

## Conference Paper

# Effect of Shari'ah Governance on Performance of Fully Fledged Islamic Banks in Africa

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**ORCID**Aishatu Usman Muhammad: <https://orcid.org/0000-0002-3198-0991>**Abstract.**

The performance of Islamic banks has seen an improvement throughout the last three decades; the great concern, however, is about Islamic banks' adherence to Shari'ah guidelines and procedures. Despite the industry's growth, Africa has not seen much progress even though they have a significant number of Muslim population. Therefore, the study intends to investigate how Shari'ah governance affects fully-fledged Islamic banks in the African continent using panel 28-Islamic banks between years of 2015 and 2020 and analyzed using STATA. The results demonstrate that the performance of Islamic banks is positively and considerably impacted by the size of the Shari'ah board and the Shari'ah audit committee. Nevertheless, the performance of Islamic banks is significantly adversely affected by board size. The findings also indicate that size and age of banks positively and significantly influence Islamic banks performance. This implies that Shari'ah guideline is no doubt vital and recommends Islamic Banks to make it of significance and center of focus.

**Keywords:** performance, Shari'ah governance, Islamic banks, Africa

## 1. Introduction

The banking sector is vital for developing a nation's economy because the banking sector has control over the money supply. As Rengasamy asserts that a strong banking sector will enhance economic development when mobilized resources are effectively and efficiently utilized, leading to more jobs, more wealth, eradicating poverty, boosting entrepreneurial activities, and increasing Gross Domestic Product (GDP) [1]. As of 2019, the size of Islamic banking was \$1.9 billion (expected to grow up to \$3.6 billion in 2024), which is 69% of the total share of Islamic finance assets, with 526 number of instruments/institutions from 74 different countries across the globe According to Islamic Finance Development Report of 2020.

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The stability of Islamic Financial Institutions depends on good Shariah governance, and the institutionalisation of an effective Shariah governance system boosts public trust in Islamic financial firms' management, operations, and integrity [2]. To ensure that Islamic bank transactions are conducted in accordance with the Shariah governance system, effective mechanisms, controls, and procedures must be established, and ensure operations comply with Shariah [3]. Shari'ah governance and corporate governance are sometimes used interchangeably by some researchers; even though they have similarities, they are also different [4]. While corporate governance is general to both Islamic and conventional corporations, shari'ah governance is specific to Islamic institutions. Shari'ah is the primary defining factor that separates Islamic banks and conventional banks. As such success or failure of Islamic banks relies on the application and interpretation of shari'ah in a novel and regulatory environment [5].

Islamic banking has improved greatly recently according to global Islamic economic report 2020, with the GCC (Gulf Cooperation Council) region having the most prominent proportion of global assets held by Islamic banks, at 45.4%. With the Middle East and South Asia (MESA) coming second with 25.9% and South-East Asia with 23.4%. On the other hand, the African region accounts for only 1.6% even in addition to North African shares (which constitute most of the Islamic banks) and Sub-Saharan African countries. Given the different efforts and activities, Islamic banking in the region appears promising, even though the proportion of global assets held by Islamic banks are low in sub-Saharan Africa. Islamic banking is just coming up in Africa [6], but there is still growth in the sector when compared to its existence in the last two decades around the continent.

From the third Quarter of 2013 to third Quarter of 2019, Islamic banking has maintained its profitability, even more profitable than conventional banking within the same period. The year 2020 report from IFSIR (Islamic Financial Services Industry) asserts that the return on equity (ROE) of Islamic banks was 14.30% as compared to the conventional counterpart in the United State of America with 11.6%. unfortunately, Africa still has the lowest share of Islamic banking with only 1.6% despite having 34% of the Muslim population.

The concept of an Islamic bank is solely dependent on its adherence to laid down shari'ah principles, which adhere to the core values of maqasid al shari'ah to achieve the primary goal of justice, fairness. This goal can only be achieved when a bank is fully shari'ah governed by appropriately qualified individuals. Hence, this study examines how shari'ah governance affects Islamic banks performance across the African continent. The continuous financial crisis around the globe has made individuals and

corporations seek a more ethical option of banking. This gives Islamic banking an advantage because most financial problems are caused due to laxity of corporate governance [7], lack of corporate governance structure [8] and complexity of financial structure [9]. However, this can only be achieved if Islamic banks are established based on shariah which deals with justice, fairness and equity, rather than profit. This research adds to the modest but expanding body of literature on Shari'ah governance, especially in Africa, with very few academic papers needed for the large untapped Islamic banking market available in the region.

