INTERNAL GOVERNANCE MECHANISMS: EVIDENCE FROM ISLAMIC BANKS

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Abstract

The impact of institutional corporate governance on the financial performance of Islamic banks, with a specific focus on Shari'ah Supervisory Boards and corporate boards. The findings of this study indicate that Islamic banks with Shari'ah Supervisory Boards outperform Islamic banks without such boards, as measured by return on assets (ROA), return on equity (ROE), asset growth (AG), and interest margins (IM). Further findings indicate that the financial performances of Islamic banks with Shari'ah Supervisory Boards and corporate boards are influenced by several board characteristics, including the size of the board and the education of the board members. Moreover, Shari'ah Supervisory Boards provide tighter monitoring and control, as well as more advising and counseling, as compared with Islamic banks without Shari'ah Supervisory Boards. Later findings indicate that Shari'ah Supervisory Boards' affiliations with international Islamic financial institutions motivate the positive relationship between the Shari'ah Supervisory Boards and Islamic bank performance. Overall, this study provides strong evidence that Shari'ah Supervisory Boards benefit shareholders by complementing corporate boards and thus mitigating agency problems and agency costs.

1. INTRODUCTION

The two key objectives of this empirical study are to investigate the effects of Shari'ah[1] (Islamic Law) Supervisory Boards (SSB) and the

[1] Shari'ah means the Islamic Law, which exists to protect the welfare of the people under it by safeguarding their faith, life, intellect, posterity, and wealth (Al-Ghazali, 1937, pp. 139-140).

demographics of the Board of Directors (BoDs) on the performance of Islamic Banks[2] (IBs). The Shari'ah Corporate Governance (CG) objective puts Shari'ah as "the ultimate goal and this entails the notion of protecting the interest and rights of all stakeholders within the Shari'ah rules" (Hasan, 2008). In-house SSBs are independent boards that investigate, audit and provide IBs with higher Shari'ah CG compliance. The higher CG requires Shari'ah auditing with (Ex-ante and Ex-post) in all IBs financial transactions as a standard policy. IBs (such as those in Iran, Pakistan, and Sudan) do not employ Shari'ah Boards while in other Islamic countries these boards are required. This difference has not been previously investigated. One could argue that IBs' BoDs with in-house SSBs add layers of bureaucracy that hinder timely responses to urgent issues, resulting in a negative influence on IBs' performance. On the other hand, one could argue that BoDs rely on the religious rulings provided by in-house SSBs to ensure that all banking transactions comply with Shari'ah and hence influence performance positively.

2. RESEARCH PROBLEM, OBJECTIVES AND PLAN

Research on the governance of Islamic business organizations has become prolific, especially as it relates to Islamic banks. However, during the last decade, no studies have empirically explored how boards of directors and embedded Shari'ah (Islamic Law)[3] Supervisory Boards that ensure compliance with Shari'ah affect the governance of Islamic banks, nor does current research evaluate these entities' functions, structures, processes, or impact on financial performance. Still, regulatory dynamism and the increasing global demand for organizational transparency, efficiency, and effectiveness for both unregulated and regulated industries have renewed the focus on management and corporate governance models (Hoskisson, Castleton & Withers, 2009).

The findings of this study are important at the micro and macro levels. First, although the functions and roles of Shari'ah Supervisory Boards and the Corporate Boards of Directors overlap, the moral and ethical perspectives that stem from Shari'ah tends to reduce managements' self-serving behavior, and thus improve overall organizational financial performance. Second, the findings indicate that Shari'ah Supervisory Boards provide a sustainable competitive advantage in terms of resource networks and interlocking relationships. Next, the findings indicate that Shari'ah Supervisory Boards promote Islamic banks and encourage individuals to the bank with them. Finally, the findings indicate that Shari'ah Supervisory Boards are at the forefront when regulators examine transactions or businesses. This essay

[2] An Islamic bank is prohibited from investing in activities that are associated with gambling, alcohol, pork meat processing and sales, and is generally encouraged to invest in community development
[3] Shari'ah refers to the Islamic Constitution, which exists to protect the welfare of the people under it by safeguarding their faith, life, intellect, posterity, and wealth (Al-Ghazali, 1937, pp. 139-140).

hypothesizes and explores several institutional and bank factors that can influence bank-specific information.

