DOES SHARI'AH SUPERVISORY BOARD CHARACTERISTICS AFFECT ISLAMIC BANKS' FINANCIAL PERFORMANCE? EVIDENCE FROM SAUDI ARABIA

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Abstract

Shari'ah (Islamic law) governance has drawn considerable interest in the past few decades in an effort to enhance the outcomes and prolonged success of banks that follow the Islamic banking system. There is widespread awareness that Shari'ah governance enhances public trust in the integrity, management, and business functioning of Islamic banks and prevents any financial crisis that could affect the performance of banks. The current study has a primary objective to analyze the influence of Shari'ah Supervisory Board (SSB) characteristics upon the financial performance of the banks that follow the Islamic banking system in the Kingdom of Saudi Arabia (KSA) based on features possessed by the SSB. The data considered for the period spans between 2013 and 2022 and focuses on four fully-fledged Islamic banks operating in the KSA. The Authors collected the annual reports of the banks to extract the financial data and analyzed it under descriptive statistical analysis. Further, an ordinary least square regression model was also applied in this study. The analytical outcomes reveal that the independence and the experience of the Shari'ah board exert a remarkable influence on the financial performance of the Islamic banks whereas the size of the Shari'ah board has no significant influence to note. The study suggests that the Saudi Central Bank (SAMA) should accelerate the incorporation of the Shari'ah governance framework in the banks that follow the Islamic banking system. Therefore, there is an urgent need to establish a central SSB to coordinate the efforts of the committees of Saudi local banks and provide the necessary technical assistance for implementing optimal Shari'ah governance practices.

Keywords: Shari'ah Governance, Shari'ah Supervisory Board, Islamic Banking, Bank Performance

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1. INTRODUCTION

Due to the Vision 2030 announcement made in 2016, the Kingdom of Saudi Arabia (KSA) is undergoing massive transformations in almost every aspect of its economy and society. In this background, Islamic finance is observed as a crucial component that supports the economic growth of the country and its financial institutions, as part of that transformational plan, which aims at diversifying the Saudi economy away from its dependence on oil resources (Islamic Financial Services Board [IFSB] & Saudi Central Bank [SAMA], 2021).

Among dual banking systems, KSA contains the world's largest Islamic banking sector. In 2020, Islamic banking assets accounted for more than 65% of the major components of Islamic financing assets, or $544 billion (IFSB & SAMA, 2021). It is significant to note that during the year 2020, the Islamic banking assets in the KSA experienced a 17% increase which was primarily backed by Islamic law or Shari'ah-adhering financing guidelines in the retail business line, especially residential mortgage (Aljazira Capital, 2022a). In terms of assets among the Islamic financial jurisdictions across the globe, the KSA possesses the top Islamic banking, insurance and Islamic investment fund sectors. The Islamic finance industry in the KSA is under the maintenance of Shari'ah governance and is controlled by the in-hour Shari'ah Supervisory Board (SSB). This board ensures the financial activities at an institutional level while any new Islamic financial products are to be approved by SSB.

The Shari'ah governance framework was provided to the banks that operate in the KSA by the SAMA so that these institutions can adhere to Shari'ah governance in the banking sector of the nation (SAMA, 2020). Islamic Financial Services Board (IFSB) and other multilateral bodies have framed the international best practices for Islamic banks, based on which SAMA also developed the framework for the KSA banks. These guidelines define the basic structure of Islamic banking operations as per Shari'ah governance. In addition to this, it also defines how a Shari'ah board should be set up and the establishment of executive management, board and their formation, appointment of members, rules and responsibilities of the board of directors, etc. Further, the guidelines also detail the internal control functions of the board, how Islamic windows should be operated in conventional banks and the guidelines to develop Shari'ah-adhering products as well as services.

The top priority of the Financial Sector Development Program (FSDP), an initiative under Islamic finance strategy, is to enhance the Shari'ah governance framework among the Islamic financial institutions operating in the KSA. Though Shari'ah governance has already decentralized KSA's financial institutions that operate under Islamic banking laws, a holistic Shari'ah governance framework can upgrade the confidence among the investors and the banking customers upon Shari'ah decision decision-making that stands with international best banking practices. According to the strategy, two commitments should be met within the year 2025 in order to provide complete freedom to expert Shari'ah scholars in the Islamic finance domain. In addition to this, the Islamic finance strategy also provides a few strategic actions to be incorporated by SAMA and the Capital Market Authority (CMA) by the year 2030 in order to enhance Shari'ah governance in the Islamic financial institutions, by supervising its functions. The following are the initiatives recommended by the strategy (IFSB & SAMA, 2021):

1. Upregulation of Shari'ah committees in the banking system as well as other financial organizations so that the issues regarding its regulations across the institutions are addressed. Further, such rules also take care of the other aspects regarding governance, guidelines, membership requirements, responsibilities and the statutory power of such committees.
2. Shari'ah compliance functions should be established at financial institutions. This activity aims to detail the functions of Shari'ah compliance units at banking and financial institutions. This activity is inclusive of developing Shari'ah-adhering products and services and analyzing them prior to introduction in the market. Such units are accountable for imparting the resolutions of the Shari'ah committee to the management.
3. Ensure the performance of the financial institutions by continuous monitoring and internal Shari'ah audits. This is inclusive of the implementation of resolutions recommended by the Shari'ah committee and regular compliance reporting to it.

