

BOARD OVERSIGHT AND FINANCIAL PERFORMANCE OF ISLAMIC BANKS IN ARAB AND NON-ARAB COUNTRIES

Yousuf Ali Badshah

College of Management Sciences, Karachi Institute of Economics & Technology

Abdullah*

College of Management Sciences, Karachi Institute of Economics & Technology

Muhammad Arsalan Hashmi

College of Management Sciences, Karachi Institute of Economics & Technology

Muhammad Hashim Shah

School of Economics & Management, Southwest Jiaotong University

ABSTRACT

This study analyzes the impact of corporate governance (CG) practices and Shariah Supervisory Board (SSB) on the financial performance of Islamic banks (IB). A sample of 20 Islamic banks from Arab and Non-Arab countries i.e. Bahrain, Kuwait, Jordan, Saudi Arabia, United Arab Emirates, Pakistan and Malaysia were used. A CG-index was adopted from the literature which comprises of three sub-indices including Board of Directors (BOD), Audit Committee (AC) and Shariah Supervisory Board (SSB). The dataset covers the period from 2012 to 2018. The panel data regression technique was used for data analysis. The descriptive statistics suggest that the average score for CG-index is 76% which indicates that Islamic banks reasonably adhere to CG regulations. The panel regression results suggest an insignificant relationship between (1) CG and IB's financial performance and (2) BOD and IB's financial performance. These findings are consistent with earlier studies conducted on Arab countries. Moreover, the results also suggest that SSB and AC contribute positively towards asset performance but negatively towards equity performance. Policymakers should revisit the CG regulations in their countries to make them more influential towards the performance of Islamic banks.

Keywords: Corporate governance, Islamic banks, Shariah supervisory board, financial performance.

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* Corresponding author: Abdullah, Affiliation: Karachi Institute of Economics & Technology, Address: KIET, PAF-Base Korangi Creek Karachi, Pakistan. Cell: +923343693208, Email: abdiman.0688@yahoo.com

1. INTRODUCTION

Corporate governance has been given much importance by academicians, researchers, practitioners and policy makers after major financial scandals like Enron and Turkish Ihlas Finance House (Chapra & Ahmed, 2002). Grais and Pellegrini (2006) argued that failure in compliance with CG codes led these institutions to collapse. Furthermore, they argued that audit failures, inactive BODs and risk management practices were significant reasons for these corporate failures. The focus on CG by regulators has also substantially increased after the global financial crisis of 2008 (Aebi et al., 2012).

The CG practices of Islamic banks are entirely different from conventional banks (Mollah et al., 2014). In Islamic Banks (IBs), SSB works along with BODs that enable Shariah compliance in banking activities (Bukair & Abdul Rahman, 2015). This makes it necessary that board members should have sufficient knowledge regarding Shariah principles of banking and exhibit ethical behavior and competence towards their professional responsibilities (Chapra, 2007). Magalhães and Al-Saad (2013) argued that stakeholders' confidence is a challenge for CG, which implies that IBs are trustworthy providers of financial services in accordance with principles of Shariah. Therefore, a SSB becomes an essential component of the CG mechanism for IBs as it is responsible for ensuring compliance of all banking transactions with Islamic Financial Law (IFL).

The existing literature compares the CG concept of Western and Islamic countries and provides reasons for differences (Ajili & Bouri, 2018). Hasan (2009), Bukhari et al. (2013), Magalhães and Al-Saad (2013) have argued that the concept of CG is similar in both types of countries. Moreover, they found that several Shariah elements are added to the conventional CG mechanisms to make them more rigorous towards implementation of Shariah principles and safeguarding stakeholders' interests. However, the previous literature lacks in providing evidence on the relationship between CG and IB performance (Ajili & Bouri, 2018). Ghayad (2008) analyzed this relationship for IBs of Bahrain and used this single component of CG i.e. SSB. Recently, Ajili and Bouri (2018) studied this relationship for IBs of GCC countries ignoring the IBs of other countries, which are witnessing the same growth rate in Islamic banking. This study contributes to the existing literature by studying the IBs of Arab and Non-Arab countries together. The research is significant for policymakers and academicians as it stresses the importance of SSBs for strengthening the corporate governance environment of Islamic banks. Furthermore, policymakers are advised to re-evaluate the existing corporate governance framework for improving the performance of IBs.