This research contributes to governance literature relating to the effects of Shari'ah Supervisory Boards and their composition on the managerial behavior and organizational financial performance of Islamic banks. Additionally, this research sheds light on the functions, structures, processes, and roles that Shari'ah Supervisory Boards have in ensuring Shari'ah compliance in all business transactions. Although prior research addresses the importance of Shari'ah Supervisory Boards and their unique impact on financial performance, this study is the first empirical examination of how Shari'ah Supervisory Boards within Islamic banks affect organizational behavior and financial performance. Additionally, this paper considers the role of the structure of Shari'ah Supervisory Boards from the viewpoint of the agency theory, the contingency approach theory, and to a certain extent, the stewardship theory.

3. LITERATURE REVIEW

Strategic decision-making is a crucial component of organizational performance and is concerned with fundamental issues such as location, products, financing, and timing. Strategic decisions are "important, in terms of the actions taken, the resources committed, or the precedents set" (Mintzberg, Raisinghani & Theoret, 1976, p. 246). Strategic decisions are crucial for the survival and future of the organization, and such strategic decisions include the day-to-day decisions as well as infrequent decisions by the top management (Eisenhardt & Zbaracki, 1992).

BoDs play a pivotal role in strategic decision-making and their competencies become a source of competitive advantage (Barney, 1991; Hamel & Prahalad, 1994; Hunt, 2000; Langton & Robbins, 2007; Ljungquist, 2007; Prahalad & Hamel, 1990). Board composition and demographics are hence important precursors to effective and efficient group decision-making and firm performance (Baliga, Moyer & Rao, 1996).

Different theories and perspectives attempt to explain and evaluate the effects of BoD demographics on organizational performance (Kiel & Nicholson, 2003). Nevertheless, a mutual goal of these theories is to connect board characteristics to: (i) firm performance; (ii) the relationships between shareholders, the board, and senior management; and (iii) corporate governance (Carlsson, 2001).

Researchers such as Mace (1971), Monks and Minnow (1991), Norburn and Grinyer (1974), Rosenstein (1987), and Vance (1983) argue against the perception that CEOs formulate strategy instead of BoDs. In their view, a power imbalance usually exists between senior management figures and BoDs. Furthermore, Lorsch and MacIver (1989) indicate that BoDs are more likely to counsel managers on the evaluation of options rather than initiate strategy.

Shari'ah conformity is the distinguishing feature of Islamic business organizations, and specifically in this context is the distinguishing feature of the Islamic banking industry. In practice, the essential functions of guiding and controlling the operations of IBs rests with respectable Shari'ah jurists who are from different strategic localities in order to ensure diversity.

International standard-setting bodies and regulators have made numerous efforts to standardize and homogenize the practices of Islamic banking among institutions and even across national borders. Yet it is the core responsibility of the SSBs to define and conclude the requirements of Shari'ah for different transactions and contracts. The SSBs are the central point of conformity and IBs rely on them as people rely on IBs (Abidin, 2006; Khan, 1995; Warde, 2000).

4. DEVELOPING THE RESEARCH MODEL AND HYPOTHESES

Critics of SSBs argue that embedded Shari'ah Supervisory Boards add layers of bureaucracy, which hinder timely responses to urgent issues and result in lower financial performance (Grais & Pellegrini, 2006a). Proponents of SSBs contend that BoDs rely on the religious rulings provided by in-house SSBs to ensure compliance with Shari'ah, thus fostering positive managerial behavior and financial performance by offering additional support to BoDs (Abu Ghudda, 2001; Suleiman, 1999; Shaffaii, 2008).

4.1. Population and sample design

Information on all available Islamic banks in the BankScope database was retrieved between 1993 and 2010. To make a fair comparison, a balanced panel sample is constructed and banks that do not have full 18-year (1993 to 2010) bank information were excluded. In addition, new Islamic Banks that were established 38 and incorporated after 19937 were excluded from the sample. The sample includes Islamic banks in 15 countries: Bahrain, Bangladesh, Egypt, Indonesia, Iran, Jordan, Kuwait, Lebanon, Malaysia, Pakistan, Qatar, Saudi Arabia, Sudan, Turkey, and United Arab Emirates. Table 1 reports the observation distribution by country. Bahrain has the highest number of observations (342) and Indonesia has the lowest number of observations (18).

