, poor investor protection policies and poor legal systems, it is an academic issue to examine SSB composition and its impact on the performance of IBs in the GCC due to the uniqueness of their dual governance model. This paper provides contributions to the literature from both practical and theoretical perspectives. From a practical perspective, it sheds more light on the relationship between the SSB composition and the performance of IBs with a unique focus on independence as well as frequency of meetings. This study could, therefore, provide guidelines regarding the appropriate number of independent directors and SSB meetings that will eventually result in reduced monitoring costs and improved profits. Consequently, this paper will prove quite useful to Islamic standard-setters (such as the Accounting and Auditing Organization for Islamic Financial Institutions, AAOIFI) and regulatory bodies in the GCC in establishing policies regarding SSB composition. Additionally, financial information on IBs will be useful to the GCC governments to assess the performance of such organizations.

From a theoretical perspective, the study contributes knowledge to the current literature by addressing fresh research questions and providing recent information on Sharīʿah governance and IBs. This research may form a basis for further studies in this field where it would contribute knowledge to future research. The results of this study can be applied to the Middle Eastern countries as well, as they share comparable economic, political and social environments.

The remainder of this paper is structured as follows. The next section provides a review of relevant literature and hypotheses. It is then followed by an elucidation of the model used in this study and description of the research design. The results are presented in the following section. The summary and conclusion are provided in the last section.

Literature review

Islamic banking is perceived as an alternative to conventional banking and has been attracting the attention of many researchers and investors in the last decades. The existing framework of Islamic banking is implemented differently across countries with diverse practices and models of Sharīʿah governance. For example, while some countries prefer greater involvement of the regulatory authorities (e.g. Malaysia), others prefer only slight intervention (e.g. the GCC countries) (Hasan, 2011). Sharīʿah governance guidelines are issued by three main organizations: the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the Islamic Financial Services Board (IFSB) and Bank Negara Malaysia (BNM). Kasim *et al.* (2013) undertook a comparative analysis of the three guidelines, and this study provides a summary of their analysis in Table I. Additionally, this study referred to the Sharīʿah governance guidelines (AAOIFI, 2018; IFSB, 2009; BNM, 2010) for additional information on the various principles.

With regards to the context of this study, Hasan (2011) further elaborates and explains that the GCC countries mainly have two Sharīʿah approaches: regulated through legal and supervisory requirements in Bahrain, Kuwait, the United Arab Emirates (UAE), Qatar and Oman, or through self-regulation in Saudi Arabia. For instance, Bahrain and Oman follow the AAOIFI governance standards (as per Table I); it requires IBs to establish SSBs to ensure compliance with the Sharīʿah. Moreover, the UAE requires the establishment of a Higher Sharīʿah Authority to supervise and consult all Islamic institutions. Additionally, with regards to SSBs, the UAE requires a minimum of three members who are competent to perform their duties and who need to be approved by the higher authority.

On the other hand, in Kuwait, the Sharīʿah governance system requires that the appointment of SSB members be made by the bank's General Assembly. In terms of composition, Kuwaiti Islamic banks are required to appoint a minimum of three members and this requirement is similar to Bahrain, the UAE and Oman. With regard to the Sharīʿah governance applicable in Qatar, SSBs must not consist of less than two qualified Muslim members. However, what differentiates Qatar from the other GCC countries is that IBs are required to appoint highly qualified directors and senior management who are trained and experienced in Islamic finance. Finally, the Sharīʿah governance model in Saudi Arabia is based on a more self-regulated approach; that is, there is no standard guideline for Sharīʿah governance issued by regulatory authorities.

Hasan (2011) concluded that despite the GCC countries having a minimalist approach towards Sharīʿah governance, they have developed their own governance frameworks, where the majority of IBs in the GCC countries have developed their own Sharīʿah guidelines and standard processes on Sharīʿah compliance.