## 2. Literature Review

Governance is an essential tool for organizational performance, be it Islamic or conventional. While corporate governance applies to all organizations, shari'ah governance is only applicable to Islamic organizations. More so, there are significant differences between corporate governance and shari'ah governance regarding operational, financial and market performance [10] because they also differ in their operations, financial and market activities.

Stakeholder theory states that a company should benefit all stakeholders, not just shareholders, and this theory is primarily used in organizational management and ethics [11]. Discussions on stakeholder theory focus on the relationship between firms and their communities, as Brown and Caylor asserts that an organization's actions can impact people [12]. More so, the theory emphasizes on organizational ethics, which in turn covers for the proper shari'ah ethics and conduct required for an organization to achieve organizational goals and objectives. The interest of all stakeholders involved is vital to avoid any damage that might be detrimental to all stakeholders. Hence, the need to deal justly with all stakeholders cannot be overemphasized, and when managers attend to stakeholders, it is a means of achieving great organizational goals [13-15].

Unlike agency theory, stakeholder theory advocates for the involvement of interest of other parties and not just owners. This is considered a fundamental basis for governance and performance relationships, which relates to principles of accountability and supervision in shari'ah [16]. Business dealings in Islam are responsible for protecting all rights of concerned parties [17]. This is because shari'ah promotes social justice as well as economic development while dealing in fairness, which are fundamental rules for IBs [18].

As mentioned in Qur'an Chapter 2 verse 18 as follows:

*"And do not consume one another's wealth unjustly or send it (In bribery) to the rulers so that (they might aid) you to consume a portion of the wealth of the people in sin, while you know (it is unlawful)".*

Empirically, how strictly the shari'ah is enforced and how well it is adhered might differ between countries in various studies. Buallay asserts that their shari'ah governance influences Islamic banks performance in the MENA region [10]. In respect to shari'ah governance and performance, Al-Gamdi and Rhodes revealed no relationship, while on the contrary [19-21] findings indicated that there is a correlation between good governance and high levels of performance. The presence of the Shari'ah supervisory board, shari'ah committee and shari'ah audit committee, which form the shari'ah governance factors, will be the focus of the study.

## 2.1. Shari'ah Supervisory Board and Performance (SSB)

IFIs and banks must have an independent shari'ah supervisory board (SSB). The SSB establishes shari'ah government. The Shari'ah board oversees Islamic banking activities to make sure they adhere to shari'ah. The SSB is regarded as the backbone of any Islamic based institution [22]. Shari'ah principles involve accountability, transparency, responsibility, integrity, honesty, and trustworthiness of stakeholders involved [23]. And one of the main objectives of SSB is to protect all stakeholders, not just stockholders [24]. Theoretically, there have been different assertions on the relationship between performance and board structure. In some findings, there was a positive relationship between board size and performance [25-28]. On the contrary, some findings found an adverse relationship between performance and board structure [29-31]. While on the other hand, Other research indicates that the performance and board size relationship is insignificant [32].

Regarding board size, several studies assert that a smaller board size like the study of [33-35]. However, contrary to this assertion, some studies proclaim that a larger board size is synonymous with performance [34,36,37]. On the issue of board independence, Hassan asserts that SSB independence has an adverse relationship with the performance of Islamic banks in Pakistan [22]. While some research claims there is no correlation between board independence and performance [38,39]. Meanwhile, Daily & Dalton assert that board independence and performance had a positive relationship [40]. And on the contrary Duchin, Matsusaka & Ozbas claims that board independence

and meetings only matter when disclosure is high and governance costs are low [41]. Accordingly, this study hypothesizes the following:

*H<sub>1</sub>: There is a positive impact of SSB size on the performance of Islamic banks in Africa.*

## 2.2. Shariah Committee and Performance (SC)

The Shariah Committee is vested with the obligation to provide comprehensive advice to Islamic banks to ensure Shari'ah compliance. SC ensures that transactions are per the shari'ah [31]. Therefore, SC supervision greatly influences performance and provides solutions to barriers and conflicts that might arise in an organization [42]. Conflict of interest can significantly affect the outcome, effectiveness, and structure of IFIs. According to Grassa, the presence of SC greatly enhances the shari'ah governance structure [32]. However, Nawaz asserts that higher intellectual capital efficiency aids Islamic banks in improving their chances of survival, which also helps maintain profitability [43]. The study further shows that shariah governance on its own may not fully explain the growing trend in the Islamic finance industry.