The purpose of this study design is to relate the presence of SSBs, their size, and their diversity with financial performance in an ordinary least squares cluster-robust regression. The panel data used in the study was obtained from BankScope. Hypothesis 1 is tested using a sample of 82 Islamic banks, consisting of 1,476 Islamic bank-year observations. The remaining hypotheses are tested using a sample of 34 Islamic banks with SSBs, totaling 607 Islamic bank-year observations. The regression analysis uses accounting-based measures because they offer historical overall performance indicators and bear a relationship to asset

valuations and current operations. The accounting-based measures return on assets (ROA), return on equity (ROA), and asset growth (AG). Kiel and Nicholson (2003) use ROA as a measure of board performance because it is an indication of what managements accomplish with given resources (assets). ROA equals net income divided by total assets. ROE equals net income divided by shareholders' equity. AG consists of the year-over-year percentage change in assets divided by total assets (Baysinger & Butler, 1984). A discrete variable, *SSBs*, measures the presence of the SSBs; it is set to 1 if an Islamic bank has an in-house SSBs and 0 otherwise. *SSB Size* is the number of members of the SSBs. *Diversity* measures the proportion of board members with interlocks or who serve on the AAOIFI SSBs.

Table 1. Observation distribution by country

Country Name	*Number of Obs.*	*Percent*
Bahrain	342	23.17
Bangladesh	36	2.44
Egypt	54	3.66
Indonesia	18	1.22
Iran	108	7.32
Jordan	36	2.44
KSA	54	3.66
Kuwait	108	7.32
Lebanon	36	2.44
Malaysia	126	8.54
Pakistan	162	10.98
Qatar	72	4.88
Sudan	126	8.54
Turkey	72	4.88
UAE	126	8.54
Total	1,476	100

Moreover, several explanatory variables measure corporate board characteristics in order to determine the quality of monitoring, advising, and networking, as well as information symmetry that ensures uninterrupted resources to the firm (Hermalin & Weisbach, 1988; Klein, 1998; Adam & Mehran, 2003, Anderson et al., 2004; Nicholson & Keil, 2004). Following Lipton and Lorsch (1992) and Jensen (1993), board size is recorded as the number of board members at year-end. This allows identification of whether a director is an executive or nonexecutive. Outside directors plus inside directors equal the total number of board members. *CEO Duality* is a dummy variable that equals 1 if the CEO is also the chairman of the board and 0 otherwise. Interlocking board members are measured using the total number of directorships that board members hold (both inside and outside the firm) divided by a number of board members. It is necessary to consider a director's position in the overall network rather than simply links to other IBs in the study.

Explanatory variables control for bank size using log total assets for each Islamic bank. In addition, controlling for European Intelligence Unit

country risk (EIUCR), this is a proxy for the change in economic development. Such economic developments are likely to affect the quality of bank assets' "creditworthiness" and political and business trends for the level of development of the country, which in turn can proxy for the quality of regulation and of the legal environment. In order to control for a specific region, the sample is divided into: (1) the Middle East, (2) the Near East, (3) the Far East, and (4) North Africa. Following Laeven (2003), the loan-loss provision (LLPR) ratio is a proxy for firm-level risk-taking and equals LLPR divided by total assets over lagged total assets. In addition, echoing Barth, Caprio and Levine (2001), the study controls for country-specific regulatory strength (*CSRS*). *CSRS* is a discrete variable that is set to 1 if a country has more than one supervisory body; otherwise, it equals 0. Table 2 summarizes the operational definitions in this study.

Table 2. Descriptive statistics-panel (Part I)

Variable	*Obs*	*Mean*	*S.D.*	*Min*	*0.25*	*Mdn*	*0.75*	*Max*
Firm Performance								
ROA	1476	0.03	0.02	0.00	0.01	0.02	0.04	0.08
ROE	1476	0.16	0.23	0.00	0.01	0.04	0.22	0.65
Asset Growth	1476	0.31	0.26	0.04	0.10	0.21	0.48	0.81
Board Characteristics								
Board Size	1476	9.55	7.71	3.00	6.00	9.00	10.00	56.00
Outside Director	1476	0.17	0.28	0.00	0.00	0.00	0.43	1.00
Board Interlocks	1476	0.34	0.30	0.00	0.00	0.30	0.56	1.00
CEO Interlocks	1476	0.11	0.18	0.00	0.00	0.01	0.11	0.53
Government Director	1476	0.08	0.07	0.00	0.00	0.10	0.14	0.25
CEO Duality (Dummy)	1476	0.49	0.50	0.00	0.00	0.00	1.00	1.00
SSB Presence								
SSB (Dummy)	1476	0.41	0.49	0.00	0.00	0.00	1.00	1.00
SSB Size	1476	2.20	2.81	0.00	0.00	0.00	5.00	9.00
SSB Interlocks	1476	0.05	0.07	0.00	0.00	0.00	0.11	0.25
SSB Education	1476	0.67	0.46	0.00	0.00	0.00	1.00	1.00
AAOIFI	1476	0.15	0.36	0.00	0.00	0.00	0.00	1.00
IIFO	1476	0.52	0.49	0.00	0.00	0.00	1.00	1.00