Sharīʿah supervisory boards and performance

Sharīʿah compliance is the foundation of Islamic banking and finance. There are several studies that have been undertaken on Sharīʿah governance across countries (Grais and Pellegrini, 2006; Hasan, 2011; Alam *et al.*, 2019). These studies mostly focused on the diverse governance practices implemented by the different countries. One of the main standards of Sharīʿah governance is the appointment and composition of Sharīʿah supervisory boards (SSBs). Based on Abdullah (1997), an SSB is an independent panel of Sharīʿah scholars that have extensive knowledge and experience in Islamic financial laws. Due to their qualifications, these scholars have both supervisory and consultative roles. Their supervisory roles include approving new products and services, auditing financial statements and issuing fatwas (legal pronouncements). On the other hand, their consultative roles include providing Sharīʿah-compliant solutions, calculating zakat (mandatory charity) and conducting workshops to educate the management in Islamic law (Nathan, 2010).

Rahman and Bukair (2013) argue that the factors that might influence the BODs and corporate governance will also influence SSBs as they share similar functions. Based on the IFSB (2009), the Sharīʿah governance system complements the existing corporate governance system, the control and compliance functions of an IB. The IFSB draws a comparison between conventional banks (CBs) and IBs regarding the additions to the corporate governance system in IBs; i.e. in addition to BODs, IBs have an SSB. Where the

Table I. Comparative analysis among the Sharīʿah governance guidelines

Discussion	AAOIFI	IFSB	BNM
Base	The Kingdom of Bahrain	Kuala Lumpur, Malaysia	Kuala Lumpur, Malaysia
Clients	Islamic financial institutions including Islamic banks	Regulators	Islamic financial institutions including Islamic banks
Definition of Sharīʿah governance	Definition not provided.(Sharīʿah compliance)	A set of institutional and organizational arrangements through which an IFI ensures that there is effective independent oversight of Sharīʿah compliance	Definition not provided
SSB independence	SSB members are not to subordinate their judgment on Sharīʿah supervision matters to third parties They should not be the employees of the same IB and should not be involved in any matter concerning managerial decisions and operational responsibilities of the IBs SSB is required to continuously assess IBs to resolve any issues of independence impairment	The SSB should play an independent oversight role, with sufficient capability to implement objective judgment on matters related to Sharīʿah without influence from management or inappropriate outside interests No individual or group of individuals shall be allowed to dominate the Sharīʿah board's decision-making	Independence of the SSB should be recognized at all times by the board in exercising their duties. In turn, the SSB is expected to make objective and informed decisions Decisions made by the SSB should not be discarded or changed without its approval
SSB competence	AAOIFI requires that SSB members be specialized in Islamic commercial jurisprudence (*fiqh al-muʿāmalāt*) Nonetheless, an SSB may include a member other than a *fiqh al-muʿāmalāt* specialist, but they need to be an expert in the field of Islamic financial institutions with knowledge of *fiqh al-muʿāmalāt*	The IFSB requires that the board of directors consider the following criteria when recommending members for the SSB: a. good character including, honesty, integrity, fairness and reputation; and b. competence, diligence, capability and soundness of judgment An SSB member must at least hold a bachelor's in Sharīʿah from a recognized university	Requires that any person who bears responsibilities outlined in the Sharīʿah governance framework for an IB needs to have the necessary competency and continuously improve their knowledge and understanding on the Sharīʿah and Islamic finance The majority of members in the Sharīʿah Committee shall at least hold a bachelor's degree in Sharīʿah from a recognized university

(continued)