In the event of implementing the above-mentioned strategies, it is expected to enhance the financial stability of the nation and its inclusiveness. Thus, the Islamic finance sector of the country is established as a strong one globally, fostering trust, confidence and transparency to the global audience. This scenario further enhances the trust among customers and investors whose interests are protected by adherence to the Shari'ah framework followed by its internal audit.

The application of Shari'ah governance, with its multiple dimensions and standards in the financial sector, remains crucial at a time when the growth of Islamic banking is accelerating at the local and global levels. The KSA is becoming increasingly interested in a number of issues, the most important of which is its ambition to become a center for Islamic finance by 2030.

Islamic banks have a different governance system than conventional corporate governance, namely, Shari'ah governance, as represented by the SSB. So, the latter remains the prime feature that differentiates the Islamic banks from the conventional ones. The SSB is the main body within the Islamic bank responsible for monitoring adherence towards Shari'ah standards in the day-to-day functioning of Islamic banks and their financial activities. Further, this Islamic form of governance is a means to improve the performance of banking as well as the rest of the financial organizations that are in line with the provisions of Islamic Shari'ah and fulfill the continuous need to develop its practice, which increases its competitiveness in an ever-changing and highly competitive business.

When the Shari'ah governance standards are applied in banks, it results in the development of a culture of transparency and improves the performance of the banking system followed by Islamic nations and their financial organizations. Due to the drastic growth and development of the Islamic banking domain across the globe, there is an urgent need to increase the applicability of Shari'ah governance standards since this phenomenon tends to enhance the transparency and efficiency of the Islamic banks. Further, it also improves their competitiveness in a highly competitive business landscape.

As shown in Table 1, the profitability scenario of the Islamic banking sector has been a stable one from the year 2016 though it got a minor impact in the year 2020 as a result of COVID-19 outbreaks. It is significant to note that there was an improvement in net profit margin from 44% in the year 2016 to 50% in 2019, which further increased to 53% in 2021. This is attributed to strong adherence to the Shari'ah norms in financial institutions in 2020 and the liquidity support from SAMA (Aljazira Capital, 2022b). Accordingly, the stability of the Islamic banks and windows in terms of return on assets (ROA) was also commendable, i.e., 2.1% during this period. However, in 2020, COVID-19 caused a slight decline in the ROA as a result of a 4% fall in the net income. In the year 2021, the Islamic banking sector experienced a full-year profit in terms of net income, compared to the previous five years.

Table 1. Selected financial ratios for the Islamic banking sector in the KSA, 2016–2021

Indicator (%)	*2016*	*2017*	*2018*	*2019*	*2020*	*2021*
ROA	1.9	2.2	2.4	2.2	1.8	2.0
Net profit margin	44.4	49.2	51.2	49.5	45.1	53.3
Gross nonperforming financing ratio	0.9	1.0	1.5	1.6	1.9	1.9
Provisions for gross nonperforming financing	152.0	167.2	157.5	143.4	132.1	130.7
Capital adequacy ratio (CAR)	21.1	21.9	20.8	20.2	19.5	18.6
Tier 1 capital to risk-weighted asset (RWA)	19.2	20.1	18.9	18.4	17.7	16.9
Liquid assets	26.0	28.5	24.6	33.5	31.6	30.5
Liquidity coverage	203.4	167.1	161.8	158.4	159.0	150.3

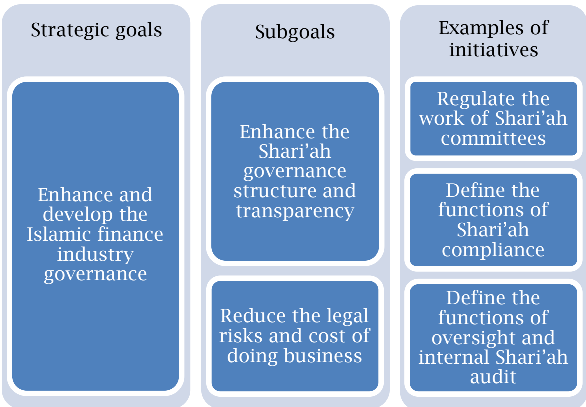
Source: IFSB and SAMA (2021).

In terms of asset quality, there was a continuous increment in the non-performing financing ratio of the Islamic banking sector in the KSA between the years 2016 and 2020, as shown in Table 1. This scenario was primarily due to heightened disruptive growth in automobile, construction and manufacturing domains, followed by the closure of the businesses at the time of COVID-19 lockdowns. In spite of the increase observed in provision coverage for the non-performing financing ratio, the condition was stable and way ahead of weakened financial observations.