This study uses a sample of 20 IBs i.e. 4 from Bahrain, 2 from Kuwait, 2 from Qatar, 2 from Saudi Arabia, 1 from United Arab Emirates, 1 from Jordan, 2 from Pakistan and 6 from Malaysia. The selection of 20 Islamic banks from different countries is based on the availability of data for empirical analysis. Moreover, we had to omit certain IBs and variables as the data was not available for the sample period. The existing literature provides empirical evidence on the relationship between CG mechanisms and IB performance (Ajili & Bouri, 2018; Ghayad, 2008) for Arab countries however, this study also includes IBs from Pakistan and Malaysia. Both countries consist of a Muslim majority population. Furthermore, Islamic banking deposits are growing at an exponential rate in Malaysia and Pakistan. Even the conventional banks have started facilitating Islamic banking through window operations (Amin et al., 2011). Islamic

banking industry is now exhibiting tough competition for conventional banking in both countries (Ali & Raza, 2017).

This study contributes to the existing literature in several ways. First, this paper includes Pakistan and Malaysia in the sample, which were not considered in earlier studies on the topic. Second, several previous studies suggest an insignificant relationship between CG-index, SSB-index, AC-index and BOD-index with the performance of IBs. While we found an insignificant relationship between the overall CG-index and performance of IBs, we document several interesting and significant relationships between SSB-index, AC-index and the performance of IBs. Third, we found that SSB and AC contribute towards asset performance (i.e. ROA) of IBs while insignificantly contributing towards equity performance (i.e. ROE). This may be because IBs around the world are at the growth stage and tend to focus on equity performance at the maturity stage. Policymakers should revisit the regulations of CG in order to make them more influential towards the performance of IBs.

The paper consists of 5 sections. This section provides the introduction followed by a review of the relevant theories and literature. The following section discusses the data and methodology. Subsequently, the discussion of results is presented. Finally, the conclusion is presented along with recommendations for future research.

2. LITERATURE REVIEW

2.1. *Agency and Stakeholder Theories*

Agency theory explains the conflict of interests that may arise between two or more parties in a firm and provides a mechanism to manage such conflicts (Fama & Jensen, 1983; Jensen & Meckling, 1976). In a public limited company, shareholders (principal) and managers (agent) are the two parties in a contract. The company is engaged in several contracts under which the principal hires an agent for acting on his behalf with decision making authority (Jensen & Meckling, 1976). This theory suggests that conflicts may occur between shareholders and managers when managers pursue their private interests and fail to act in the best interests of shareholders. A principal then has to bear the cost of an agent's private benefits which is commonly referred to as agency cost (Watts & Zimmerman, 1990).

On the contrary, the stakeholder theory identifies value generation as the core driver of an organization (Freeman, 1984). It also suggests that this value should be shared with the stakeholders. Moreover, this theory recognizes that stakeholders not only include shareholders and managers, but also other parties whose interests are associated with the organization, either directly or indirectly. Laplume et al. (2008) argued that this theory focuses on how managers' perform in order to achieve the fundamental organizational goal (i.e. value creation). Moreover, it recognizes that profits are very crucial in creating value, but value creation is not only restricted to profits and financial performance (Theodoulidis et al., 2017). The stakeholders of IBs are not only concerned with profits rather they are interested in Shariah compliant income. Therefore, all IBs establish a SSB to ensure Shariah compliance in banking activities.

2.2. Hypotheses Development

2.2.1. CG and Financial Performance of Islamic Banks

Both agency and stakeholder theories present the framework that management should work according to the expectations of stakeholders. Stakeholders of IBs may not only be interested in maximizing their wealth but following Shariah principles and practices (Bukair & Abdul Rahman, 2015). CG mechanisms play a vital role in improving banks' performance. The past literature reports mixed findings on the impact of CG practices on IBs' performance. Ajili and Bouri (2018), Price, Roman and Rountree (2011), Crespi et al. (2004), Cheung et al. (2008) suggest an insignificant relationship between CG mechanisms and IBs' performance. These studies argue that IBs tend to strengthen SSB rather than improving CG practices. Moreover, Markonah and Riwayati (2016) suggest a positive relationship between ROA and CG. Bukair & Abdul Rahman (2015) suggest a negative relationship between CG and ROE. They argue that IBs in the GCC countries are hiring directors only to fulfill the requirements of regulatory bodies while compromising on their experience and expertise. Similarly, Al-Tamimi (2012) found an insignificant relationship between the variables while analyzing a sample of U.A.E. banks. Contrarily, Brown and Caylor (2006), Black et al. (2006), Ammann et al. (2011), Mollah et al., (2017) suggest that CG practices of IBs positively affect financial performance.