Discussion	AAOIFI	IFSB	BNM
SSB responsibility	The main responsibility of the SSB is to provide direction, guidance, supervision related to the activities of IBs. The purpose is to ensure IBs are in compliance with Sharīʿah rules and principles SSBs have binding authority to direct, review and supervise the activities of IBs	The SSB has a clear mandate and responsibility for ensuring Sharīʿah compliance with respect to all Islamic financial products and services that the IB offers	An IB shall set out the accountability and responsibility of every key functionary involved in the implementation of the Sharīʿah governance framework This principle outlines the responsibilities of the board of directors (BoDs), SSBs and management
Frequency of SSB meetings	Not discussed	SSBs are required to meet regularly to carry out periodic reviews to monitor Sharīʿah compliance of the operations of the IFIs As and when necessary, the SSB can hold a meeting if the IB urgently requires to settle some matters related to the Sharīʿah The number of meetings to be held by the SSB is not provided. However, the IFSB requires that the SSB should meet with the board of directors at least twice a year	SSBs are required to hold regular meetings to ensure that the SSB is in touch with the operations of the IB The SSB meetings shall be held at least once every two months The number of SSB meetings held in the year, as well as the attendance of the SSB members, shall be disclosed in the IB's annual report. (At least 75% attendance is required)
Sharīʿah review and Sharīʿah audit	Sharīʿah review as an examination of the extent of an IB's Sharīʿah compliance It holds the management accountable for compliance as the Sharīʿah board is only responsible for forming and expressing opinions on the extent of Sharīʿah compliance AAOIFI does not require the establishment of a separate internal Sharīʿah audit department. However, AAOIFI recommends the establishment of an Audit and Governance Committee at the board level	To maintain a control mechanism, the IFSB requires IBs to have both an internal and external Sharīʿah review unit in addition to the conventional internal and external auditors	Required to maintain a Sharīʿah compliance function consisting of both review and audit functions, supported by risk management control process and internal research capacity The Sharīʿah review function ensures that the operations of the IFI do not breach the Sharīʿah The Sharīʿah audit function ensures an effective internal control system for Sharīʿah compliance

(*continued*)

Table I.

Table I.

Discussion	AAOIFI	IFSB	BNM
Risk management function	Not discussed	Not discussed	Required to identify, measure, control and monitor Sharīʿah non-compliance risks which result from the IB's operations and activities
Research function	Not discussed	Not discussed	Conducts research, pre-product approval process, and administrative and secretarial dealings relating to the SSB

Source: Adapted from IFSB (2009), BNM (2010), AAOIFI (2018) control function of CBs involves internal and external auditors, IBs have an additional internal and external Sharīʿah review unit. As for the compliance function, IBs are required to have an internal Sharīʿah compliance department in line with the existing regulatory and financial compliance department.

However, as Sharīʿah is the core and foundation of Islamic banking, Islamic finance specialists claim that the Sharīʿah governance system is the single most important difference between CBs and IBs (Mizushima, 2014). Mizushima (2014) further claims that Sharīʿah compliance is the most important priority of IBs and surpasses corporate values, vision and strategy. Similarly, Nathan (2010) states that the success of IBs depends on a good corporate governance system which mainly relies on the existence of effective SSBs. It can therefore be argued that the SSB is very influential to IBs when making decisions related to Sharīʿah matters, as no one can supersede or discard these decisions (Table I).

The Islamic Finance Advisory and Assurance Services (Raza, 2011), an international consultancy specialized in Islamic finance, explained the differences and similarities in the functions of the SSBs and the conventional regulatory frameworks. The functions of the SSB include ensuring ethical trading, fairness, capital adequacy, disclosures, profit sharing, social responsibility, profit distribution and compliance with the Sharīʿah sales policy. The bank's existing regulatory framework involves fairness, social responsibility, transparency, and risk and money laundering control. Despite both frameworks having overlapping functions, most studies have focused on BOD composition and performance (Zahra and Pearce, 1989; Belkhir, 2004; Al-Sartawi and Sanad, 2015; Shaukat *et al.*, 2015; Al-Sartawi, 2019). This study, as such, focuses on the second constituent of the dual governance model to examine the relationship between SSB characteristics and performance.

Kasim *et al.* (2013) argue that the independence of SSBs is vital to build the confidence of stakeholders in IBs in terms of compliance with Sharīʿah rules and principles. To maintain the independence of SSBs, the three main Islamic finance authorities (AAOIFI, IFSB and BNM – see Table I) state that SSBs should be recognized as independent from the BODs, whereby they have freedom in exercising their duties to make informed and objective decisions. Members should also not be the employees of the same bank and should not be involved in managerial decisions and operational responsibilities. Therefore, the AAOIFI Governance Standard No. 1 states that shareholders have the authority to appoint SSB members during the annual general meeting. This is to ensure independence from management's board as managers do not have the power to appoint or dismiss them (AAOIFI, 2018). Based on the AAOIFI Governance Standard No. 1, the SSB is not only independent from the BODs but can also attend their meetings to discuss the religious aspects of their decisions. Moreover, when the SSB is at the same level as the BOD, it releases the SSB from any restrictions that might be imposed by the board or its executive management (AAOIFI, 2018). This separation between SSBs and management may inhibit managers from engaging in activities that directly benefit themselves and cause shareholders to bear the costs of their actions. Hence, the independence of SSBs mitigates the agency problem, reduces financing costs and improves the performance of IBs.

