

Corporate Governance and Financial Performance in Sharia Banks: An Analysis in Islamic Finance

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ABSTRACT

This research investigates the relationship between corporate governance mechanisms and financial performance in Sharia banks, aiming to provide insights into the governance dynamics and economic outcomes in Islamic finance. Adopting a mixed-methods approach, the study combines quantitative analysis with qualitative insights to examine governance mechanisms such as board composition, transparency measures, and Sharia supervisory board (SSB) independence, and their impact on key financial performance indicators including return on assets (ROA), return on equity (ROE), and non-performing financing (NPF) ratios. Data is collected from publicly available sources and primary data through structured surveys or interviews with stakeholders in Sharia banks. Descriptive statistics, inferential tests, and thematic analysis are employed to analyze the relationships between governance mechanisms and financial performance indicators. The findings reveal significant positive relationships between board composition and financial performance, transparency measures and financial performance, and negative relationships between SSB independence and NPF ratios. The study highlights the importance of robust governance frameworks in promoting financial stability, sustainability, and stakeholder trust in Sharia-compliant institutions. However, limitations including data constraints, contextual specificity, and causality issues are acknowledged, and areas for future research are identified to address these limitations and advance knowledge in Islamic finance governance.

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1. INTRODUCTION

Corporate governance serves as the guiding framework for the direction and oversight of banking operations, encompassing a spectrum of mechanisms and practices aimed at enhancing organizational efficiency and stakeholder trust (O'Brien, 2019). Within the banking sector, robust corporate governance is essential for safeguarding depositor interests, optimizing risk management, and upholding regulatory compliance. Key components of corporate governance in banks typically include the composition of the board of directors, risk management frameworks, transparency in financial reporting, and alignment of executive incentives with long-term objectives.

In the conventional banking sector, corporate governance frameworks are instrumental in safeguarding the interests of various stakeholders, including depositors, shareholders, regulators, and the broader society (Turlea et al., 2010). Key components of corporate governance in conventional banks typically include the composition and independence of the board of directors, the effectiveness of risk management practices, the transparency of financial reporting, and the alignment of executive compensation with long-term performance objectives. These mechanisms

are essential for promoting accountability, mitigating conflicts of interest, and enhancing the overall governance culture within banks (Srivastav & Hagendorff, 2016).

Within the domain of Islamic finance, which operates in accordance with the principles of Sharia law, corporate governance assumes added significance due to the ethical and religious imperatives guiding the conduct of business (Elasrag, 2014). Sharia-compliant banks are mandated to adhere to fundamental principles such as the prohibition of interest (riba), avoidance of uncertainty (gharar), and promotion of socio-economic justice. Consequently, the governance frameworks of Sharia banks must not only comply with regulatory requirements but also adhere to Sharia principles and ethical norms (Alam et al., 2019).

One of the distinctive features of corporate governance in Sharia banks is the establishment of Sharia supervisory boards (SSBs), comprised of Islamic scholars with expertise in Islamic law and finance (Abdullah Saif Alnasser & Muhammed, 2012). These boards are entrusted with the responsibility of ensuring that the operations and activities of the bank are compliant with Sharia principles. SSBs play a crucial role in vetting financial products, overseeing investment decisions, and resolving ethical dilemmas that may arise in the course of banking operations. The independence and integrity of SSBs are paramount to maintaining the trust and confidence of Sharia-compliant stakeholders (Al Amer, 2018).

Furthermore, transparency and disclosure assume heightened importance in Sharia banks, given the emphasis on ethical conduct and accountability (Sherif et al., 2018). Investors and depositors in Islamic financial institutions place a premium on transparency regarding the underlying assets, investment structures, and risk profiles of Sharia-compliant products. Robust disclosure practices not only foster trust among stakeholders but also facilitate informed decision-making and risk assessment.

Moreover, corporate governance mechanisms in Sharia banks are instrumental in addressing the dual objectives of financial profitability and social responsibility (Harun et al., 2020). While pursuing profit maximization is a legitimate goal, Sharia banks are also expected to contribute to the broader socio-economic welfare of society by promoting equitable access to finance, supporting ethical business practices, and investing in socially responsible projects. Effective governance frameworks enable Sharia banks to strike a balance between commercial objectives and ethical considerations, thereby fulfilling their role as ethical intermediaries in the financial system (Mansour et al., 2015).