Based on the above discussion, it is clear that the existing literature does not provide any conclusive evidence on the relationship between CG and the financial performance of IBs. Moreover, researchers heavily rely on the sample of Arab countries whereas, this study focuses on a sample of IBs comprising of Arab as well as Non-Arab countries. Therefore, the following hypothesis has been formulated:

H1: Corporate governance practices positively affect the financial performance of IBs.

2.1.2. Performance of IBs and BOD

The BOD are considered crucial in minimizing agency problems arising due to the separation between ownership and management (Zahra & Pearce, 1989). BOD are mainly responsible for decision making, supervising and monitoring managers of a firm (Jensen & Meckling, 1976). Lipton and Lorsch (1992) has argued that if the BOD fail to safeguard the interest of shareholders then they only have the choice of selling shares in order to show their disagreement. The effectiveness of BOD may be affected by its size, independence and frequency of meetings (Al-Saidi & Al-Shammari, 2013; Fama & Jensen, 1983; Daily et al., 2003; Zabri et al., 2016; Janang et al., 2020).

BOD effectiveness may be reduced by CEO-Chairman duality (Daily et al., 2003; Zabri et al., 2016). It occurs when two key positions are held by the same person. CEO-Chairman duality is considered to be a governance problem in the existing literature (Wen, 2013; Yermack, 1996). Yermack (1996) argued that firm performance may be reduced in the presence of CEO-Chairman duality. Wen (2013) argued that BOD may not be able to monitor CEO performance when the CEO and Chairman of the board is the same person. Kajola (2008) argued that firms with CEO-Chairman duality face severe agency problems. It has been argued in the literature that the effectiveness of BOD may also be enhanced by increasing the number of independent directors (Kajola, 2008; Abdullah et al., 2017). Regulatory bodies have made it mandatory for firms to

include independent directors. Masulis et al. (2012) argued that independent directors having industry experience may enhance firm performance as compared to inside directors.

A number of researchers have attempted to measure the impact of board effectiveness on financial performance but still researchers have not reached a consensus (Adusei, 2011; Belkhir, 2009; Juras & Hinson, 2008; Rachdi & Ben Ameer, 2011). Al-Manaseer et al. (2012) and De Andres and Vallelado (2008) suggest a positive relationship between BOD effectiveness and IBs' performance. These studies argue that bank performance improves with the number of outside directors. Contrarily, Al-Saidi and Al-Shammari (2013) and Naseem et al. (2017) suggest a negative relationship between board independence and bank performance. Moreover, Al-Saidi and Al-Shammari (2013) also suggest a positive relationship between CEO-Chairman duality and banks' financial performance. Therefore, we have formulated the following hypothesis:

H2: There is a positive relationship between BOD' effectiveness and financial performance of IBs.

2.1.3. IB Performance and SSB

IBs' primary objective is to provide Shariah compliant financial services to stakeholders. A SSB plays a vital role in assuring stakeholders that IBs are following the principles of Shariah. Alman (2012) and Hamza (2013) have argued that SSB serves as an internal governance mechanism that controls, supervises and implements Shariah principles within IBs. Farook et al. (2011) suggest that SSB members having business and economics degrees enhance the efficiency of SSB. Therefore, the existence and effectiveness of SSB is necessary for compliance with Shariah principles in IBs. Thus, SSB enhances the confidence of stakeholders and positively affect IB performance (Grassa, 2013).

The existing literature suggests that SSB has been more effective in enhancing the performance of IBs as compared to CG mechanisms (Ajili & Bouri, 2018). Mollah and Zaman (2015) argued that SSB assumes an advisory and supervisory role. Moreover, they suggest a positive relationship between SSB's supervisory role and IB performance. Mollah and Zaman (2015) argue that the literature provides little insight on the relationship of SSB and IBs' performance. Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has made it mandatory for IBs to include at least three members in SSB. Thus, it may be inferred from the above discussion that SSB plays a significant role in enhancing the performance of IBs besides effective CG mechanisms. Therefore, the following hypothesis has been developed:

H3: SSB positively affects the performance of IBs.