Nevertheless, Fich and Shivdasani (2006) claim that the role of independent directors does not exceed a supervisory role, as they are often busy with their parent companies (where they serve as executive or non-independent directors) and find it difficult to understand operations of the host company (where they are non-executive or independent directors). This concept is in line with the stewardship theory that argues that increasing the number of independent members on the board will have a negative impact on performance due to high costs and the imposition of further controls on the host company (Cicero *et al.*, 2013). On the other hand, the stewardship theory also states that non-independent directors will contribute positively to the performance and interests of investors as they seek their own interests through the company (Fahlenbrach *et al.*, 2010). That is, the greater the number of non-independent members, the better the performance of the company (Baysinger and Hoskisson, 1990). Similarly, Mobbs (2013) argues that non-independent members are more familiar with the circumstances of the company and are characterized by a greater capacity to make decisions that contribute to improved performance. Additionally, non-independent members are more willing to spend on research and development than independent directors, which would contribute to better outcomes and performance (Hill and Snell, 1988; Baysinger *et al.*, 1991).

Therefore, Shaukat *et al.* (2015) found a direct and positive relationship between board independence and performance. Based on the above, we can conclude that board independence will enhance the quality and volume of disclosure, hence increasing the transparency of accounting information and reducing the asymmetry of the data provided to investors. Companies that are associated with independent members are characterized with better operational performance and better shares performance (Mobbs, 2013). In addition, companies with complex processes desire to appoint more independent members, given their vast experience that can be transferred from their parent company, as their expertise is directly proportional to performance (Atmaja, 2010). Zahra and Pearce (1989), and Daily and Dalton (1992), on the other hand, concluded that board independence has no effect on performance. Overall, the empirical findings have been rather mixed with more studies indicating a positive relationship between board independence and performance. Nonetheless, this study hypothesizes the following:

H1. There is a positive relationship between Sharīʿah supervisory board independence and performance of IBs in the GCC.

In addition to the above, regular and frequent board meetings are considered an important indicator of the SSB's ability to control executive managers and to ensure the protection of shareholders' equity (Ntim *et al.*, 2017). According to Banaga *et al.* (1994), one of the functions of SSBs is to hold regular meetings to discuss all the enquiries received from the entire community. Previous studies on Sharīʿah governance show that there is a positive and significant relationship between the frequency of SSB meetings and the performance of the SSB as measured by fatwas issued. Moreover, education of executive management in Sharīʿah affairs will be improved as well. This postulation is in parallel with earlier research (Nathan, 2010). It can further be assumed that the improved performance of the SSBs leads to improved performance of IBs.

Vafeas (2003) claims that frequent meetings enhance loyalty and moral values among board members, shareholders as well as employees of the company, which in turn improves performance. Moreover, regular meetings contribute to the achievement of actual control by the SSB on all transactions carried out by the company, which helps them in making rational decisions that contribute positively to performance (Ntim *et al.*, 2017).

However, there are studies that argue that regular meetings may contribute to negative performance as the majority of the meetings are dominated by protocols, especially in the case of independent members who will spend most of their time trying to understand company issues (Vafeas, 1999). This weakens the ability of the SSB to consider the issues that concern the interests of the company. Moreover, advocates of this theory believe that an increase in the number of board meetings will be accompanied by an increase in the cost of the preparation and processing of information for the meetings, leading to lower profits (Vafeas, 1999).

Moreover, some theorists believe in replacing regular meetings with emergency meetings only, that is, in periods of financial crisis, or in the case of replacing the CEO, or in the case of the emergence of any situation that might endanger equity rights (Ntim *et al.*, 2017). Therefore, it is concluded that the large number of meetings or the negligibility of meetings do not affect performance, as performance is positively affected by the important decisions that are taken during critical situations. Contrarily, Vafeas (1999) found a negative and statistically significant relationship between the frequency of meetings and performance.