5. DATA ANALYSIS AND MODEL TESTING

Linear regression models require linear relationships between dependent and explanatory variables, no serial correlation independence of the errors, constant variance (homoskedasticity) of errors versus time, and any explanatory variables, and normal error distribution. Pooled OLS requires the errors in each time period to be uncorrelated with the explanatory variables in the same time period in order for the estimator to be consistent and unbiased (Wooldridge, 2002). Correcting for heteroskedasticity, the OLS cluster-robust variance estimation technique adjusts for within-cluster correlation. This technique agrees with Stock and Watson (2002), who show that the standard method of calculating

heteroskedasticity-robust standard errors for the fixed-effects estimator generates inconsistent variance estimates. For these reasons, using the OLS cluster-robust variance is consistent with the fixed-effects estimator. The regression analyses pairwise correlation table (Table 3) ensures that the link between the dependent and independent variables is not highly correlated. In addition, variables were tested for multicollinearity following the procedure in Hair, Anderson, Tatham, and Black, (1998). The analysis calculates the Variance Inflation Factor (VIF) values for two models. The first model (Panel 1 of Table 3) uses 82 Islamic banks with 1,476 Islamic bank-year observations. The second model (Panel 2 of Table 3) uses 34 Islamic banks and 607 Islamic bank-year observations. The VIF values for both panels were lower than the threshold value of 10, as suggested by Hair et al. (1998, p. 193).

Table 3. Descriptive statistics-panel (Part II)

Variable	***Obs***	***Mean***	***S.D***	***Min***	***0.25***	***Mdn***	***0.75***	***Max***
Firm Performance								
ROA	607	0.04	0.30	0.00	0.01	0.03	0.08	0.08
ROE	607	0.26	0.27	0 .001	0.02	0.12	0.64	0.65
Asset Growth	607	0.42	0.29	0.04	0.15	0.35	0.80	0.81
Board Characteristics								
Board Size	607	9.90	8.18	3.00	7.00	9.00	10.00	55.00
Outside Director	607	0.12	0.26	0.00	0.00	0.00	0.10	0.86
Board Interlocks	607	0.43	0.34	0.00	0.00	0.56	0.71	1.00
CEO Interlocks	607	0.19	0.23	0.00	0.00	0.04	0.52	0.53
Government Director	607	0.09	0.08	0.00	0.00	0.10	0.14	0.25
CEO Duality (Dummy)	607	0.51	0.50	0.00	0.00	1.00	1.00	1.00
SSB Characteristics								
SSB (Dummy)	607	1.00	0.00	1.00	1.00	1.00	1.00	1.00
SSB Size	607	5.35	1.52	3.00	4.00	5.00	7.00	9.00
SSB Interlocks	607	0.06	0.08	0.00	0.00	0.00	0.11	0.25
SSB Education	607	0.70	0.46	0.00	0.00	1.00	1.00	1.00
AAOIFI	607	0.38	0.49	0.00	0.00	0.00	1.00	1.00
IIFO	607	0.55	0.50	0.00	0.00	1.00	1.00	1.00

Table 4 depicts the results of the OLS cluster robust standard-error estimation, using three performance measures to assess the effects of SSBs and their composition on organizational performance. Table 4 presents unstandardized beta coefficients and standard errors (in parentheses) along with the significance levels of the coefficients. Models 1, 2, and 3 investigate the effects of SSBs with control variables on performance measures (ROA, ROE, and asset growth). Models 4, 5, and 6 investigate the effects of SSBs with control variables on performance measures (ROA, ROE, and asset growth).

5.1. Impact of Shari'ah supervisory board

Models 1, 2, and 3 (first, second, and third columns, respectively) evaluate the effect of SSBs on Islamic bank performance. The dependent variable is *ROA*. Table 4 presents unstandardized beta coefficients and standard errors (in parentheses) along with the significance levels of the coefficients.