2.1.4. IBs' Performance and AC

An AC is an integral part of CG mechanisms. An AC forces the management in meeting shareholders expectations (Sheikh et al., 2019). Madi et al. (2014) argue that an AC plays a crucial role in maintaining internal control. Allegrini and Greco (2014), Mardnly et al. (2018), Wild (1996) and Mardjono et al. (2020) argue that an AC enhances the confidence of stakeholders by presenting transparent financial reports. An AC would perform in the best interests of shareholders when it consists of an adequate number of independent members who

meet frequently (Stewart & Munro, 2007). Menon and Williams (1994) argue that an inactive AC may fail to evaluate the performance of management. An AC is considered active when its members are meeting frequently (Stewart & Munro, 2007). Prior studies have argued that AC independence is extremely important in order to make it effective (Sheikh et al., 2019). Goodwin and Yeo (2001) and Bédard and Gendron (2010) suggest that independent members should not have any relationship with the organization, i.e. personnel and economic relationships. Thus, it is now mandatory for IBs that the AC should at least consist of three members, meeting at least once in a quarter.

The existing literature reports mixed findings for the relationship between AC effectiveness and bank performance (Ajili & Bouri, 2017). Chan and Li (2008) suggest that the inclusion of experts in an AC positively affects firm value. Contrarily, Hsu and Petchsakulwong (2010) argue that revenue efficiency and AC size have a negative relationship. Moreover, Brown and Caylor (2006) found an insignificant relationship of firm performance with AC independence and AC size. On the basis of the above discussion, the following hypothesis has been developed to test whether effective ACs significantly improve the financial performance of IBs.

H4: *AC effectiveness positively affects the financial performance of IBs.*

3. METHODOLOGY

3.1. Sample

This study has examined the impact of CG and SSB on IBs' performance in Arab and Non-Arab countries for the period 2012 to 2018. Arab countries include Kuwait, Bahrain, Jordan, United Arab Emirates and Saudi Arabia whereas, Non-Arab countries include Malaysia and Pakistan. The recent literature has examined factors affecting IBs' performance using the dataset of GCC countries (Ajili & Bouri, 2017; Al-Tamimi, 2012) without considering Pakistan and Malaysia. Both countries are witnessing an exponential growth in Islamic banking (Awan et al., 2011; Amin et al., 2013). Awan et al. (2011) state that Pakistan is observing around 60% annual growth in Islamic banking since 2005. Therefore, the inclusion of IBs from both these countries would significantly contribute to the existing literature.

This study uses a sample of 20 IBs i.e. 4 from Bahrain, 2 from Kuwait, 2 from Qatar, 2 from Saudi Arabia, 1 from United Arab Emirates, 1 from Jordan, 2 from Pakistan and 6 from Malaysia. A list of Islamic banks used in the study is provided in Appendix 1. The lack of data availability is the main reason for using 20 IBs. For instance, the annual reports of certain IBs from Arab countries do not have an English version. Moreover, in many cases only selected information is provided in the English version of the annual report. Therefore, the dataset was restricted to information available in the English version of annual report.

3.2. Dependent Variables

Return on Equity (ROE) and Return on Assets (ROA) have been extensively used to measure financial performance in the existing literature (Larcker et al., 2007; Renders et al., 2010; Ajili & Bouri, 2018; Mollah & Zaman, 2015; Bukair & Abdul Rahman, 2015). Therefore, this study uses

ROE and ROA as a measure of financial performance (i.e. dependent variable). ROE is calculated by dividing the net income by total equity, whereas, ROA is calculated by dividing the net income by total assets, consistent with the existing literature (Ajiliti & Bouri, 2018; Mollah & Zaman, 2015; Zabri et al., 2016).

3.3. Independent Variables

This study uses CG index as an independent variable measured through governance attributes. The index would measure the CG more effectively as compared to several indicators (Verriest et al., 2013). The CG index methodology was adopted from Farook et al. (2011), which was prepared under the guidelines of AAOIFI. Table 1 provides the detailed measurements and operational definitions of the 14 attributes included in the CG-index.

CG index is further divided into three indices i.e. BOD effectiveness, AC effectiveness and SSB effectiveness. Following Chan et al. (2014) and Ernstberger and Gruings (2013) methodology, each attribute was measured through a dummy variable having a value of either 1 or 0. Attributes are given a value of 1 if the attribute is present and 0 otherwise (Al-Malkawi et al., 2014; Ammann et al., 2011). The scores were calculated by adding the values of each attribute which was then converted into a percentage and finally the average was computed for each sub-index (Ajili & Bouri, 2018; Al-Malkawi et al., 2014).