This study extends previous studies by investigating the relationship between the frequency of SSB meetings and the performance of IBs. Therefore, the second hypothesis can be formulated as follows:

H2. There is a positive relationship between Sharīʿah supervisory board frequency of meetings and performance of IBs in the GCC.

Research methodology

Sample selection

To address the research questions, the study collected data from a sample of 48 standalone IBs listed on the GCC stock exchanges. The population of the study consisted of 54 standalone banks; however, six banks were disregarded due to the unavailability of published annual reports online. This study opted to include only the standalone IBs in the GCC to maintain uniformity. That is because IBs need to conform to both the regulatory and Sharīʿah requirements, and these vary for the different types of banks such as windows or subsidiaries or standalones. The number and names of the listed GCC IBs were obtained from the Arab Banking and Finance Directory (2016), the GCC central banks, and the GCC stock exchanges. Therefore, the empirical study of the current research depended on a sample, which consisted of 48 standalone IBs listed on the GCC stock exchanges for the period between 2013 and 2017. Data were collected from the published annual reports of the banks. As a result, this study covers a period of five years based on the availability of the reports which were downloaded from the banks' websites.

Model development and variable measurement

The purpose of this study was to investigate the relationship between SSBs' characteristics (board independence and frequency of board meetings) and the performance of listed IBs in the GCC. A multiple linear regression model was developed to investigate this relationship, which included Return on Assets (ROA) as the dependent variable. The ROA proxy was used because it is regarded as the most common measure of firm performance (Schendel *et al.*, 1991). As for control variables, this paper reviewed the literature and found several factors that might influence performance. These included bank size (Hadriche, 2015), leverage (Beltratti and Paladino, 2015), bank age (Majumdar, 1997), institutional ownership (Belkhir, 2004), and type of audit firm (Al-Sartawi and Sanad, 2015). Equation (1) reflects the relationship between the dependent variable (ROA) and the control variables, while Table II defines the variables under study.

$$ROA_i = \beta_0 + \beta_1 SSB\_INDP_i + \beta_2 SSB\_FM_i + \beta_3 L\_FSZ_i + \beta_4 LVG_i + \beta_5 AGE_i + \beta_6 IOW_i + \beta_7 BIG4_i + \varepsilon_i \quad (1)$$

Data analysis

Descriptive statistics

Table III reports the minimum, maximum, mean and standard deviation of the variables of the study. The mean of ROA is 0.04846, which is regarded as a low figure when compared

Code	Variable name	Operationalization
Dependent variable		
ROA	Return on assets (%)	Net income/Average total assets
Independent variables		
SSB_INDP	Sharīʿah board independence (%)	A binary variable: 0 indicates that the Sharīʿah board member has direct or indirect relationship with the firm; 1 indicates otherwise
SSB_FM	Sharīʿah board frequency of meetings	Total number of SSB meetings during the year
Control variables		
L_FSZ	Firm size	Natural logarithm of total assets
LVG	Leverage	Total liabilities/total assets
AGE	Firm age	The difference between the establishing date of the firm and the report date
IOW	Institutional investor	The ratio of shares held by institutional investors to total number of shares outstanding
BIG4	Auditor type	A binary variable: 1 means the company is audited by the Big 4; 0 indicates otherwise
Ei	Error	

Table II. Description of the variables under study

Continuous variables	*N*	Maximum	Minimum	Mean	SD
ROA	240	−0.898	0.285	0.04846	0.168035
Total assets	240	52297	768595345	1.19E8	1.688E8
Leverage	240	0.13	0.91	0.6747	0.23819
Age	240	0	49	21.02	13.854
Institutional ownership	240	0.12	1.17	0.5383	0.25631
SSB independence	240	0.50	1.00	0.9672	0.09973
SSB frequency of meetings	240	3	10	6.53	1.910
Discontinued variables	*N*	Achieved	*(%)*	Not Achieved	*(%)*
Big4	240	200	83	40	17

Table III. Descriptive statistics

with the mean of total assets. This could be a result of the restrictions and regulations constraining IBs, as they are characterized with high cash savings due to a more conservative investment decision-making approach.