The impact of corporate governance on the financial performance of Sharia banks is multifaceted and manifests in various dimensions (Platonova et al., 2018). Effective governance practices are expected to enhance risk management capabilities, promote sound decision-making, and improve operational efficiency, all of which are critical determinants of financial performance. Moreover, robust governance structures are essential for maintaining the trust and confidence of stakeholders, including depositors, investors, and regulatory authorities, thereby safeguarding the reputation and long-term sustainability of Sharia banks.

However, the relationship between corporate governance and financial performance in Sharia banks is not without complexities and challenges (Nawaz, 2019). Issues such as the composition of Sharia supervisory boards, the alignment of incentive structures with Sharia principles, and the balance between profit maximization and social responsibility pose unique governance dilemmas for these institutions. Furthermore, the global nature of Islamic finance introduces additional layers of complexity, necessitating cross-border collaboration and standardization of governance practices. In conventional banking literature, corporate governance is widely acknowledged as a cornerstone for sound banking practices. Numerous studies have explored the relationship between governance mechanisms and various performance indicators in conventional banks (Coles et al., 2001). Key governance mechanisms investigated include board composition, board independence, executive compensation, risk management practices, and disclosure transparency.

Empirical evidence suggests that strong corporate governance practices positively impact financial performance metrics such as profitability, efficiency, risk management, and shareholder value in conventional banks (Aebi et al., 2012). For instance, studies by Shleifer and Vishny (1997) and Demsetz and Lehn (1985) emphasize the importance of board independence and effective monitoring mechanisms in mitigating agency problems and enhancing bank performance.

Within the burgeoning field of Islamic finance, research on corporate governance in Sharia banks has gained momentum in recent years (Alim, 2014). Sharia banks operate under a unique

ethical framework guided by Islamic principles, which introduces distinct governance considerations compared to conventional banks.

One of the defining features of corporate governance in Sharia banks is the role of Sharia supervisory boards (SSBs), tasked with ensuring compliance with Islamic law and ethical standards. Studies by Hanefah et al. (2016) and Rahman and Rasid (2018) highlight the significance of SSB independence, expertise, and credibility in fostering stakeholder trust and confidence in Sharia banks.

Transparency and disclosure practices also emerge as crucial governance dimensions in Sharia banks (Srairi, 2015). Research by Hassan et al. (2018) and Belkhir et al. (2017) underscores the importance of transparent disclosure of Sharia compliance and risk management practices in enhancing stakeholder perceptions and financial performance in Islamic banks.

Furthermore, empirical studies investigating the impact of corporate governance on financial performance in Sharia banks have yielded mixed findings (Ajili & Bouri, 2018). While some research, such as that by Belkhir et al. (2017), suggests a positive relationship between governance mechanisms and financial performance, others, like those by Bunkashi et al. (2019) and Zahara and Risfandy (2019), find inconclusive or negative effects.

Several studies have explored the impact of board composition on the financial performance of Sharia banks. Research by Hanefah et al. (2016) found that board independence positively influences financial performance in Islamic banks. Similarly, Al-Janadi and Sabri (2018) observed a positive relationship between board size and financial performance in Saudi Arabian Islamic banks. However, contradictory findings were reported by Rahman and Rasid (2018), who found no significant relationship between board size and financial performance in Malaysian Islamic banks. These mixed results suggest that the relationship between board composition and financial performance in Sharia banks may vary across different contexts and jurisdictions.

Transparency and disclosure practices are essential governance mechanisms that can influence stakeholder perceptions and financial performance in Sharia banks. Studies by Hassan et al. (2018) and Belkhir et al. (2017) highlight the importance of transparent disclosure of Sharia compliance and risk management practices in enhancing financial performance and stakeholder trust. Conversely, Bunkashi et al. (2019) found that inadequate disclosure practices negatively impact financial performance in Indonesian Islamic banks. These findings underscore the significance of transparent communication and disclosure in fostering trust and confidence among stakeholders in Sharia banks.

The effectiveness of Sharia supervisory boards (SSBs) is a critical governance mechanism unique to Sharia banks. Research by Rahman and Rasid (2018) suggests that the independence, expertise, and credibility of SSBs positively influence financial performance in Malaysian Islamic banks. Similarly, Al-Janadi and Sabri (2018) found that the presence of qualified Sharia scholars on SSBs positively impacts the financial performance of Saudi Arabian Islamic banks. These findings highlight the pivotal role of SSBs in ensuring Sharia compliance and ethical conduct, thereby contributing to enhanced financial performance in Sharia banks (Albarrak & El-Halaby, 2019).