There are various aspects of shari'ah committee that different researchers have discussed. These include shari'ah committee size [44]; qualification [30], and the reputation of members [44], meetings [45], gender diversity, experience etc. On committee meetings, higher meetings mean greater opportunities to meet, discuss and resolve issues [45]. On the contrary, Malik & Makhdoom assert that frequent meetings negatively affect the company, which negatively affects performance [35]. Mollah & Zaman investigated the impact of shari'ah supervision and revealed a positive relationship between the shariah committee and performance when the committee have a supervisory role [30]. Likewise, Faraq et al. also assert that there is a positive association between the performance of IBs and shari'ah committee in 13 countries [46]. Isa & Lee on the other hand found that the shariah qualification of committee members is negatively correlated to performance, and the size of the committee and meetings are unrelated to Islamic banks performance in Malaysia [47]. Following the discussion above, the following hypothesis was developed:

*H<sub>2</sub>: There is a positive impact of shari'ah committee size on Islamic banks performance in Africa.*

## 2.3. Shari'ah audit and performance

Shari'ah audits ensure that the Islamic financial institution's shariah supervisory board and other regulatory bodies' product and service guidelines are followed e.g., AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions). Shari'ah audit is highly required to deter potential negative influence on Islamic financial products. It also plays essential role in giving the public assurance and trust in the product [48]; and is a key element that helps adhere to shari'ah goals [49], also concerned with a robust and effective internal control system for Shari'ah compliance is required. Competence and efficiency of shari'ah audit are positively significant to performance [49], while deficiency of shari'ah audit can cause damage to confidence in IFIs [48]. Empirical review shows conflicting views on shari'ah audit and performance; for example, Khalid observed a positive correlation between performance and shari'ah audit [49]. Shari'ah audit is undoubtedly a vital pillar in the Islamic financial system; this is to ensure strict adherence to the aims and objectives of Islamic finance. Therefore, Shari'ah audits are crucial to monitoring Islamic bank performance; henceforth, the following hypothesis was developed:

*H<sub>3</sub>: There is a positive impact of shari'ah audit on Islamic banks performance in Africa.*

## 3. Research Methodology

### 3.1. Sample and data

The sample covers 28 fully-fledged Islamic banks in Africa on the fitch connect database. Only banks with complete data from 2015 to 2020 were selected, leading to 168 sample observations for regression analysis. The shari'ah governance and performance variables were obtained from the bank's financial statements, GDP was from World Bank.

A long sample of data was chosen because it provides room for modification in terms of regulations or policies to take effect. The formula below shows the study's 168 observations:

$$N \times T = 28 \times 6 = 168 \text{ Observations; } N = \text{IBs and } T = \text{No. of Yrs}$$

### 3.2. Definition of variables

The dependent variables is performance of IBs, which comprises ROA and ROE. While the independent variables measure Shari’ah governance, which comprises of Shari’ah Supervisory Board (SSB), Shari’ah Committee (SCM) and Shari’ah Audit (SAU). Meanwhile, Bank size (SIZE), bank age (AGE), and GDP are the control variables.

### 3.3. Data analysis technique

To investigate the connection between performance and Shari’ah governance and performance, the study used the multivariate regression technique. Multivariate regression is used because the model has more than one dependent variable and more than one independent variable. Multivariate regression extends multiple linear regression by interpreting possible linear relationships between inputs and outcomes.

Simple regression with one independent variable is thus  $Y = \alpha + \beta\chi$

This research incorporates multiple independent variables; Consequently, the model is amended so that it include all of the other variables:  $Y_i = \alpha + \beta_1\chi + \beta_2\chi + \beta_3\chi + \beta_4\chi + \beta_5\chi + \beta_6\chi + \mu_i$

Thus, Y is DV;  $\alpha$  is the intercept of the IV’s value when the dependent variable is zero;  $\beta$  is the n coefficient of DV ( $\chi$ ), which shows how  $\chi$  affects Y; and  $\chi$  is the IV; and  $\mu$  the error term.

Furthermore, panel data methodology is used to improve analysis reliability in the study. Panel data probes cross-sectional units across time. Thus, the regression model will include panel data as follows:

$$Y_{it} = \alpha + \beta\chi_{it} + \mu_{it}$$

### 3.4. Model specification

These approaches evaluate Shari’ah government and performance with the following model:

$$\text{Performance} = \alpha + \sum\beta_1 \text{Shari’ah Supervisory Board Size} + \beta_2 \text{Shari’ah Committee Size} + \beta_3 \text{Shari’ah Audit} + \beta_4 \text{Bank Age} + \beta_5 \text{Bank Size} + \beta_6 \text{GDP of Country} + \mu$$

$$\text{ROA} = \alpha + \sum\beta_1 \text{SSB}_{it} + \beta_2 \text{SCM}_{it} + \beta_3 \text{SAU}_{it} + \beta_4 \text{BA}_{it} + \beta_5 \text{BS}_{it} + \beta_6 \text{GDP}_{it} + \mu_{it} + \mu_{it}$$

$$\text{ROE} = \alpha + \sum\beta_1 \text{SSB}_{it} + \beta_2 \text{SCM}_{it} + \beta_3 \text{SAU}_{it} + \beta_4 \text{BA}_{it} + \beta_5 \text{BS}_{it} + \beta_6 \text{GDP}_{it} + \mu_{it} + \mu_{it}$$