Additionally, the majority of IB assets are funded by debt instruments as shown by the overall leverage of 67.5 per cent. Perhaps this reinforces the notion that the increase in customer deposits is greater than the increase in investments, which would overstate the size of assets and reduce the size of their returns (Al-Sartawi and Sanad, 2015). The lower levels of ROA and the higher levels of leverage can be attributed to the nature of the conservative decisions made by the SSBs, especially when the level of institutional ownership is at 54 per cent, and the level of independence of SSBs is 97 per cent, as independent members strictly protect the rights of shareholders, and are not tempted by higher profits when compared to non-independent members.

Conservatively, the higher level of frequency of meetings can be attributed to the nature of the banks' investment decisions and the increased levels of the operational expenses, which could be due to eagerness of institutional investors to increase their own profits, thereby increasing agency costs and reducing ROA (Bushee *et al.*, 2014). Table III further demonstrates that the mean age of IBs is 21. It can therefore be assumed that IBs have a high level of experience in the matters of Sharīʿah, which has the effect of giving higher credibility to the results of the study and hence improving the generalization of the results. Finally, the results show that 83 per cent of the IBs are audited by the Big 4 auditing firms, which means an increase in costs due to higher fees.

Path analysis

The researcher divided the IBs into two groups and conducted a path analysis (as reflected in Table IV) to determine the extent of the differences between the banks based on the size of their assets. The first group included banks which exceeded the median, and the second group included banks below the median.

The results of the path analysis show that the ROA in larger banks is greater than small-sized banks. The positive value of the *t*-test indicates that larger IBs tend to have higher ROAs than smaller IBs. One reason for this could be that larger banks have better management and better technology, which leads to performance improvement. Large banks have more resources to mobilize more funds for their depositors, leading to higher returns. In addition, the table shows a positive and significant relationship between leverage and size; i.e. the larger the size of the bank, the greater its reliance on debt instruments for financing asset investments. This could be due to the lower risks associated with larger banks when compared to smaller ones (Al-Sartawi and Sanad, 2015).

Moreover, the results of the path analysis showed that there is a positive relationship between age and SSB independence with size. One reason for this could be that older and more experienced banks are more attractive to depositors and investors, which would contribute to an increase in the size of their assets and leverage. As for Sharīʿah board independence, it can be noticed that larger banks were able to appoint a greater number of qualified and experienced Sharīʿah scholars who require fewer board meetings, thus reducing costs and increasing the ROA.

Similarly, it can be deduced that the higher number of independent members and the reduced number of meetings could be due to the reduced number of institutional owners who are highly experienced in managing corporations, therefore increasing the need for independent members. Additionally, the results showed an inverse relationship between

Table IV. Distribution of variables based on bank size

		Bank size		Two independent sample *t*-test	
Variables	*N*	Large	Small	*t*-test	Significance
ROA	120-120	0.08067	0.01626	1.759	0.003*
Leverage	120-120	0.7016	0.6478	3.019	0.040**
Age	120-120	21.93	20.12	1.011	0.313
Institutional ownership	120-120	0.4971	0.5796	−2.523	0.006**
SSB independence	120-120	0.9707	0.9636	0.549	0.291
SSB frequency of meetings	120-120	6.21	6.85	−2.635	0.005*
Big4	120-120	0.83	0.83	0.000	1.000

Notes: $^{*}p < 0.1$ level; $^{**}p < 0.5$ level institutional ownership and size, as well as a positive and statistically significant relationship between the quality of the auditors and bank size.

Testing regression assumptions

To test the regression assumptions of multicollinearity and normality, various key tests were conducted. Table V summarizes the Pearson's correlation matrices which test the statistical relationship between the independent and dependent variables, and if multicollinearity exists among the data before assessing the model. Table V shows that total assets (bank size) and ROA had the highest correlation (0.238). Other variables were also found to be correlated. As no correlation coefficient exceeds 0.8, it is assumed that no multicollinearity issue exists.