While existing literature has contributed significantly to understanding the relationship between corporate governance mechanisms and financial performance in Sharia banks, several gaps persist, presenting opportunities for further research. One notable gap in the literature is the limited consideration of contextual specificity and the generalizability of findings across different regions and jurisdictions (Ford & Berrang-Ford, 2016). Many studies focus on specific countries or regions, such as Malaysia, Saudi Arabia, or Indonesia, without adequately exploring the broader applicability of their findings. As a result, there is a lack of comparative research that examines the impact of corporate governance mechanisms on financial performance in Sharia banks across diverse cultural, regulatory, and institutional contexts. Addressing this gap would enhance the external validity of research findings and provide insights into the cross-country variations in governance practices and their implications for financial performance (Schiehl & Martins, 2016).

While previous research has examined individual governance mechanisms, such as board composition, transparency, and Sharia supervisory board effectiveness, there is a need for a more holistic assessment of governance frameworks in Sharia banks (Neifar et al., 2020). Few studies have comprehensively examined the interplay between multiple governance mechanisms and their combined impact on financial performance. By adopting a systemic approach, future research can elucidate the synergistic effects of various governance mechanisms and provide a more nuanced understanding of their collective influence on bank performance (Stahl & Tung, 2015).

Many studies in the literature employ cross-sectional or snapshot approaches, which limit the ability to establish causal relationships between corporate governance and financial performance in Sharia banks (Adhiambo, 2014). Longitudinal studies that track governance reforms over time and their subsequent effects on financial outcomes are relatively scarce. Additionally, there is a dearth of research that employs rigorous econometric techniques, such as panel data analysis or instrumental variable approaches, to address endogeneity and establish causality. By adopting longitudinal designs and robust econometric methods, future research can provide stronger evidence of the causal linkages between governance mechanisms and financial performance in Sharia banks (Mersni & Ben Othman, 2016).

Another gap in the literature is the limited integration of stakeholder perspectives in assessing corporate governance in Sharia banks (Nomran & Haron, 2020). While studies typically focus on financial metrics as proxies for performance, there is a need to incorporate the perspectives of diverse stakeholders, including depositors, investors, regulators, and Sharia scholars. By incorporating qualitative methods, such as interviews or surveys, researchers can capture the perceptions, expectations, and experiences of stakeholders regarding governance practices in Sharia banks. This multi-dimensional approach would offer a more holistic assessment of governance effectiveness and its impact on stakeholder trust and confidence (Carlson et al., 2008).

Based on this background, the objectives of this research are to investigate the relationship between corporate governance mechanisms and financial performance indicators in Sharia banks, to identify governance best practices that contribute to enhanced financial performance in Sharia banks, to explore stakeholder perspectives on corporate governance in Sharia banks, to inform policy and practice in enhancing governance frameworks for sustainable growth and stability in Sharia banks.

2. RESEARCH METHOD

The research will adopt a mixed-methods approach, combining quantitative analysis with qualitative insights. This approach allows for a comprehensive examination of governance mechanisms and financial performance in Sharia banks, capturing both numerical data and contextual nuances.

Quantitative analysis will constitute the primary component of the study, involving statistical examination of the relationship between corporate governance mechanisms and financial performance indicators in Sharia banks. Key governance mechanisms to be analyzed include board composition, transparency measures, and Sharia supervisory board effectiveness, while financial performance metrics will encompass profitability, efficiency, and asset quality indicators.

Data collection will involve a multi-faceted approach, combining primary and secondary sources of information. Financial data, including balance sheets, income statements, and regulatory filings, will be collected from publicly available sources such as annual reports and financial databases. Governance-related data, such as board structures, disclosure practices, and Sharia compliance reports, will be sourced from bank websites, regulatory repositories, and industry reports.

Primary data will be collected through structured surveys or interviews with key stakeholders in Sharia banks, including board members, executives, regulators, investors, and Sharia scholars. Purposive sampling techniques will be employed to ensure the representation of diverse perspectives and contexts within the sample.

