

GOVERNANCE DIMENSIONS AND COMMITMENT TO SHARIAH GOVERNANCE IN SAUDI BANKS: THE MEDIATING ROLE OF EXECUTIVE PROCEDURES FOR GOVERNANCE FRAMEWORK

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Abstract

This study investigates the relationship between governance dimensions and the level of commitment to the Shariah (Islamic law) governance framework in Saudi banks. To understand the intricacies of governance dimensions in shaping Shariah governance practices in depth, this study also examines the mediating role of executive procedures between governance dimensions and commitments to the Shariah governance framework. Structural equation modeling is used to test the hypotheses regarding the relationship between studied variables. The findings underscore the significance of the availability of executive procedures and disclosure and transparency in fostering commitments to the Shariah governance framework, with both constructs exhibiting substantial direct effects on the Shariah governance commitment level. Additionally, monitoring, auditing, and accountability emerged as crucial

determinants of governance in banks, highlighting the importance of robust oversight mechanisms in ensuring adherence to Shariah principles. Meanwhile, organizational structure exhibited a minor decrease in its direct effect on commitment to Shariah governance. The findings of this study can guide the strategic decision-making process for promoting ethical and sustainable Shariah governance practices in Saudi banks.

1. INTRODUCTION

In recent years, the landscape of banking governance and compliance with Shariah (Islamic law) principles has garnered increasing attention, particularly following the emergence of Islamic banking alongside the conventional banking system. This study investigates this crucial intersection by examining the relationship between governance dimensions and the level of commitment to the Shariah governance framework in Saudi banks. To understand the intricacies of governance structures in shaping Shariah compliance, this research investigates the mediating role of executive procedures and measures within Shariah governance framework in Saudi Arabia. As Islamic banking and finance continue to expand globally, understanding the nuances of governance mechanisms becomes imperative for both regulatory authorities and banking institutions to ensure sustainable and ethical financial practices.

The Saudi Central Bank has issued several key principles for Shariah governance, forming a framework to assist banks in enhancing overall governance (Saudi Arabian Monetary Authorities [SAMA], 2020). This framework represents the minimum supervisory and regulatory requirements for promoting Shariah governance practices in banks operating in Saudi Arabia (Bashir & Babiker, 2023a).

This study investigates the relationship between governance dimensions and the level of commitment to the Shariah governance framework in Saudi banks. To gain an in-depth understanding of the intricacies of governance dimensions in shaping Shariah compliance practices, it examines the mediating role of executive procedures between governance dimensions and commitments to Shariah governance framework. It provides a novel contribution to the limited literature on the relationship between governance dimensions and commitments to Shariah governance framework in Saudi banks. However, this study is limited in terms of sample size; therefore, to ensure more representative results, future research should include a greater number of participants.

2. METHODOLOGY

Using a dataset collected by Bashir and Babiker (2023b), this study performed a comprehensive analysis of survey data collected from

95 respondents who were actively involved in Shariah governance practices across 11 banks between March 1 and April 15, 2022. This study sought to offer insights into the effective governance strategies that foster Shariah compliance, thereby enriching the scholarly discourse and guiding practical implications for banking institutions operating within Islamic finance paradigms. The structural model to examine the hypothesized relationship between variables was tested using SmartPLS 3.2 (www.smartpls.com).

2.1. Reliability and validity

All constructs in the study exhibited Cronbach's alpha values above 0.7, indicating satisfactory internal consistency (Latif et al., 2021). Similarly, all constructs had rho values above 0.7, indicating good reliability. Finally, most constructs had average variance extracted (AVE) values above 0.5, indicating satisfactory convergent validity (Hair et al., 2014). Overall, the results of the construct reliability and validity analysis suggested that the measurement model exhibits good reliability and convergent validity. The results of the Fornell-Larcker criterion supported the discriminant validity of the measurement model, indicating that each construct measures a distinct underlying concept and is not highly correlated with other constructs in the model.