In terms of adequate capital presence, the Islamic banks were found to be well-capitalized. This can be understood from a 19% average Tier 1 capital to risk-weighted assets (RWA) ratio to a 20% total capital adequacy ratio for the years spanning 2016 and 2021. Both these measures were way ahead of the requirements set by Basel III standards. This achievement was made possible due to highly proportionate retail banking assets and low off-balance-sheet activities that altogether produced low-risk weightings. On the other hand, the Islamic banks ensured to have high liquidity levels that are not only healthy on the balance sheets but also continued to grow in terms of liquid assets. In spite of the remarkable decline observed in the sector in terms of liquidity coverage ratio (LCR), the Islamic banks met the Basel III requirement with ease.

The 2021 charter for the FSDP encompassed the Islamic finance strategy that aimed at the Islamic banking industry's development in the KSA so that it is globally positioned as a significant one and acts as a benchmark for the year 2030. Four strategic goals have been identified in this strategic handbook such as governance, international positioning and education, innovation and research and development (R&D). In addition to these, 7 supporting sub-goals and 11 unique activities are also framed in the strategy as shown in Figure 1. FSDP has developed a set of short-term goals to be achieved for the Islamic finance development vision in the KSA. This strategy also focuses on the growth of the assets, R&D activities by 2025, Shari'ah governance and supporting the broader Islamic finance strategy (Council of Economic and Development Affairs [CEDA], 2022).

Figure 1. FSDP of Islamic finance strategy



Sources: IFSB and SAMA (2021) and CEDA (2022).

SSB plays a crucial role in the development and implementation of Islamic finance strategy in the KSA whereas this objective is under scrutiny as the board members' effective functioning remains questionable. It is obvious that the role of SSB reflects the characteristics possessed by the members of the Shari'ah board. There exists a close relationship between the roles and features of SSB with that of a bank's financial performance. In case, an Islamic bank management fails to comply with Shari'ah principles, then the customers, depositors, and investors tend to withdraw from dealing with the bank, and performance in general will therefore be affected, with a particular decline in profitability (Grassa, 2015; Adinugroho et al., 2023; Usman Muhammad & Yusoff, 2023).

In literature, studies have been conducted to evaluate the relationship that exists between the characteristics of SSB with that of the Islamic bank's performance (Minaryanti & Mihajat, 2023; Hudayati et al., 2023; Putri et al., 2023; Tashkandi, 2023; Wijayanti & Setiawan, 2023; Septiani et al., 2022;

Soveinia & Haryanto, 2022; Gati & Basuki, 2020; Rahayu et al., 2019). Such characteristics are classified as three main variables in literature such as the independent nature of SSB, its number of members and their relevant experience. With an intention to fill the research gap, this study was conducted through a thorough analysis of the influence exerted by the application of governance indicators upon the bank's financial performance in the KSA.

Few studies have investigated the impact of the SSB on the performance of Islamic banks in KSA. To the researchers' knowledge, Almutairi (2022) and Bashir (2023) are the only studies to have focused on the effects of the SSB in Islamic banks in the KSA. Furthermore, neither study examined all the characteristics of the SSB that affect the performance of Islamic banks, with the former covering a limited period and the latter covering only one bank. Thus, the current study can fill this research gap; moreover, it contributes to the growing literature on the impact of SSB characteristics on the performance of Islamic financial institutions.

The purpose of this study is to examine whether SSB can influence the financial performance of Islamic banks in the KSA. Thus, the problem statement of this paper can be formulated in the following main research question:

RQ1: What characteristics are the most influential on the performance of Islamic banks in the KSA?

This main question is divided into the following specific questions:

RQ1a: How does the independence level of SSB members impact the financial performance of Islamic banks?

RQ1b: How does the size of SSB impact the financial performance of Islamic banks?

RQ1c: How does the experience level of SSB members impact the financial performance of Islamic banks?

This investigational work evaluates the Shari'ah governance among Saudi banks that provide fully-fledged Islamic banking services. Out of 12 local banks, only 4, including Al Rajhi Bank, Alinma Bank, Bank Al-Bilad, and Bank AlJazira, are fully Shari'ah-compliant (SAMA, 2022). This study addressed the crucial practices that are involved in the Shari'ah governance banking sector in the KSA. It also seeks to determine how much these practices have achieved in view of international practices. It also discusses the challenges facing the application of Shari'ah governance in Saudi banks and analyzes possible development opportunities in the context of responding to the challenges ahead. The intention of the current study is to contribute towards Islamic finance literature in various forms. The study has a holistic perspective on fully-fledged Islamic banks that are operating in the KSA and also analyzes the influence of Shari'ah governance on banks' performance in an empirical manner.

This paper contains the following sections. Section 1 outlines the Shari'ah governance system and its framework for the Islamic banking system in the KSA. Section 2 reviews the relevant literature and develops the hypotheses. Section 3 explains the methodology and the sources of data collected to realize the objectives. Section 4 presents the results. Section 5 summarizes the main findings, presents policy implications, and makes recommendations.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1. Determinants of Shari'ah board characteristics

As per the literature, the influence of SSB on how the Islamic banks are performing financially remains a key element in Shari'ah governance. Several factors, including member expertise, board size, reputation, and cross-membership, are used to represent the characteristics and quality of the Shari'ah board (Nugraheni, 2018). The findings of related empirical research are reviewed in this section.