To further test multicollinearity, the variance inflation factor (VIF) test was conducted. The VIF scores reported in Table VI indicate that no score exceeds 10 for any independent or control variable in the model. It was, therefore, concluded that no problems were found with regard to collinearity in the model. Table VI also reports the normality test in terms of the skewness and kurtosis test. The test suggests that all the predictive variables are normally distributed except for firm size and Sharīʿah board independence, which were adjusted using the natural logarithm.

Furthermore, to test for autocorrelation, the Durbin–Watson test (Table VII) was used where the value was less than 2, which indicates a positive correlation. As a result, Lag (1) was used to overcome this issue in the model.

Testing hypotheses

Table VIII reports the findings of the regression analysis of the study model. These findings show that the *p*-value is less than 5 per cent. This finding statistically supports the significance of the regression model. To overcome the lack of research in SSBs' independence and performance, this study will refer to the literature on BODs from a conventional point of view. As Rahman and Bukair (2013) stated, the factors that might influence the BODs and corporate governance will also influence SSBs as they share similar functions. With regard to *H1* and 2, the results showed a statistically significant and negative relationship between the composition of the SSBs and performance. This means that the higher the number of independent members and meetings, the lower the ROA of the bank. One reason for this could be the increased cost associated with strict monitoring. This contradicts the findings of some studies (Mollah and Zaman, 2015; Hassan *et al.*, 2017), which could be due to the fact that Sharīʿah Supervisory Boards in the GCC focus mainly on advisory rather than supervisory roles. In theory, managers and BODs cannot supersede the decisions made by the SSBs, but in reality the situation is more complicated and Sharīʿah scholars might be influenced by others.

Nevertheless, many previous studies have indicated that a high level of SSB independence will encourage independent members to direct the host companies towards raising capital through leverage as opposed to investments, therefore benefiting their own parent companies (Fahlenbrach *et al.*, 2010). This is indicated in Table III where the overall leverage is 67.5, which is a high figure when compared to the percentage of the SSBs' independent board members. This relationship influences board composition in the sense that the higher the independence of Sharīʿah boards and the frequency of meetings, the greater the reliance on financial leverage. Additionally, independent scholars lack complete information and are unable to get the full details of the host company's operations, thus increasing the need for more meetings. This also contributes to the high costs associated with the processing and preparation of the data they require to be able to make decisions

Table V.
Correlations matrix

Variables	ROA	Total assets	Leverage	Age	Institutional ownership	Sharīʿah board independence	Frequency of meetings	Big4
ROA	1							
Total assets	0.238**(0.000)	1						
Leverage	0.171**(0.008)	0.137*(0.033)	1					
Age	−0.147*(0.022)	0.010(0.875)	0.053(0.418)	1				
Institutional ownership	−0.071(0.273)	−0.149*(0.021)	−0.108(0.097)	−0.230**(0.000)	1			
SSB independence	−0.005(0.942)	0.022(0.738)	0.084(0.194)	0.064(0.322)	0.099(0.127)	1		
SSB frequency of meetings	−0.135*(0.037)	−0.197**(0.002)	−0.125(0.053)	0.075(0.249)	0.083(0.203)	0.084(0.195)	1	
Big4	−0.100(0.122)	−0.020(0.762)	0.014(0.835)	0.199**(0.002)	−0.211**(0.001)	−0.065(0.314)	0.019(0.775)	1

Notes: **Correlation is significant at the 0.01 level (two-tailed); *Correlation is significant at the 0.05 level (two-tailed)

(Liu *et al.*, 2015). This may be reflected in returns and performance due to the higher costs of holding frequent meetings (Duchin *et al.*, 2010).

Table VIII also reports a positive and significant relationship between the size of assets, leverage, and ROA. The results further showed an inverse yet insignificant relationship between institutional ownership and ROA. One reason for this could be that IBs that consist mostly of institutional investors will not be willing to appoint independent members, thus reducing the frequency of meetings, and improving performance through ROA. Furthermore, the results showed a negative but insignificant relationship between the type of auditor and ROA. This may be due to the higher costs associated with the appointment of the Big 4 auditors as compared to other audit companies, leading to an increase in costs.