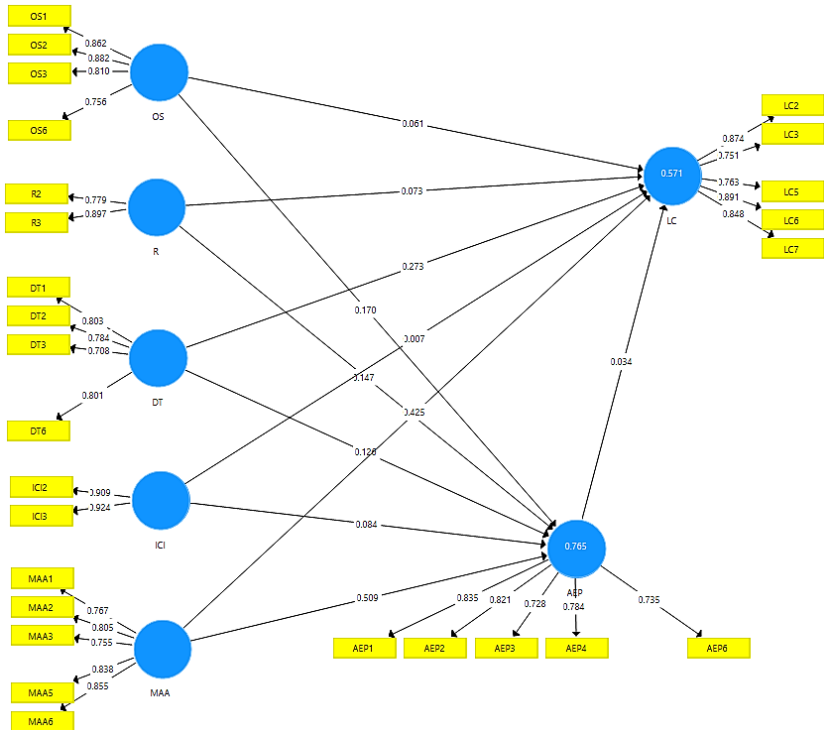
2.2. Measurement model

The measurement model serves as the foundation for assessing the relationships between latent constructs and their observed indicators (Latif, 2021). It validates the measurement of theoretical constructs by examining the reliability and validity of the indicators used to operationalize them.

The measurement model (see Figure 1) was refined through the removal of certain manifest indicators, resulting in satisfactory factor loadings exceeding 0.7 for the remaining indicators. The purpose of this process was to enhance the precision of the model and ensure that each indicator adequately represented its underlying construct. The fit summary provides insights into the model's goodness-of-fit statistics. The saturated and estimated models exhibited comparable values across various fit indices. The standardized root mean square residual (SRMR) remained consistent at 0.090 for both models, indicating a good fit between the observed and model-implied covariance matrices. In addition, the discrepancy indices (d_ULS and d_G) and Chi-square values were identical between the saturated and estimated models, suggesting minimal differences in model fit. Despite these favorable fit indices, the normed fit index (NFI) indicated moderate fit, with values of 0.629 for both models. This discrepancy may stem from the complexity of the model or unaccounted-for variance within the data. However, the root

mean square theta (rms Theta) value of 0.173 indicates a reasonable model fit. Overall, while the model exhibited satisfactory factor loadings and comparable fit indices to the saturated model, further exploration may be warranted to address any potential sources of model misfit and refine the measurement model for greater precision and accuracy.

Figure 1. Measurement model

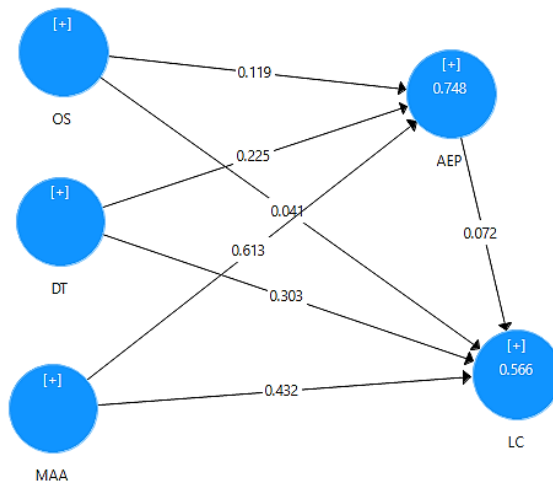


2.3. Structural equation model

The structural equation model (SEM) analysis aimed to investigate the relationships between governance dimensions and the level of commitment to Shariah governance in Saudi banking institutions. Path coefficients were examined to determine the direct effects of each governance dimension on Shariah compliance, while specific indirect effects and total effects were calculated to assess mediation and overall impact. We developed a revised SEM to refine the relationships between governance dimensions and the level of commitment to the Shariah governance framework. Path coefficients, total effects, and fit indices