In the study conducted by Bourkaba and Gherbi (2015), the researchers analyzed the influence of implementing corporate governance rules on the Islamic banks' performance in the Gulf Cooperation Council (GCC). The study found the presence of a positive relationship among factors such as the ROA, size, number and the composition of the board of directors. In case when the number of SSB members increases, it automatically increments the ROA. However, the ROA and the concentration of ownership were found to be negatively associated with Islamic banks.

Ausat (2018) evaluated the relationship among factors such as corporate governance, finance, as well as performance outcomes. This study focused on Islamic banks and the data was collected from 2013–2017, using a sample that included 12 listed Islamic banks from different countries. The results revealed a positive relationship between a few corporate governance variables with that of the company's performance. The study found the crucial factor that affects the financial performance of the Islamic banks was board size. Chief executive officer (CEO) duplication, board independence, and the SSB size were used to test its impact on the company. Interestingly, the study showed that CEO duplication affects the Islamic bank's performance, while some independent as well as control variables exhibited no significant correlation with that of the company's performance.

Al-Samarrai (2018) explained that the predominant implementation of corporate governance practices in banks under study affected the return on equity as well as the ROA. The researcher concluded that corporate governance is a system in which the operational operations of banks are monitored and is a key element in improving economic efficiency, which in turn affects economic and financial stability.

Al-Jahdali and Obaid (2019) assessed the influence of corporate governance practices on enhancing the financial performance of the banking domain in the KSA, through the calculation of profitability of the banks. In this study, the authors considered a total of 12 banks in the KSA and the study period was between 2014 and 2017. The study outcomes found variations in liquidity indicators for the years 2010–2013 and 2014–2017, with the former period recording a 21% accounting average of cash balance ratio and the latter period recording 18% of the same measure.

This denotes the negative impact experienced by the banks in terms of the rate of returns. The outcomes also infer that in the case when the liquidity is too high, then it reduces a crucial financial objective of the bank, i.e., profit. Based on a 4% return on equity (ROE) and 1% ROA, it can be inferred that the profitability of the banks was lower than the high liquidity period.

Khan and Zahid (2020) analyzed the influence of Shari'ah as well as corporate governance practices on the performance of Islamic banks in a few selected Asian countries. In this study, the authors made use of data from 2011 to 2016 with regards to Shari'ah as well as corporate governance practices followed by 79 Islamic banks, spread across 19 Asian countries. Further, the sub-sampling of the analysis work included supervisory vs. advisory roles, GCC countries vs. non-GCC, and the large vs. small impact of Shari'ah and corporate boards upon the performance of Islamic banks. As per the study outcomes, the influence of Shari'ah governance-related variables was found to be higher when it comes to defining the financial performance of the banks under study. Regression analysis was conducted in terms of Shari'ah supervisory vs. advisory boards and the results infer the significance of the Islamic Corporate Governance Index (ICGI) in both models. However, the domination of the general board in performance tracking was very clear, when the Shari'ah boards remained weak. In comparison between the GCC and non-GCC countries, the non-GCC countries exhibited excellent governance patterns. Further, in terms of Islamic bank size, i.e., large and small, those banks with huge levels of total assets exhibited excellent governance characteristics. Theoretically, the roles of the Shari'ah board are as follows; providing fatwa for the financial products that are newly developed and introduced to the market, Shari'ah audit and monitoring so that the bank's products adhere to the Shari'ah laws, determination of zakat, disposal as well as the distribution of income that did not adhere to Shari'ah laws and helping banks to achieve a holistic social role so that it can act as a pillar for Islamic banking. The prime aim of the Shari'ah board is to enhance the credibility held by the Islamic finance industry and improve the confidence of the stakeholders in the products and activities of the Islamic banks.

In the study conducted by Al-Aqraa (2020), the authors analyzed the influence of SSB characteristics on the performance of Islamic banks in terms of financial outcomes. This study considered the data extracted from the Yemeni Islamic banks for the period spanning 2000 and 2016. According to the study outcomes, there is a significant positive impact exerted by a few variables such as size, independence and the expertise of SSB upon the financial performance of the Islamic banks. However, variables such as the educational background and cross-membership of the SSB members negatively impact the financial performance of the banks.

According to Aslam and Haron (2020), both the Shari'ah board as well as their audit committee tend to have a positive influence on the financial performance of Islamic banks, in terms of their ROE and return on investment (ROI). On the other hand, the Islamic bank's performance is negatively impacted by the size of the board of directors and the risk management committee of the banks. In addition to these, the performance of Islamic banks has a mixed relationship with that of the duality of the CEO as well as the non-executive directors. The researchers emphasized the need for Islamic banks to enhance their financial practices to improve their performance.