Conclusion and recommendations

The SSB is one of the most important Sharīʿah governance mechanisms used by IBs to ensure compliance with Islamic laws and principles. This addition to the governance structure; i.e. the conventional BODs of IBs, provides a unique perspective on the performance of IBs. Being an independent panel, shareholders are required to appoint Sharīʿah scholars with vast knowledge and experience in the Sharīʿah principles as they will

Variables	Tolerance	VIF	Skewness	Kurtosis
Total assets	0.930	1.076	2.042	4.060
Leverage	0.953	1.049	−0.961	−0.483
Age	0.907	1.102	0.202	−1.615
Institutional ownership	0.875	1.142	0.284	−0.926
SSB independence	0.962	1.039	−2.929	7.408
SSB FM	0.933	1.072	−0.332	−0.742
Big4	0.926	1.080	−1.800	1.251

Table VI. Collinearity statistics test

Model	R	*R* square	Adjusted *R* square	Standard error of the estimate	Durbin–Watson
1	0.538	0.314	0.187	0.1605	1.79

Table VII. Autocorrelation

Variables	Beta	*t*-test	Significance
Total assets	0.197	3.068	0.002***
Leverage	0.138	2.177	0.031**
Age	−0.153	−2.352	0.020**
Institutional ownership	−0.074	−1.121	0.263
SSB independence	−0.164	−3.549	0.013**
SSB frequency of meetings	−0.189	−5.004	0.086*
Big4	−0.083	−1.286	0.200
R^2	0.314		
F	4.280		
Sig (F)	0.000		

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

Table VIII. Multi regression

have both consultative and supervisory responsibilities. SSB independence contributes to the effectiveness of Sharīʿah supervision, and failure to maintain independence may prove that IBs are Sharīʿah non-compliant in the eyes of customers, thus increasing deposit withdrawals and investment cancellations and negatively affecting performance.

Therefore, this paper sets out to answer whether an SSB is an influential part of the IB's dual governance system and whether the effectiveness (independency) and efficiency (frequency of meetings) of SSBs improve performance. The study sample consisted of 48 standalone IBs listed on the GCC stock exchanges for the period between 2013 and 2017. The empirical evidence reported in this paper strongly indicates that there is a negative relationship between the independent variables (SSB independence and frequency of meetings) and performance. This could be due to Sharīʿah scholars acting as advisors rather than supervisors, allowing managers to supersede their decisions. Moreover, as independent Sharīʿah scholars lack complete information about the internal operations of the IB, they need to meet more often to get the full picture and answer enquires. This results in high costs associated with the processing and preparation of the data they require to be able to make decisions, and this may be reflected in returns and performance due to the higher costs of holding frequent meetings.

Based on the overall results, the study advises the regulators of IBs in the GCC to develop a set of strict restrictions for the selection of independent Sharīʿah board members to reduce the cost of information asymmetry. Moreover, SSB members should not be appointed according to personal relationships, as some studies have suggested (Hussain and Mallin, 2003) that independent members in some GCC countries enjoy a superficial independency due to being appointed through personal connections with the directors or with the chairperson of the board. This study further encourages the GCC countries to follow a more proactive Sharīʿah governance model so as to strengthen their frameworks from both regulatory and non-regulatory aspects.

The researcher further highlights the importance of not increasing the number of executive members in the Sharīʿah board as it might have an adverse effect on the ROA, and may limit the operations of the IB industry, especially since the GCC is still in its legislative phase and follows a minimalist approach. Moreover, the lower number of independent members will contribute to solving the problem of information asymmetry and thus will contribute to reducing the number of annual meetings of the SSB. Therefore, the study further suggests that SSB meetings should be held on a quarterly basis to discuss the most important quarterly financial statements and reports, which would reduce the cost of organizing such meetings and improve the level of ROA. It is also recommended that the SSB should set a minimum quorum which needs to be disclosed in the IBs' annual reports along with the attendance of each board member.

Future research could be undertaken by expanding the framework of this study, through the addition of other accounting-based performance indicators such as the Return on Equity (ROE), Earnings Per Share (EPS), Economic Value Added (EVA), and market-based performance indicators such as Tobin's Q to draw comparisons among the relationships of board characteristics and the indicators. This would contribute to providing regulators in the GCC banking environment with a clearer perception of the nature of the relationship between IBs and a wider range of performance indicators.

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