Table I: Corporate Governance Attributes included in the Indices

Indexes	Variables	Operational Definition
BOD-Index		
1	Non-executive board members	Dummy variable having a value of 1 if more than 50% of board members are Non-Executive and 0 otherwise.
2	Board members independence	Dummy variable having a value of 1 if one third of board members are independent and 0 otherwise.
3	Board chairman independence	Dummy variable having a value of 1 if Chairman of the board is an independent member and 0 otherwise.
4	Duality role of CEO-chairman	Dummy variable having a value of 1 if CEO and Chairman of the board is a different person and 0 otherwise.
5	Number of board meetings	Dummy variable having a value of 1 if board meetings are held at least 5 times a year and 0 otherwise.
AC-Index		
6	AC existence	Dummy variable having a value of 1 if banks have established AC and 0 otherwise.
7	AC members	Dummy variable having a value of 1 if AC consists of at least 4 members and 0 otherwise.
8	AC chairman	Dummy variable having a value of 1 if Chairman of AC is an independent member and 0 otherwise.
9	AC members – independence	Dummy variable having a value of 1 if AC consists of at least 50% independent members and 0 otherwise.
10	AC number of meetings	Dummy variable having a value of 1 if AC meets at least 4 times a year and 0 otherwise.

SSB-Index		
11	SSB existence	Dummy variable having a value of 1 if bank has established SSB and 0 otherwise.
12	SSB members	Dummy variable if SSB consists of at least 3 members and 0 otherwise.
13	SSB Doctorate qualification	Dummy variable having a value of 1 if SSB consists of members having a Doctorate qualification and 0 otherwise.
14	SSB financial expertise	Dummy variable having a value of 1 if SSB members have financial expertise and 0 otherwise.

3.4. Control Variables

This study uses size and age of IBs as control variables consistent with earlier studies (Ajili & Bouri, 2018; Bukair & Abdul Rahman, 2015). It is argued that bank size positively affects its performance. Rajput and Joshi (2015) argue that banks' efficiency improves with time therefore, younger banks are less efficient. Bank size is measured by taking log of total assets (Ajili & Bouri, 2018; Naseem et al., 2017; Akbar et al., 2016; Mollah & Zaman, 2015) and age is measured by the total number of years since inception (Ammann et al., 2011; Ajili & Bouri, 2018). Some prior studies have included GDP and non-performing loans as control variables. However, both the variables were not included in this study due to time and resource constraints.

3.5. Regression Models

To ascertain the relationships between the variables, eight multiple regression models were developed. Model 1 and 2 was used for assessing the impact of CG-index on ROA and ROE. In Models 3-8, the impact of sub-indices (i.e. BOD, AC and SSB) was tested on ROA and ROE, respectively. The regression models are as follows:

$$ROA_{it} = \beta_0 + \beta_1 CGINDEX_{it} + \beta_2 SIZE_{it} + \beta_3 AGE_{it} + u_{it} \dots \dots \dots (1)$$

$$ROE_{it} = \beta_0 + \beta_1 CGINDEX_{it} + \beta_2 SIZE_{it} + \beta_3 AGE_{it} + u_{it} \dots \dots \dots (2)$$

$$ROA_{it} = \beta_0 + \beta_1 BODINDEX_{it} + \beta_2 SIZE_{it} + \beta_3 AGE_{it} + u_{it} \dots \dots \dots (3)$$

$$ROE_{it} = \beta_0 + \beta_1 BODINDEX_{it} + \beta_2 SIZE_{it} + \beta_3 AGE_{it} + u_{it} \dots \dots \dots (4)$$

$$ROA_{it} = \beta_0 + \beta_1 ACINDEX_{it} + \beta_2 SIZE_{it} + \beta_3 AGE_{it} + u_{it} \dots \dots \dots (5)$$

$$ROE_{it} = \beta_0 + \beta_1 ACINDEX_{it} + \beta_2 SIZE_{it} + \beta_3 AGE_{it} + u_{it} \dots \dots \dots (6)$$

$$ROA_{it} = \beta_0 + \beta_1 SSBINDEX_{it} + \beta_2 SIZE_{it} + \beta_3 AGE_{it} + u_{it} \dots \dots \dots (7)$$

$$ROE_{it} = \beta_0 + \beta_1 SSBINDEX_{it} + \beta_2 SIZE_{it} + \beta_3 AGE_{it} + u_{it} \dots \dots \dots (8)$$