were analyzed to evaluate the impact of the revisions on the model’s explanatory power and goodness-of-fit. Based on the empirical results, the coefficients between independence and confidentiality of information (ICI) and availability of executive procedures (AEP), and responsibility (R), and level of commitments of Shariah governance (LC) were too weak; therefore, we revised the model by removing those weak coefficient constructs. In the revised model, the path coefficients remained consistent with the previous model for most governance dimensions. AEP continued to demonstrate a positive and significant direct effect (0.071) on Shariah compliance, albeit with a slight increase compared to the previous model (0.042). Similarly, disclosure and transparency (DT) maintained a positive direct effect on Shariah compliance (0.303), reflecting its importance in fostering compliance within banking institutions. However, organizational structure (OS) exhibited a minor decrease in its direct effect on Shariah compliance (0.041) compared to the previous model (0.163). Total effects in the revised model confirmed the findings observed in the path coefficients. AEP and DT continued to exert the most substantial influence on Shariah compliance, with total effects of 0.071 and 0.311, respectively. Fit indices in the revised model remained consistent with the previous model, indicating a similar level of model fit. The standardized root mean square residual (SRMR), discrepancy indices (d_ULS and d_G), and Chi-square values did not show significant changes. Additionally, the NFI maintained its moderate fit, suggesting the revisions did not substantially impact the overall model fit.

Figure 2. Revised structural equation model



2.4. Mediating effects and total effects

Mediation analysis was performed to assess the mediating role of AEP on the relationship between disclosure and transparency (DT), monitoring, auditing, and accountability (MAA), organizational structure (OS), and level of commitments of Shariah governance (LC). Table 1 illustrates the results of mediating indirect effects. The results revealed an insignificant moderating role of AEP on the relationship between DT, MAA, OS, and LC. Therefore, the scenario is as follows: the indirect effect is insignificant, while the total effect is significant, so there is no mediation yet the total effect is significant. There are several possible explanations for why the indirect effects are insignificant while other paths are not.

Table 1. Indirect and total effects

| | <i>Mean</i> | <i>St. Dev.</i> | <i>t-statistics</i> | <i>p-values</i> |
|-------------------------|-------------|-----------------|---------------------|-----------------|
| <i>Indirect effects</i> | | | | |
| DT ≥ AEP ≥ LC | 0.023 | 0.043 | 0.378 | 0.705 |
| MAA ≥ AEP ≥ LC | 0.051 | 0.105 | 0.420 | 0.675 |
| OS ≥ AEP ≥ LC | 0.009 | 0.025 | 0.345 | 0.730 |
| <i>Direct effects</i> | | | | |
| AEP ≥ LC | 0.076 | 0.157 | 0.445 | 0.656 |
| DT ≥ AEP | 0.240 | 0.075 | 3.063 | 0.002 |
| DT ≥ LC | 0.332 | 0.101 | 3.145 | 0.002 |
| MAA ≥ AEP | 0.594 | 0.085 | 7.080 | 0.000 |
| MAA ≥ LC | 0.455 | 0.138 | 3.436 | 0.001 |
| OS ≥ AEP | 0.130 | 0.096 | 1.302 | 0.194 |
| OS ≥ LC | 0.066 | 0.128 | 0.416 | 0.677 |