In the study that analyzed the influence of SSB characteristics upon the financial performance of Islamic banks, functioning in the Gulf, the authors (Abdul Rahman & Ali, 2021) made use of four independent variables of SSB characteristics such as the size, educational qualification, reputation and cross-membership of the SSB. On the other hand, the ROA was considered as the dependent variable to determine the financial performance of the banks under study. In this research work, the authors considered eight Islamic banks that function in the GCC and the study period was between 2015 and 2019. The hypotheses were tested using multiple regression analysis while the outcomes infer the presence of a significant relationship between the size of the Shari'ah board and cross-membership with that of the financial performance of the banks. However, the study also found an insignificant relationship between two features of the Shari'ah board, i.e., reputation and educational qualification with that of the Islamic banks' financial performance.

In literature, Khalifa (2021) analyzed the influence of applying corporate governance on the financial performance of Islamic banks that are listed on the Iraqi Stock Exchange. The study outcomes infer that when corporate governance rules are applied to Islamic banks, it creates a positive impact on the ROA and ROE of the Islamic banks, and accordingly financial performance. In the research work authored by Issa et al. (2022), it has been found that corporate governance practices in Islamic banks positively impact the green banking environment. In other terms, it can be explained that the corporate governance practices positively increase the level of interest among the Iraqi Islamic banks, when it comes to handling green banking challenges.

Hafez (2022) analyzed the influence of audit committee characteristics on the relationship between the financial performance of Islamic banks and their social responsibility disclosure status. In this study, a total of 8 Islamic banks were considered and the results confirmed the presence of a significant difference among the banks considered in terms of social responsibility disclosure. The authors found that the Islamic banks operating in Egypt exhibit a weak commitment towards this variable, excluding the ethical level, in comparison to their counterparts in KSA and Jordan. The study statistically established that social responsibility positively and significantly affects the financial performance of Islamic banks. Further, the authors also found that most of the characteristics of the audit committee have a direct impact on the disclosure level of the social responsibility clause. However, no significant impact is created by independence on the level of social responsibility disclosure. In the end, the research work concluded the presence of a significant and direct impact on the characteristics of the audit committee upon the financial performance of the Islamic banks as well as their social responsibility disclosure levels.

In the research work published by Soveinia and Haryanto (2022), the authors analyzed the relationship between corporate governance practices and the performance of Indonesian Islamic banks in which a few indicators were used, i.e., independent audit committee, size of the board of directors, institutional and management ownership followed by size, independency and the meetings among the audit committee. On the other hand, the following control variables were considered: size of the company, its debts, age of the firm, its impact on the performance of the firm and ROA for the study period spanning between 2013 and 2020. As per the statistical analysis outcomes, the performance of Islamic banks is significantly impacted by board size, company size and the debts of the company. Further, no significant impact is created by a few variables such as the size, meetings and the independence of the audit committee, age of the firm and managerial and institutional ownership, upon the performance of the Islamic banks.

In conclusion, based on the review of the literature regarding the relationship between the characteristics of SSB and Islamic bank performance, it is clear that studies related to the KSA are lacking. This gives the current study great importance and paves the way for in-depth research on the characteristics of the SSB and their role in Shari'ah governance frameworks.

2.2. Hypotheses development

Based on the review of literature that dealt with the characteristics of SSB and the financial performance of Islamic banks, the following research hypotheses are developed as follows.

2.2.1. Shari'ah board independence

From an agency theory perspective, the size of an Islamic board determines the board's ability to monitor and advise management. Resource dependency theory also suggests that larger shariah boards bring diverse knowledge and experience and consequently they are able to provide better advice to banks. A larger SSB will allow for higher shariah observance and reduce the level of bank risk. Jiraporn et al. (2009) revealed that the existence of a large board can help create effective board sub-committees which can improve company performance.

Given their responsibility for ensuring that banks remain compliant with the provisions of Shari'ah, committee members must be independent, honest, and reputable, and must possess the relevant skills to meet the expectations of customers and investors and help the bank gain the trust of the public (Accounting and Auditing Organization for Islamic Financial Institutions [AAOIFI], 2006). Therefore, if the SSB is independent, the Shari'ah committee can fulfil its primary role and its key actions; on this basis, this attribute is important and necessary in the Shari'ah supervision of banks (Hamza, 2013; Haddad & Souissi, 2022; Adinugroho et al., 2023). Accordingly, the first hypothesis can be formulated as follows:

H1: There is a positive impact of the independent Shari'ah board members on bank financial performance.

2.2.2. Shari'ah board size

Saudi banks vary in terms of their SSB size, which typically ranges from three to five. This arrangement adheres to the Shari'ah governance framework followed in the KSA. In other terms, every bank should have a specific number of members in their SSB that meets the bank's size and the nature of banking, their banking activities, etc. Further, the number of SSBs should not go down three and not above five. The AAOIFI recommended that the SSB should have not less than three members (AAOIFI, 2010). Not only the number of members but also the diversity of their specializations between Shari'ah sciences and financial and economic sciences are of great importance. This diversity, together with the higher number of SSB members, will improve the quality and efficacy of the role of the committee (Farag et al., 2018; Quttainah et al., 2013; Haddad & Souissi, 2022; Usman Muhammad & Yusoff, 2023). Therefore, the second hypothesis can be stated as follows:

H2: There is a positive impact of the size of the Shari'ah board on the bank's financial performance.