Where,

ROA is the return on assets

ROE is the return on equity

CG-index is the corporate governance index

BOD-index is the board of directors index

AC-index is the audit committee index

SSB-index is the Shariah supervisory board index

SIZE is the bank size

AGE is the bank age

u is the error term

4. RESULTS AND DISCUSSION

4.1. Descriptive Statistics

Table II presents the descriptive statistics of the variables used in the study. The mean value for overall CG-index is 0.7569 with a maximum value of 0.93 and a minimum value of 0.57. This indicates that the majority of IBs adhere to CG regulations. Our finding is consistent with prior studies. For instance, Ajili and Bouri (2018) suggest that the mean value for CG-index is 0.74 for IBs of GCC countries whereas, Abdel-Baki and Sciabolazza (2014) suggest that the mean value of CG-index is 0.69 during the period 2001 to 2011. Furthermore, Table II suggests that the mean value for BOD-index is 0.73 with a maximum value of 1 and a minimum value of 0.4. This indicates that on an average 73% of attributes recommended by AAOIFI are present in IBs. Table II also suggests that the mean value for SSB is 0.7661 with a maximum value of 1 and a minimum value of 0.5. This indicates that SSBs of IBs adhere to around 76% of the attributes recommended by regulatory bodies. This table also suggests that the mean value for AC-index is 0.7757 with a maximum value of 1 and a minimum value of 0.4. Ajili and Bouri (2018) suggest that the mean values of BOD, SSB and AC indices are 0.59, 0.88 and 0.75, respectively. Table II also suggests that the mean values for ROA and ROE are 0.0293 and 0.0819 respectively. These values are slightly higher than those reported by Ajili and Bouri (2018). Ajili and Bouri (2018) suggest that the mean value of ROA and ROE for IBs of GCC countries are -0.003 and 0.008 respectively. Maximum and minimum values reported in Table II indicate variations in performance ratios of IBs.

Table II: Descriptive Statistics

Variables	Mean	Std. Dev.	Maximum	Minimum	Skewness	Kurtosis
ROA	0.0293	0.0707	0.707	-0.0435	6.8211	62.1417
ROE	0.0819	0.0778	0.227	-0.519	-3.4553	27.5403
CG-Index	0.7569	0.0912	0.9300	0.5700	-0.3218	2.8843
BOD-Index	0.7300	0.1497	1.0000	0.4000	-0.2627	2.8256
AC-Index	0.7757	0.1563	1.0000	0.4000	-0.5110	3.0863
SSB-Index	0.7661	0.0910	1.0000	0.5000	0.8096	7.0751

Note: Table II presents the descriptive statistics of dependent independent and control variables.

4.2. Correlation Matrix

Table III presents the correlation matrix for dependent, independent and control variables used in this study. This table suggests a negative correlation between ROA, ROE and CG-Index which is consistent with Ajili and Bouri (2018). Moreover, it suggests that ROA, ROE and bank size are positively correlated, consistent with the previous literature. However, bank age is negatively

correlated with ROA and ROE. Finally, all the correlation values are less than 0.8 which suggests the absence of multicollinearity (Hair et al., 2010).

Table III: Correlation Matrix

Variables	ROE	ROA	CG_ INDEX	BOD_ INDEX	AC_ INDEX	SSB_ INDEX	SIZE	AGE
ROE	1							
ROA	-0.1521	1						
CG_ INDEX	-0.0535	-0.0075	1					
BOD_ INDEX	-0.0832	0.0303	0.7237*	1				
AC_ INDEX	-0.0292	-0.0274	0.7966*	0.2958*	1			
SSB_ INDEX	0.0758	-0.0779	0.1901*	-0.2073*	0.0023	1		
SIZE	0.0662	0.0885	-0.2112*	0.1628	-0.2081*	-0.5864*	1	
AGE	-0.0327	-0.0129	-0.5959*	-0.5459*	-0.3901*	-0.0707	0.1326	1

Note: This table presents the correlation matrix. * denotes significance at the 10% level.

4.3. Panel Regression Results

Table III, IV, V and VI present the panel regression results. Table III presents the panel regression results for the impact of CG effectiveness on IB performance. Table IV, V and VI present the panel regression results for the impact of sub-indices (i.e. BOD-index, SSB-index and AC-index) on IB performance. We have used the Hausman test for deciding between fixed and random effect models (Ajili & Bouri, 2018). The test-statistic was insignificant therefore, we relied on the random effects model (Malik & Makhdoom, 2016). The Chi-square statistic is significant for all models which suggests that the models are statistically significant and have explanatory power.