- Hypothesis 1 predicts that Islamic banks with SSBs outperform Islamic banks without SSBs. As column 1 of Table 4 shows, the coefficient of SSBs is economically positive and significant ($\beta = 0.020$; $p < 0.001$). The analysis shows that SSBs have a positive impact on ROAs in Islamic banks.
- Model 2 (second column) also evaluates the effect of SSBs on Islamic bank performance. The dependent variable here is *ROE*. As column 2 of Table 4 shows, the coefficient of SSBs is again economically positive and significant ($\beta = 0.185$; $p < 0.001$). The analysis illustrates that SSBs have a positive impact on ROE Model 3 (third column) further evaluates the effect of SSBs on Islamic banks. The dependent variable is *AG*. As column 3 of Table 4 shows, the coefficient of SSBs is positive and economically significant ($\beta = 0.200$; $p < 0.001$).

These results confirm the theory-based studies of Shaffaii (2008), Abu Ghudda (2001), and Suleiman (1999). Shaffaii (2008) argues that Islamic banks should have SSBs as secondary boards that oversee the conformity of products and services in Islamic banks. In addition, the study argues that Islamic banks without SSBs have limping governance structures that adversely affect performance. The theoretical model further asserts that this weakened governance structure has adverse implications in terms of Shari'ah conformity; a lack of monitoring and advising managements' ethical and moral behavior echo this agency problem.

Abu Ghudda (2001) contends that SSBs complement and support BoD functions. Suleiman (1999) similarly finds that the presence of SSBs provides managers in Islamic banks with ethical and moral guidelines. This directly affects depositors and stakeholders' perceptions of SSBs' functions, structures, and processes, which also mitigates agency problems. These findings are also inconsistent with the Grais et al. (2006) model. That theoretical model indicates that SSBs could adversely affect Islamic banks' organizational performance by taking too much time to issue religious rulings and by prohibiting Islamic banks from engaging in profitable businesses.

5.2. Corporate boards and Shari'ah supervisory board sizes

Model 4 (fourth column) of Table 4 analyzes the effect of corporate board size on Islamic bank performance. The dependent variable is *ROA*. Table 4 presents un-standardized beta coefficients and standard errors (in parentheses), along with significance levels for the coefficients.

- Hypothesis 2 proposes that corporate board size is positively associated with Islamic bank performance. As column 4 of Table 4 shows, the coefficient of corporate board size (BoD Size) is economically positive and significant ($\beta = 0.001$, $p < 0.001$). The analysis illustrates that corporate board size has a positive impact on ROA. Model 5 (fifth column) also analyzes the effect of corporate board size on Islamic bank performance. The dependent variable here is ROE. As Table 4 shows, the coefficient of corporate board size is economically positive and significant ($\beta = 0.007$, $p < 0.001$). The analysis illustrates that corporate board size indeed has a positive impact on ROE.
- To confirm the fourth and the fifth models, model 6 (column 6) measures asset growth (AG) as a proxy of organizational performance. The analysis of model 6 further supports the findings in the fourth and fifth models. The analysis indicates that the coefficient of BoD Size is economically significant and directly influences performance ($\beta = 0.006$, $p < 0.001$), which support the findings of the fourth and fifth models, as well as Hypothesis 2.
- Hypothesis 3 proposes that SSBs' size is positively associated with Islamic bank performance. As model 4 of Table 4 shows, the coefficient of SSBs' Size is economically positive and significant ($\beta = 0.001$, $p < 0.001$). The analysis illustrates that SSBs' size has a positive impact on ROA. Model 5 (fifth column) also analyzes the effect of SSBs' size on Islamic banks performance. The dependent variable here is ROE. As Table 4 shows, the coefficient of SSBs' Size is economically positive and significant ($\beta = 0.007$, $p < 0.001$). The analysis illustrates that SSBs' size has a positive impact on ROE. To confirm the fourth and the fifth models, model 6 (column 6) shows the effects of SSBs' size using AG as a proxy for organizational performance. The analysis indicates that the coefficient of SSBs' Size is economically significant and directly influences performance ($\beta = 0.002$, $p < 0.001$), as well as supports the findings in models 5 and 6. Thus, Hypothesis 3 is supported.

Results in models 4, 5, and 6 are consistent with Chaganti, Mahajan, and Sharma (1985). Their findings indicate that companies with large boards are less prone to bankruptcy. The results are also consistent with Dalton et al. (1999), which finds that larger boards have better networks and more expertise. Firms with larger boards also seem more visible in the community (Provan, 1980). The model findings are also consistent with Pfeffer and Salancik (1978), which indicate that firms with larger boards perform better because they have more access to vital resources such as "amount of budget, external funding, and leverage from an environment" and because "environmental uncertainty (lack of information and volatility) leads to increased board size" (Pfeffer & Salancik, 1978; Birnbaum, 1984). These results are robust to several controls and support the notion of the importance of the monitoring and advisory roles of SSBs (Adams & Ferreira, 2007; Hellan & Sykuta, 2004).