2.2.3. Shari'ah board experience

The acquisition of experience for SSB members in banks is an important element to ensure that they conduct their responsibilities, such as providing fatwas on new and innovative issues, with optimal efficiency. One way to improve the experience of members is to ensure their presence in Shari'ah committees in international and professional institutions such as AAOIFI.

Shari'ah board membership experience relates to knowledge that has been known and mastered by members of the Shari'ah board as a result of working for a certain amount of time. With the experience possessed by members of the Shari'ah board, they can make a significant contribution in dealing with Shari'ah problems faced by banks, including the implementation of bank operations as a whole. The experience possessed by Shari'ah board members can increase their ability to supervise and ensure that products, services, sales and business activities are in accordance with Shari'ah principles, which can further improve bank performance. Therefore, the third hypothesis is framed as given below.

H3: There is a positive impact of the Shari'ah board membership experience on bank financial performance.

3. RESEARCH METHODOLOGY

The current study considered a total of four Islamic banks (namely, Al Rajhi Bank, Alinma Bank, Bank Al-Bilad, and Bank Aljazira) that operate in the KSA and are listed on the country's stock exchange. These four banks represent financial institutions that are exclusively licensed to operate banking businesses with fully-fledged Shari'ah compliance. Meanwhile, all conventional banks providing banking services that only partially adhere to Shari'ah norms were excluded from this study. There are a total of eight conventional banks that have partial activities in Islamic banking. These banks either had started their Islamic banking activities in the recent past or made a smaller contribution to the market share of Islamic banking and finance than did the institutions selected for this study; therefore, their data during the study period were not available, and it would have been inappropriate to compare them with Islamic banks.

The information collected from the four Islamic banks consisted of bank financial performance and Shari'ah board characteristics. The researchers extracted the data from the annual reports published by the four Islamic banks from 2013 to 2022. The dependent variable, namely, bank performance, was measured by the *ROA*, while the independent variables were the size of the Shari'ah board (*SBSIZ*), the expertise of Shari'ah members (*EXP*), and board independence (*IND*). The control variable was the *ROE*.

The main equation for the multiple regression model is as follows.

$$ROA_{it} = \alpha_0 + \alpha_1 IND_{it} + \alpha_2 SBSIZ_{it} + \alpha_3 EXP_{it} + \alpha_4 ROE_{it} + \varepsilon_{it} \quad (1)$$

where,

- *ROA* — return on assets (%);
- *IND* — independence of Shari'ah board ("1" if SSB member was appointed by the general assembly of the institution, otherwise "0");
- *SBSIZ* — Shari'ah board size (*N* of members on the SSB);
- *EXP* — experience of Shari'ah board member (% of members who sit on SSB of AAOIFI and other financial institutions);
- *ROE* — return on equity (%);
- α_0 — constant term;
- $\alpha_1 \dots \alpha_4$ — coefficients of the model;
- ε — random term.

To estimate the model parameters based on the model specification above, we applied the pooled-time series ordinary least squares (OLS). Where *ROA* is a metric that indicates bank performance based on profitability in relation to its total assets, *SBSIZ* corresponds to the count of Shari'ah board members, *IND* denotes the percentage of Shari'ah board members with that of the whole board members and finally, the members' experience is denoted by *EXP*. In this study, the control variable was designed to have a control on the bank's characteristics as it may affect the dependent variable. The current study made use of *ROE* as the control in line with the literature (Al-Saidi & Al-Shammari, 2013; Alsartawi, 2019; Hanafi et al., 2021; Usman Muhammad & Yusoff, 2023; Bashir, 2023).

4. RESEARCH RESULTS AND DISCUSSION

4.1. Descriptive and correlation analysis

Descriptive analysis was performed to compute the average and standard deviation of the study variables. Additionally, the researchers conducted skewness and kurtosis as well as analysed the dataset's normality. The descriptive statistics of the study are shown in Table 2.

Table 2. Descriptive statistics

Variable	*Mean*	*Std. deviation*	*Skewness*	*Kurtosis*
IND	0.775	0.4229	-1.369	-0.135
SBSIZ	4.725	0.78406	-0.134	-0.296
EXP	43.3333	27.22182	0.487	-0.901
ROA	1.6663	0.64032	-0.397	0.256
ROE	12.7275	4.58462	-0.031	0.267

Source: Authors' elaboration based on EViews output.

According to Byrne (2010), in case when the value of skewness lies in the range of ±2 and the kurtosis value lies in the range of ±7, then the data can be said as normally distributed. As shown in Table 2, the data of dependent, independent, and control variables fell within the range of normal distribution. Therefore, the dataset utilized in this data can be said as normally distributed.

Table 3 showcases the outcomes of Pearson correlation coefficients between the independent variables. The author found the highest correlation between independent member and board size ($r = 0.655$) while it was the least in case of independent member and *ROE* ($r = -0.006$). Shari'ah board size was significantly correlated with the independent member, while *ROE* was significantly correlated with member experience. The overall results infer the presence of a low-to-medium correlation among the independent variables. So, no correlation coefficient was above 0.90 due to which the collinearity between the variables is no longer an issue in this study (Hair et al., 2010).