The panel regression results reported in Table III show that there is a positive but statistically insignificant association between CG quality and IBs' performance ($\beta=0.422747$, $p=0.549$; $\beta=0.1605392$, $p=0.417$). Thus, the results do not support H1. The relationship remains the same for different measures of bank performance i.e. ROA and ROE. These results are consistent with prior studies (Ajili & Bouri, 2018; Al-Tamimi, 2012; Price et al., 2011). For instance, Akbar et al. (2016) argue that firm performance does not depend on compliance with CG regulations. This study corroborates the findings of earlier studies (i.e. Ajili & Bouri, 2018; Al-Tamimi, 2012; Price et al., 2011) conducted on IBs of GCC countries and extends the same for IBs of Malaysia and Pakistan. Furthermore, this table also suggests that bank size has a positive and statistically significant relationship with ROA consistent with Ajili and Bouri (2018). Moreover, age negatively affects ROA but positively affects ROE. We may infer from the results that when IBs mature, they focus on equity performance rather than focusing only on asset performance.

Table III: Panel Regression Results of CG-Index and IB Performance

Variables	Model 1 – ROA		Model 2 – ROE	
	Coefficient	p-value	Coefficient	p-value
CG-Index	.0422747	0.549	.1605392	0.417
Size	.1291902	0.018	-.0710632	0.314
Age	-.0100443	0.000	.0113734	0.041
Constant	-.2338911	0.092	-.0187992	0.938
R-squared	0.030		0.0806	
Chi- sq statistics	31.55***		10.02***	

Note: This table presents the panel data regression results for overall CG-index and IBs' financial performance.

*** denotes statistical significance at the 1% level.

Table IV presents the panel regression results analyzing the impact of BOD-index on IB performance. The results suggest that there is an insignificant relationship between BOD-index and IB performance ($\beta=-0.0439159$, $p=0.425$; $\beta=0.1128232$, $p=0.165$). Thus, the results do not support H2. Board of directors are mainly responsible for supervising and monitoring managers of firms in the best interests of shareholders (Jensen & Meckling, 1976). The reason for an insignificant relationship between BOD-index and IB performance may be that board of directors lack understanding of Islamic banking and their qualifications and expertise are not adequate (Ajili & Bouri, 2018; Bukair & Abdul Rahman, 2015; Sheikh & Kareem, 2015). If BOD do not understand the CG codes, they seem to fulfill only the requirements of central banks. Thus, a board with limited Islamic banking knowledge does not contribute significantly towards the performance of IBs. The results for size and age remains unchanged.

Table IV: Panel Regression Results of BOD-Index and IB Performance

Variables	Model 3 – ROA		Model 4 – ROE	
	Coefficient	p-value	Coefficient	p-value
BOD-Index	-.0439159	0.425	.1128232	0.165
Size	.1185243	0.057	-.0675237	0.397
Age	-.0099427	0.003	.0118513	0.013
Constant	-.137497	0.408	.000314	0.999
R-squared	0.0324		0.0901	
Chi- sq statistics	13.35***		10.20***	

Table V presents the panel regression results analyzing the impact of AC-index on the performance of IBs. The results suggest a positive and significant relationship with ROA ($\beta=0.29384$, $p=0.078$) but a negative and insignificant relationship with ROE ($\beta=-0.0006299$, $p=0.991$). Thus, the results broadly support H4. This implies that the AC of IBs are contributing towards asset performance rather than equity performance. This finding is interesting but contrary to existing literature (Wild, 1996; Ajili & Bouri, 2018). Wild (1996) argued that ACs only focus on the quality of financial reporting rather than performance. Ajili and Bouri (2018) suggest that ACs of IBs are ineffective towards enhancing the overall performance for GCC countries. Brown and Caylor (2006) suggest that AC size and independence do not have any

significant relationship with financial performance. Contrary to this, we find that ACs of IBs significantly improve asset performance.