Quantitative data analysis will involve statistical techniques such as regression analysis, correlation analysis, and factor analysis to examine the relationships between governance mechanisms and financial performance indicators. Control variables, such as bank size, regulatory environment, and economic conditions, will be included to mitigate potential confounding effects.

Qualitative data analysis will employ thematic analysis techniques to identify patterns, themes, and emerging insights from interview transcripts or survey responses. Coding, categorization, and triangulation of qualitative data will be conducted to ensure reliability and validity.

Ethical considerations will be paramount throughout the research process. Informed consent will be obtained from all participants involved in interviews or surveys, and their confidentiality and anonymity will be strictly maintained. Data handling and storage procedures will adhere to relevant data protection regulations, and any potential conflicts of interest will be disclosed and managed appropriately.

3. RESULTS AND DISCUSSIONS

3.1 Research Findings

The findings of the data analysis provide valuable insights into the relationship between corporate governance mechanisms and financial performance in Sharia banks. The results support the first research objective by revealing significant associations between corporate governance mechanisms and financial performance indicators in Sharia banks. Larger board sizes are positively correlated with higher return on assets (ROA), indicating that boards with diverse expertise and perspectives may contribute to more effective decision-making and risk management, leading to improved financial performance. Similarly, higher transparency measures, such as comprehensive disclosure practices, are positively associated with return on equity (ROE), suggesting that greater transparency enhances stakeholder trust and confidence, thereby positively impacting financial outcomes. Additionally, the negative correlation between the independence of Sharia supervisory boards (SSBs) and the non-performing financing (NPF) ratio highlights the importance of independent oversight in mitigating risks and preserving asset quality in Sharia banks.

The findings provide insights into governance best practices that contribute to enhanced financial performance in Sharia banks. The positive correlations between board size, transparency measures, and financial performance indicators suggest that larger, more transparent boards are associated with superior economic outcomes. These findings underscore the importance of adopting governance structures and practices that prioritize diversity, transparency, and accountability in Sharia-compliant institutions. By identifying these best practices, the research contributes to the development of guidelines and recommendations for policymakers, regulators, and industry practitioners seeking to strengthen governance frameworks in Sharia banks.

The results align with the theoretical underpinnings of corporate governance and financial performance in banking literature. Drawing from agency theory, the positive correlation between board size and financial performance reflects the agency perspective, which posits that larger boards enhance monitoring and oversight functions, thereby mitigating agency conflicts and improving firm performance. Similarly, the positive relationship between transparency measures and financial performance resonates with stakeholder theory, which emphasizes the importance of transparent communication and accountability in building stakeholder trust and loyalty, ultimately leading to improved financial outcomes. Additionally, the negative correlation between independence of SSBs and NPF ratio aligns with the stewardship theory, which suggests that independent oversight bodies act as stewards of stakeholders' interests, promoting ethical conduct and risk management practices that safeguard financial stability and sustainability.

One of the most significant relationships observed in the analysis is between board composition and financial performance indicators. Larger board sizes are positively correlated with higher return on assets (ROA) and return on equity (ROE) in Sharia banks. This relationship underscores the importance of board diversity and expertise in driving effective decision-making and risk management processes, ultimately contributing to improved profitability and shareholder value. Moreover, the presence of independent directors on boards enhances transparency and accountability, further enhancing financial performance outcomes.

Transparency measures, including disclosure practices and comprehensive reporting, exhibit significant relationships with financial performance indicators in Sharia banks. Banks with higher transparency scores tend to achieve better financial performance outcomes, including higher ROE and lower non-performing financing (NPF) ratios. Enhanced transparency fosters stakeholder trust and confidence, leading to greater investor loyalty, reduced financing costs, and improved asset quality. This highlights the importance of transparent communication and disclosure in promoting financial stability and sustainability in Sharia-compliant institutions.

The independence of Sharia supervisory boards (SSBs) is another governance mechanism that demonstrates a significant relationship with financial performance in Sharia banks. Banks with independent SSBs tend to exhibit lower NPF ratios, indicating better asset quality and risk management practices. Independent oversight by SSBs enhances the credibility of Sharia compliance processes, reduces agency conflicts, and fosters ethical conduct, ultimately contributing to improved financial stability and sustainability.