Table 3. Pearson correlation

Variable	*IND*	*EXP*	*SBSIZ*	*ROE*
IND	1			
EXP	-0.200	1		
SBSIZ	-0.655**	-0.108	1	
ROE	-0.0057	-0.428**	0.304	1

*Note: ** indicates significance at the 0.01 level (2-tailed).*
Source: Authors' elaboration.

The Durbin-Watson test was performed to test whether the autocorrelation problem existed within the dataset. The Durbin-Watson value was approximately equal to 2, proving that the model is free of autocorrelation issues. A variance inflation factor (VIF) test was also performed to test the presence of a multicollinearity issue and the outcomes are tabulated in Table 4.

Table 4. Variance inflation factor (VIF)

Variable	*VIF*
SBSIZ	2.085
IND	2.022
EXP	1.359
ROE	1.339
Mean VIF	1.701

Source: Authors' elaboration.

To test the heteroskedasticity, the square of the residual was regressed against the independent variables. As shown in Table 5, the p-value of the model was more than significant by 0.05, proving that the problem of heteroskedasticity does not exist.

Table 5. F-test for heteroskedasticity

Test summary	
F-statistic	1.774
Prob.	0.156

Source: Authors' elaboration.

4.2. Regression analysis

Regression analysis was performed to test which variables significantly influenced bank performance and the outcomes are tabulated in Table 6.

Table 6. Regression analysis

Variable	*Beta*	*Standard error*	*t-stat.*	*Sig.*
IND	0.339	0.188	1.801	0.080
SBSIZ	-0.001	0.103	-0.12	0.991
EXP	-0.008	0.002	-3.326	0.002
ROE	0.085	0.014	6.041	0.000
(Constant)	0.667	0.633	1.055	0.299
R-square	0.856			
Sig.	0.000			
Durbin-Watson	2.133			

Source: Authors' elaboration based on EViews output.

The p-value of the member experience was less than 0.05, thus establishing the significant impact of member experience upon the financial performance of the banks under study at a 5% significance level. With the decrease in member experience, the performance of the bank improved. The variable, the independent member, had a significant influence on the performance at a 10% significance level. The positive direction indicates that the Shari'ah board member's independent nature increases the performance of the banks. This outcome aligns with the literature (Johennesse & Budidarma, 2022; Ramly & Nordin, 2018; Al-Aqraa, 2020). The remaining independent variable, Shari'ah board size, was insignificant. The *ROE*, which was the control variable, also significantly and positively influenced bank performance. In conclusion, all independent variables of the model accounted for 86% of variations in the dependent variable as indicated by the R-squared (R^2), implying strong goodness of fit.

4.3. Hypotheses testing

Table 7 tabulates the hypotheses analysis outcomes in which the first hypothesis (*H1*) forecasted the positive impact created by the independence of Shari'ah board members upon the performance of banks. The outcomes positively support the independence of Shari'ah board members (*IND*) with that of the bank performance with 10% significance. One of the important roles of the independent Shari'ah board is to monitor the company's management for adherence to the application of Shari'ah principles. The board is responsible for ensuring that all products, management systems, fund management and policies of Islamic financial institutions are able to work in accordance with Islamic Shari'ah principles. An independent Shari'ah board, without any influence from other parties, will have implications for the supervision and assurance of Shari'ah compliance in banking institutions. independent Shari'ah board will be able to provide maximum and objective assessment and supervision, bank management can also be carried out in a manner that is in accordance with Shari'ah principles which in turn can improve the bank's financial performance.

Independent board members are relatively unlikely to have conflicts of interest, ensuring that their decisions are based solely on their assessment of compliance with Shari'ah principles and the best interests of the bank's stakeholders. This impartiality can foster greater trust among investors, customers, and regulators, enhancing the bank's reputation and credibility in the market. As a result, the bank may attract more capital and customers, contributing to its overall financial strength and performance.

H2 was not supported as the coefficient of Shari'ah board size (*SBSIZ*) was positive and insignificant in the model. The larger size of the Shari'ah board can make coordination and communication more difficult and complicated which can impact the decisions taken by the Shari'ah board. This condition indicates the ineffectiveness of the Shari'ah board and has no impact on the bank's financial performance. This finding aligns with the outcomes achieved in the literature (Ajili & Bouri, 2018; Nomran & Haron, 2020), while it contradicts the outcomes accomplished by Nomran et al. (2017, 2018), Johennesse and Budidarma (2022), and Usman Muhammad and Yusoff (2023) since the latter studies established a positive and a significant impact of *SBSIZ* upon the performance of Islamic banks.

Furthermore, the primary responsibility of a Shari'ah board is to ensure that the bank's financial products and transactions comply with Islamic principles and ethical standards. The size of the board is not inherently linked to its ability to carry out this task effectively. It is crucial that the board comprises qualified and knowledgeable Shari'ah scholars who can provide sound guidance and decisions. Whether a board is large or small, as long as it has the necessary expertise, it can fulfill its role effectively in ensuring Shari'ah compliance. Furthermore, coordinating and reaching a consensus can be more challenging in larger boards, potentially slowing down decision-making processes.