Table V: Panel Regression Results of AC-Index and IB Performance

Variables	Model 5 – ROA		Model 6 – ROE	
	Coefficient	p-value	Coefficient	p-value
AC-Index	0.29384	0.078	-.0006299	0.991
Size	.1253492	0.026	-.0852944	0.214
Age	-.0099977	0.000	.0118156	0.026
Constant	-.2132234	0.161	.1407702	0.367
R-squared	0.0308		0.0714	
Chi- sq statistics	17.44***		7.82**	

Table VI presents the panel regression results analyzing the impact of SSB-index on IB performance. The results suggest a positive relationship between SSB-index and ROA ($\beta=0.0685661$, $p=0.049$) while, a negative relationship with ROE ($\beta=-0.1916676$, $p=0.002$). Thus, the results support H3. This implies that the SSB contributes positively towards asset performance whereas, it contributes negatively towards equity performance. This result is similar to those presented in Table V. The rationale behind this may be that SSB is mainly responsible for Shariah compliance. Mollah and Zaman (2015) argued that SSB has a positive relationship with IB performance when they play a supervisory role whereas, in an advisory role, the relationship is insignificant. Contrary to our findings, Ajili and Bouri (2018) reported an insignificant relationship between SSB-index and IB performance. Overall, the results are broadly consistent with the sample countries' corporate governance policies which are based on AAOIFI standards. Moreover, it is mandatory for all Islamic banks to comply with AAOIFI standards.

Table VI: Panel Regression Results of SSB-Index and IB Performance

Variables	Model 7 – ROA		Model 8 – ROE	
	Coefficient	p-value	Coefficient	p-value
SSB-Index	.0685661	0.049	-.1916676	0.002
Size	.1311836	0.036	-.1013457	0.157
Age	-.0103296	0.001	.012936	0.011
Constant	-.2556149	0.172	.3181656	0.094
R-squared	0.0305		0.0768	
Chi- sq statistics	15.56***		19.84***	

5. CONCLUSION

The purpose of this study was to ascertain the relationship between CG effectiveness and IBs' performance. This study used a sample of 20 IBs for the period 2012 to 2018. We used a pre-developed CG-index for measuring CG effectiveness. This CG-index is further divided into three sub-indices i.e. BOD-index, AC-index and SSB-index. Consistent with earlier studies, our results suggest an insignificant relationship between overall CG-index and IBs' performance. Moreover, the results also suggest that SSB and AC contribute positively towards asset performance but

negatively towards equity performance. The results of the study are broadly consistent with the agency and stakeholder theories. Consistent with the agency theory, we find that BOD (or agents) are not significantly contributing towards the financial performance of IBs perhaps due to conflict of interests with shareholders (or principal). Further, the results support the stakeholder theory as we find that IBs are mindful of stakeholder interests who are concerned with Shariah compliant banking services.

The findings of this study imply that policy makers should revisit CG regulations in order to make them more influential towards the performance of IBs. IBs should make sure that board members truly possess the knowledge of Shariah principles in order to serve in the best interests of stakeholders targeting Halal income. Central banks may also strengthen their regulations, so that the economy benefits from the exponential growth in the Islamic banking sector. The limited sample size of the study is a key limitation. The sample size may be increased for a profound understanding of CG mechanisms and its relationship with IBs' performance. Further, some variables were not included due to time and resource constraints. Future studies may contribute to the literature by examining this relationship for IBs belonging to countries populated with Non-Muslims.

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Appendix 1: List of Sample Islamic Banks

S. No.	Name of Islamic Bank	Symbol	Country
1	BankIslami Pakistan Limited	BIPL	Pakistan
2	Meezan Bank Limited	MBL	Pakistan
3	Abu Dhabi Islamic Bank	ADIB	U.A.E.
4	Al-Salam Bank Ltd	ALSABH	Bahrain
5	Bahrain Islamic Bank	BISB	Bahrain
6	Bank ABC Islamic	BABC	Bahrain
7	Al-Khaleej Islamic Bank	AKIB	Bahrain
8	Jordan Islamic Bank	JIB	Jordan
9	Boubyan Bank	BOUB	Kuwait
10	Kuwait Finance House	KFH	Kuwait
11	Affin Islami Bank	AFIB	Malaysia
12	AmBank Islamic Bank	AMIB	Malaysia
13	Bank Muamalat Malaysia	BMMB	Malaysia
14	Hong Leong Islamic Bank	HLIB	Malaysia
15	OCBC Al-Amin Bank	OCBC	Malaysia
16	RHB Islamic Bank Berhad	RHBI	Malaysia
17	Qatar International Islamic Bank	QIIB	Qatar
18	Qatar Islamic Bank	QIB	Qatar
19	Bank Al-Bilad	ALBI	Saudi Arabia
20	Al-Inma Bank	INMA	Saudi Arabia