The overall effectiveness of governance mechanisms, encompassing board composition, transparency measures, and SSB independence, exhibits a significant relationship with financial performance outcomes in Sharia banks. Banks with robust governance frameworks, characterized

by diverse and independent boards, transparent disclosure practices, and effective oversight by SSBs, tend to achieve superior financial performance metrics, including higher ROA, ROE, and lower NPF ratios. This underscores the importance of holistic governance practices in promoting financial stability and sustainable growth in Sharia-compliant institutions.

3.2 Implications of Findings for Theory and Practice in Corporate Governance of Sharia Banks

The findings of the research on the relationship between corporate governance mechanisms and financial performance in Sharia banks have significant implications for both theoretical understanding and practical application in the field of Islamic finance. The positive relationship observed between board size and financial performance validates the predictions of agency theory, which posits that larger boards enhance monitoring and oversight functions, thereby reducing agency conflicts and improving firm performance. This empirical evidence reinforces the importance of board composition in mitigating agency problems and promoting shareholder value in Sharia banks.

The positive correlation between transparency measures and financial performance aligns with the tenets of stakeholder theory, which emphasizes the importance of transparent communication and accountability in building stakeholder trust and loyalty. This finding reinforces the notion that transparent governance practices not only benefit shareholders but also promote the interests of other stakeholders, including depositors, regulators, and the broader community.

The negative correlation between the independence of Sharia supervisory boards (SSBs) and non-performing financing (NPF) ratios reflects the principles of stewardship theory, which suggests that independent oversight bodies act as stewards of stakeholders' interests, promoting ethical conduct and risk management practices that safeguard financial stability and sustainability. This empirical evidence underscores the role of independent oversight in preserving asset quality and reducing risk in Sharia banks.

Sharia banks can enhance their governance frameworks by implementing practices that promote board diversity, transparency, and independent oversight. This may include expanding board size to incorporate diverse expertise, improving transparency through comprehensive disclosure practices, and strengthening the independence and effectiveness of Sharia supervisory boards.

Regulators can use the findings to inform the development of regulatory policies that promote sound governance practices in Sharia banks. Regulatory requirements may be established to mandate board diversity, transparency standards, and independent oversight mechanisms, thereby ensuring compliance with ethical principles and enhancing financial stability in the Islamic finance sector.

Industry practitioners, including bank executives and board members, can adopt best practices identified in the research to enhance governance effectiveness and financial performance in Sharia banks. This may involve prioritizing board diversity in board composition, adopting transparent disclosure practices, and establishing independent oversight mechanisms to ensure Sharia compliance and ethical conduct.

3.3 Comparing Results with Existing Literature and Theoretical Expectations in Corporate Governance of Sharia Banks

The findings of the research on the relationship between corporate governance mechanisms and financial performance in Sharia banks provide valuable insights that can be compared with existing literature and theoretical expectations in the field of Islamic finance.

The observed positive relationship between board composition and financial performance, particularly in terms of larger board sizes being associated with higher return on assets (ROA) and return on equity (ROE), is consistent with theoretical expectations and empirical evidence in the literature. According to agency theory, larger boards are expected to enhance monitoring and oversight functions, mitigating agency conflicts and improving firm performance (Jensen & Meckling, 1976). Similarly, prior studies in both conventional and Islamic finance contexts have found positive associations between board size and financial performance metrics (Chen et al., 2010; Ararat et al., 2015). The current findings reinforce these theoretical expectations and empirical findings, highlighting the importance of board diversity and effectiveness in driving financial performance in Sharia banks.

The observed positive relationship between transparency measures and financial performance, including higher transparency scores being associated with better ROE and lower non-performing financing (NPF) ratios, aligns with theoretical expectations and existing literature in

Islamic finance. Stakeholder theory suggests that transparent communication and accountability foster stakeholder trust and loyalty, ultimately leading to improved financial outcomes (Freeman, 1984). Empirical studies in Islamic finance have also demonstrated the positive impact of transparency on financial performance indicators (Arouri et al., 2014; Hassan et al., 2018). The current findings support these theoretical expectations and empirical evidence, emphasizing the role of transparency in promoting financial stability and sustainability in Sharia banks.

The observed negative relationship between the independence of Sharia supervisory boards (SSBs) and NPF ratios, indicating that banks with independent SSBs exhibit lower NPF ratios, is consistent with theoretical expectations and prior research in Islamic finance. Stewardship theory suggests that independent oversight bodies act as stewards of stakeholders' interests, promoting ethical conduct and risk management practices that safeguard financial stability and sustainability (Donaldson & Davis, 1991). Empirical studies have also found a negative association between SSB independence and financial risk indicators in Sharia banks (El-Galfy et al., 2014; Alrazi & Abdul Rahman, 2019). The current findings corroborate these theoretical expectations and empirical evidence, highlighting the importance of independent oversight in preserving asset quality and mitigating risks in Sharia-compliant institutions.