H3 predicted a positive impact of the expertise of Shari'ah board members upon the performance of Islamic banks. Consequently, *H3* was supported but with a negative sign as the Shari'ah board expertise (*EXP*) coefficient was significant at 0.05; this may be because most Shari'ah board members in KSA are involved in several boards of several financial institutions locally and globally. Thus, there is a need to reduce cross-membership among Saudi scholars who serve as Shari'ah board members in Saudi banks and to limit their membership in terms of institution and period of appointment. In addition, this finding also indicates that the higher the experience of Shari'ah board members, the lower the bank's financial performance. Maybe members of the Shari'ah board only have the ability in the field of Shari'ah transactions. High experience but not accompanied by extensive knowledge can reduce the bank's financial performance. Shari'ah board members should consist of people who have diverse knowledge, such as Islamic law, modern banking and finance, and legal issues in order to be able to provide advice and suggestions to the board of directors and oversee the activities of Islamic banks so that they comply with Shari'ah principles.

This study found that the experience of Shari'ah board members has a negative effect on the performance of Islamic banks for several reasons. Firstly, experienced Shari'ah board members may tend to adopt more conservative interpretations of Islamic finance principles, which can result in overly cautious decision-making. This conservatism can limit the range of financial products and investment opportunities available to Islamic banks, potentially hindering their ability to compete with conventional banks in terms of profitability and innovation. Secondly, a high level of experience among Shari'ah board members may lead to a more rigid and inflexible approach to compliance. These board members might set stringent and uncompromising standards for Shari'ah compliance, which could increase operational costs and reduce the bank's agility in responding to changing market conditions. Additionally, it may lead to a reluctance to embrace modern financial instruments and structures, limiting the bank's ability to diversify its portfolio and achieve optimal risk-adjusted returns. In essence, while experience is valuable in ensuring adherence to Islamic principles, excessive focus on conservatism and strict compliance standards could potentially hinder the overall financial performance of Islamic banks.

Table 7. Result of hypothesis testing

Hypothesis	*Expected sign*	*Variables*	*Findings*	*Decision*
H1	(+)	*IND-ROA*	$p < 0.10$ (+)	Supported
H2	(+)	*SBSIZ-ROA*	$p > 0.10$ (+)	Not supported
H3	(+)	*EXP-ROA*	$p < 0.05$ (-)	Supported

Source: Authors' elaboration.

5. CONCLUSION

The current study analyzed the influence of SSB characteristics on the performance of Islamic banks in the KSA between 2013 and 2022. The most critical components in boosting Islamic bank performance were identified as Shari'ah board independence and the experience of the Shari'ah board member. These two factors have become the most critical aspects because they improve Shari'ah supervision and strengthen Shari'ah compliance in the bank's business and activities, helping management to focus on mobilizing the bank's resources and using them efficiently to achieve the bank's objectives and meet the needs of its customers while adhering to the Shari'ah rules. Therefore, banks should consider the inclusion of independent and experienced members in their Shari'ah board in order to boost their performance.

The current study outcomes have a few significant takeaways for bank management and the regulatory authorities. These findings are helpful for the shareholders and supervisory authors to mitigate the occurrence of any financial mishaps or fraudulent activities that may be initiated by the bank managers when performing their duties and responsibilities. In this context, regulators, stakeholders, and bankers are expected to reinforce better practices of Shari'ah governance standards.

The study provides some useful and practical implications for regulators, such as emphasizing the role played by the Shari'ah board with regard to providing access to real independence and supervisory authority in applying Shari'ah governance in all banks. It is important to establish a central Shari'ah supervisory body under the Saudi Central Bank that coordinates bank subsidiary supervisory boards. This is because the Shari'ah governance framework in the KSA is still not implemented as mandatory rules and is in the process of gradual application by banks, and in this context, we suggest that the Saudi Central Bank moves to establish a central SSB that helps banks apply the best practices of Shari'ah governance and accelerate the steps of compliance with all Shari'ah governance requirements. This is in line with the AAOIFI's recommendation to member states, including the KSA that a central Shari'ah board should be appropriately established and empowered to coordinate and harmonize Islamic banking as well as financial practices in the jurisdiction according to the rules of Islamic law (AAOIFI, 2022).

Moreover, there is a need to force the banks and financial institutions to confine the number of Shari'ah members to a certain extent so that any potential conflicts among the members can be avoided. This further enhances the reputation of Shari'ah supervision on the Shari'ah board as well. In relation to Shari'ah governance both in the GCC region and worldwide, it is necessary for Saudi regulators to encourage banks to implement best practices to improve the effectiveness and characteristics of the Shari'ah board in enhancing the performance of banks.

The limitation of this study is that the data used for analysis were collected from Islamic banks without considering Islamic windows operated by conventional banks in the KSA. In addition to the supervisory role played by SSB members in the Islamic banks, its performance is continuously monitored and audited by the rest of the boards and committees like the Shari'ah Compliance Committee, Shari'ah Audit Committee and the board of directors. This perspective also propagates the efficient nature of Shari'ah governance in Islamic banks. So, future studies should focus on these domains for further enhancement of Shari'ah governance.

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