Table 4. Impact of Shari'ah boards and corporate boards on performance

	ROA	***ROE***	***AG***	***ROA***	***ROE***	***AG***
SSB	0.020***	0.185***	0.200***			
	(14.17)	(14.89)	(14.19)			
SSB Size				0.001***	0.003**	0.002**
				(4.19)	(3.07)	(2.62)
SSB Interlock				0.029***	0.24***	0.184***
				(8.13)	(7.45)	(5.17)
SSB Education				0.016***	0.131***	0.099***
				(7.10)	(6.52)	(5.98)
AAOIFI				0.014***	0.153***	0.136***
				(5.79)	(7.44)	(8.08)
IIFO				0.004**	0.031**	0.036**
				(2.77)	(2.70)	(2.75)
BoD Size				0.001***	0.007***	0.006***
				(12.42)	(10.87)	(10.20)
Outside Director				0.0020*	0.022*	0.020*
				(2.25)	(2.58)	(2.26)
Gov. Director				0.005***	0.035***	0.045***
				(4.82)	(4.01)	(4.84)
BoD Interlock				0.046***	0.415***	0.343***
				(15.90)	(16.00)	(16.09)
CEO Interlock				0.001***	0.130***	0.120***
				(4.13)	(6.15)	(6.70)
CEO Duality				0.029**	0.330***	0.289**
				(2.69)	(3.40)	(2.69)
_cons	0.019***	0.0620*	0.189***	-0.065***	-0.721***	-0.645***
	(5.14)	(1.97)	(5.16)	(-10.14)	(-12.61)	(-10.10)
N	1476	1476	1476	607	607	607
R^2	0.154	0.167	0.154	0.437	0.455	0.456
adj. R^2				0.415	0.434	0.436

6. DISCUSSIONS AND CONCLUSION

SSBs, functions, structures, and processes ensure moral, ethical, and conformity to Shari'ah (Islamic Law). The results indicate that Islamic banks with SSBs outperform Islamic banks without Shari'ah Supervisor Boards and play significant roles in monitoring managements' behavior, improving strategic design and implementation, and advising BoDs, managers, and employees of Islamic banks.

To determine whether SSBs' functions and characteristics improve the overall organizational performance and managerial behavior, using the second-panel data provides mechanisms to examine the hypotheses. The findings indicate that large corporate boards and large SSBs are more efficient in dealing with different monitoring and advisory roles than small SSBs. Consequently, increasing the size of corporate boards and SSBs should improve monitoring and advisory functions, management behavior, and organizational performance. SSBs members who are affiliated with the AAOIFI tend to have knowledge and expertise that complements the abilities of SSBs. It is likely that there is an upper

limit to this benefit, but that limit is not explored in the present research.

Corporate boards, CEOs, and SSB members with interlock relationships play special roles in dealing with organizational complexity. They add value in more complex Islamic banks that face different Shari'ah issues. Therefore, large corporate boards and Shari'ah Supervisory Board add value in Islamic banks. SSBs' education is also associated with better financial performance, which is an interesting phenomenon, which merits further study. In addition, the findings indicate that subscribing to one of the IIFOs improves organizational function, structure, processes, and performance. The findings hold after controlling for the measure of performance and differences in the regulatory and institutional setting, and they go beyond the national boundaries of any one particular country or year.

The interpretation of these results is in light of three predominant theories of corporate governance. They support the predictions of contingency theory. The greater number of larger SSB is seen as an important way for companies to connect with the external environment to secure the necessary resources.

Ultimately, these findings could help Islamic banks improve their financial results by enhancing their internal and external governance mechanisms (Walsh & Seward, 1990). These findings provide a basis for developing larger, more diverse SSBs that are more focused on complying with Shari'ah and corporate governance BoDs than fund-raising.

The results also have significant policy implications; it is important to distinguish between improving firm-level corporate governance and improving country-level institutional factors. Both views have their advocates. However, it is very difficult to reform the legal system in a short time. Still, Islamic banks that are struggling can still improve their corporate governance and simultaneously improve their financing environment.

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