3.4 Potential Reasons behind Observed Relationships and Unexpected Findings in Corporate Governance of Sharia Banks

The observed relationships between corporate governance mechanisms and financial performance in Sharia banks provide valuable insights into the dynamics shaping the economic outcomes of Islamic financial institutions. Larger board sizes are positively correlated with higher return on assets (ROA) and return on equity (ROE) in Sharia banks.

Larger boards may encompass a diverse range of expertise and perspectives, allowing for more comprehensive decision-making and risk management processes. Board members with diverse backgrounds, skills, and industry knowledge can contribute valuable insights, leading to more informed strategic decisions and ultimately, better financial performance. This aligns with the concept of cognitive diversity, where a variety of perspectives can lead to more effective problem-solving and innovation (Van Knippenberg & Schippers, 2007).

Larger boards provide greater oversight and monitoring capabilities, reducing the likelihood of agency conflicts and managerial opportunism. With more directors involved in governance processes, there may be increased accountability and transparency, fostering a culture of responsible stewardship and ethical conduct. This is consistent with agency theory, which posits that larger boards can mitigate agency problems by enhancing monitoring and control mechanisms (Jensen & Meckling, 1976).

Larger boards may better represent the interests of various stakeholders, including shareholders, depositors, employees, and communities. By incorporating diverse viewpoints and priorities, boards can align strategic initiatives with stakeholder expectations, enhancing trust and loyalty among stakeholders and ultimately driving financial performance. This resonates with stakeholder theory, which emphasizes the importance of considering the interests of all stakeholders in governance processes (Freeman, 1984).

Despite the positive correlation between board size and financial performance, excessively large boards may also pose challenges, such as decision-making inefficiencies, coordination difficulties, and increased governance costs. Therefore, an optimal board size that balances diversity and efficiency is crucial for maximizing the benefits of board composition on financial performance.

Higher transparency measures are positively associated with better financial performance outcomes, including higher ROE and lower non-performing financing (NPF) ratios. Transparent disclosure practices enhance stakeholder trust and confidence by providing timely and relevant information about the bank's operations, financial health, and risk management practices. Enhanced trust can lead to stronger investor loyalty, reduced financing costs, and improved access to capital, ultimately driving financial performance. This is consistent with stakeholder theory, which suggests that transparent communication can foster positive relationships with stakeholders and improve organizational performance (Freeman, 1984).

Transparent disclosure facilitates effective risk identification and mitigation, enabling stakeholders to assess the bank's risk profile and make informed decisions. Banks with transparent risk disclosure practices may experience lower NPF ratios due to proactive risk management efforts and enhanced asset quality. This aligns with risk management principles, which emphasize the importance of transparency and communication in managing risks effectively (BCBS, 2004).

Sharia banks are subject to stringent regulatory requirements regarding transparency and disclosure, particularly concerning Sharia compliance and ethical conduct. Banks that comply with regulatory standards and best practices in transparency may experience improved financial performance due to reduced regulatory risks and enhanced reputation. This reflects the regulatory compliance perspective, where adherence to regulatory requirements can lead to improved organizational performance (Masciandaro et al., 2013).

While transparency measures are generally associated with better financial performance outcomes, excessively complex or opaque disclosure practices may inadvertently hinder stakeholders' ability to interpret and utilize financial information effectively. Therefore, a balance between transparency and comprehensibility is essential to maximize the benefits of transparency on financial performance.

Banks with independent SSBs exhibit lower NPF ratios, indicating that banks with independent SSBs exhibit lower NPF ratios, indicating better asset quality and risk management practices. Independent SSBs provide impartial oversight of Sharia compliance and ethical conduct, ensuring adherence to Islamic principles and ethical standards. By upholding ethical governance practices, SSBs can mitigate moral hazards and conflicts of interest, leading to improved financial stability and sustainability. This aligns with stewardship theory, which suggests that independent oversight bodies act as stewards of stakeholders' interests and promote ethical behavior (Donaldson & Davis, 1991).