3. DISCUSSION

The findings of this research indicate that DT and MAA directly influence the level of commitment to Shariah compliance governance, whereas OS does not have a significant influence. DT is crucial in fostering awareness and confidence regarding financial and operational procedures that adhere to Shariah law. Institutions can exhibit their dedication to conducting business morally and in line with Islamic principles by providing pertinent information in an understandable and open manner. This transparency ensures all stakeholders can comprehend the institution's risk management, investment decisions, and adherence to Shariah law in every facet of its operations. Furthermore, MAA is particularly advantageous as it uses a robust monitoring and control mechanism to guarantee that enterprises adhere to Shariah standards. Establishing stringent responsibility and accountability for the application of Shariah principles, closely monitoring operational activities, and performing high-quality compliance checks can all help institutions minimize the likelihood of

infractions and increase their commitment to Shariah compliance. Stakeholders can feel more confident knowing that the organization takes Shariah problems seriously and operates responsibly as a result. Consequently, by offering a robust framework and effective monitoring methods, DT and MAA not only establish a transparent and supervised environment but also reinforce the governance commitment to Shariah compliance. Both provide a strong basis for businesses to follow Shariah principles in their operations, uphold stakeholder confidence, and guarantee long-term operational integrity.

Additionally, the results of this research demonstrated that OS had no impact on LC. The primary goal of the organizational structure is to ensure effective operations and a clear division of tasks. Rather than to regulate compliance with Shariah principles, OS, which is more related to the hierarchy, duties, and responsibilities of the institution, does not directly influence the level of commitment to Shariah compliance governance. Deeper aspects of Islamic morality, ethics, and law are involved in adhering to Shariah principles; this calls for a strong commitment to upholding these values in every facet of the institution's activities, as well as a thorough comprehension of Islamic teachings. Thus, other factors like organizational culture, policies, and management practices — rather than the organizational structure itself — will probably have a more significant impact on a firm's level of commitment to Shariah governance.

Finally, the findings of this study also show that AEP does not mediate the influence of governance dimensions (DT, MMA, and OS) on LC. The essential role that AEP plays in mediating the relationship between governance dimensions and Shariah compliance governance commitment can also be influenced by the quality of its execution. AEP may have a relatively low impact on mitigating the influence of governance features on the commitment to Shariah compliance if it is only employed formally or is not routinely followed in day-to-day practice. As such, it is critical to take into account both the accessibility of AEP and the quality of its execution. For instance, the AEP will not be effective in guaranteeing Shariah compliance if an organization has explicit executive processes pertaining to Shariah compliance but its staff members do not comprehend or implement these procedures in their day-to-day work. AEP will also not be very effective in mitigating the impact of governance dimensions on Shariah compliance commitments if the procedures are merely technically followed to satisfy requirements without considering the underlying Shariah principles.

4. CONCLUSION

This study examined the intricate relationship between governance dimensions and Shariah compliance in the banking sector, distinguishing between fully Islamic banks and conventional banks with Islamic windows. Through descriptive analysis, reliability and validity

assessments, and SEM, this research offers valuable insights into the mechanisms shaping adherence to Shariah principles within banking institutions.

The findings underscore the significance of the availability of executive procedures and disclosure and transparency in fostering Shariah compliance, with both constructs exhibiting substantial direct effects on compliance levels. Additionally, monitoring, auditing, and accountability emerged as a crucial determinant of compliance, highlighting the importance of robust oversight mechanisms in ensuring adherence to Shariah principles.

Moreover, the revised SEM model elucidated the nuanced relationships between governance dimensions and compliance, with slight variations observed in the direct effects of certain constructs. While organizational structure exhibited a minor decrease in its direct effect on compliance, the overall model fit remained robust, underscoring the reliability of the findings.

Overall, this study contributes to the growing body of literature on governance and compliance within Islamic finance, providing actionable insights for banking institutions, regulatory authorities, and policymakers. By emphasizing the pivotal role of governance mechanisms in shaping compliance with Shariah principles, this research informs strategic decision-making and policy formulation aimed at fostering ethical and sustainable financial practices. Moving forward, future research could explore additional factors influencing Shariah compliance, such as cultural dynamics, regulatory frameworks, and market conditions. Additionally, longitudinal studies could facilitate insight into the evolving nature of governance practices and their impact on compliance over time. Ultimately, a holistic understanding of governance dimensions is essential for advancing the principles of Islamic finance and ensuring the integrity and resilience of banking systems worldwide.

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