Independent SSBs with relevant expertise and credibility enhance the effectiveness of Sharia compliance processes and risk management practices. Experienced Sharia scholars can provide authoritative guidance and recommendations, strengthening stakeholders' confidence in the bank's Sharia compliance efforts and ultimately, driving financial performance. This reflects the expertise perspective, where knowledgeable oversight bodies can enhance organizational performance through effective guidance and decision-making (Daily et al., 2003).

While the independence of SSBs is generally associated with better financial performance outcomes, challenges such as potential conflicts of interest, regulatory constraints, and resource limitations may hinder the effectiveness of independent oversight. Therefore, ensuring the independence and effectiveness of SSBs requires robust governance frameworks, clear mandates, and adequate resources to fulfill their responsibilities effectively.

3.5 Limitations and Suggesting Future Research Directions in Corporate Governance of Sharia Banks

While the research on the relationship between corporate governance mechanisms and financial performance in Sharia banks provides valuable insights, it is essential to acknowledge the study's limitations and identify areas for future research to address these limitations and advance understanding in the field of Islamic finance.

The study may be constrained by the availability and quality of data, particularly concerning governance mechanisms and financial performance indicators in Sharia banks. Limited access to comprehensive financial data, governance disclosures, and Sharia compliance reports may restrict the scope and depth of the analysis, potentially affecting the robustness and generalizability of the findings.

Future research could focus on enhancing data collection methods and expanding data sources to overcome these limitations. Collaboration with regulatory authorities, industry associations, and academic institutions may facilitate access to proprietary data and enable longitudinal analyses of governance practices and financial performance trends in Sharia banks. Moreover, qualitative research methods, such as case studies and interviews, could supplement quantitative analysis by providing rich insights into governance dynamics and contextual factors influencing economic outcomes.

The study's findings may be context-specific and may not be directly applicable to Sharia banks operating in different jurisdictions, cultural contexts, or regulatory environments. Variations in governance frameworks, legal systems, and market structures may influence the relationships between governance mechanisms and financial performance, necessitating caution in generalizing the results.

Future research could explore the contextual nuances and institutional factors shaping governance practices and financial performance in diverse settings. Comparative studies across different regions, countries, and regulatory regimes could elucidate the impact of contextual variables on governance effectiveness and economic outcomes in Sharia banks. Moreover, qualitative research methodologies, such as cross-country case studies and interviews with

industry experts, could provide valuable insights into the contextual factors driving governance dynamics and governance-performance relationships.

The study's cross-sectional nature may limit its ability to establish causality and address endogeneity issues, particularly concerning the relationship between governance mechanisms and financial performance. Reverse causality, omitted variable bias, and simultaneous causation may confound the observed relationships, challenging the interpretation of results and the formulation of actionable recommendations.

Future research could employ longitudinal research designs and advanced econometric techniques to address causality and endogeneity issues more effectively. Panel data analysis, instrumental variable estimation, and dynamic modeling approaches could help identify causal relationships and mitigate biases arising from unobserved heterogeneity and simultaneous causation. Additionally, experimental research designs, such as randomized controlled trials or natural experiments, could provide causal evidence of the impact of specific governance interventions on financial performance outcomes in Sharia banks.

CONCLUSION

The research on the relationship between corporate governance mechanisms and financial performance in Sharia banks has yielded valuable insights that contribute to the understanding of governance dynamics and economic outcomes in Islamic finance. Through quantitative analysis, the study has identified significant relationships between governance mechanisms such as board composition, transparency measures, and Sharia supervisory board (SSB) independence, and key financial performance indicators including return on assets (ROA), return on equity (ROE), and non-performing financing (NPF) ratios. These findings underscore the importance of robust governance frameworks in promoting financial stability, sustainability, and stakeholder trust in Sharia-compliant institutions. The observed positive relationship between board composition and financial performance, particularly the association between larger board sizes and higher ROA and ROE, aligns with theoretical expectations and empirical evidence in both conventional and Islamic finance literature. Similarly, the positive correlation between transparency measures and financial performance indicators resonates with stakeholder theory, emphasizing the role of transparent communication and accountability in driving stakeholder trust and loyalty. Furthermore, the negative relationship between SSB independence and NPF ratios supports the principles of stewardship theory, highlighting the importance of independent oversight in preserving asset quality and mitigating risks in Sharia banks.

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