Where:

ROA and ROE = Performance

$\alpha$  = fixed variable;  $\beta_1 - \beta_6$  = coefficient of IVs;  $i$  = no. of banks 1 – 28;

$t$  = study period, year 2015 – 2020;  $\mu$  = unobservable random effect,  $\epsilon$  = error term

## 4. Results and Discussions

### 4.1. Descriptive and correlation analysis

The descriptive statistics are presented in Table 1, showing the summary of statistics including measures of central tendencies.

TABLE 1: Descriptive statistics.

Variable	Obs	Mean	Std. Dev	Min	Max
ROA	168	2.3601	4.3647	-13.51	25.11
ROE	168	14.903	21.8305	-39.49	17.3
BFSIZE	168	9.8929	2.7664	4	16
SBSIZE	168	4.0833	1.2450	3	10
SAUC	168	3.8155	0.8380	3	6
SIZE	168	9.8290	0.9901	8.06	12.72
AGE	168	30.6071	20.1120	10	113
GDP	168	3.5767	3.5586	-2.50	13.32

Source: STATA Result (2021)

Islamic banks in Africa have a mean ROA of 2.3601, with a minimum of -13.51 and a maximum of 25.11. While ROE of has a mean of 14.903, with max and min of ranging from -39.49% to 17.3%. The BFSIZE averages 9.8929, with a minimum of 4 and a high of 16, while SBSIZE has a mean of 4.0833, indicating a minimum of 3 and a maximum of 10 members. Shari’ah Audit Committee (SAUC) members range from 3 to 6 with a mean of 3.8155. Bank size (SIZE) was the logarithm of total assets and min and max ranged from 8.06 to 12.72, with a mean of 9.8290, whereas bank age (AGE) was assessed as the number of years from inception, with a mean of 30.6071 and minimum and maximum of 10 and 113 years. lastly, GDP ranges from -2.50 to 13.32, with a mean of 3.5767.

#### 4.1.1. Correlation matrix

The relationship between the dependent and independent variables is shown in Table 2 for every possible combination of variables in the regression model, including explanatory variables, explained variables and independent variables.



TABLE 2: Correlation matrix.

Variables	ROA	ROE	BFSIZE	SBSIZE	SAUC	SIZE	AGE	GDP	Vif
ROA	1.0000								
ROE	0.3440	1.0000							
BFSIZE	-0.1346	-0.1799	1.0000						1.46
SBSIZE	0.0113	0.0056	0.2773	1.0000					1.18
SAUC	0.0774	-0.0770	0.4796	0.0607	1.0000				1.33
SIZE	0.2228	0.1333	-0.1993	-0.2844	-0.1629	1.0000			1.22
AGE	0.3048	0.2421	-0.1357	-0.1269	-0.0370	0.2975	1.0000		1.16
GDP	-0.0710	-0.2134	0.0300	0.0237	-0.0667	0.0684	-0.0429	1.0000	1.07
Mean VIF									1.23
Heteroskedasticity Test									0.0062

Source: STATA Result (2021)

Table 2 exhibits correlation coefficients for the dependent variable, independent variable, and control variables. With the correlation coefficients varying from -1 to 1. The correlation analysis shows that the explanatory variables shari'ah board size, audit committee, bank size, age, and GDP are positively associated with ROA and ROE of the IBs in Africa, whereas board size and GDP are negatively correlated.

#### 4.2. Regression analysis

The result of multivariate regression is shown in Tables 3 below:

Table 3 indicates an R2 value of 0.1638 for ROA, indicating that board size, Shari'ah board size, Shari'ah audit committee size, bank size, and bank age account for 16.38% of the variation in ROA of IBs in Africa. The model is fit and statistically significant with F=5.2548 and P=0.0001. The table reveals that board size, Shari'ah board size, Shari'ah audit committee size, bank size, and bank age account for 13.33% (R2 value) of African Islamic banks' return on equity. The model was fit and statistically significant with an F-value of 4.12 and P-value of 0.0007.

Board size decreases ROA and ROE, with coefficients of -0.3096 and -1.2495 and P-values of 0.024 and 0.074. This is in line with the findings of some authors [31,50], which assert that board size significantly and adversely affects Islamic banks performance in the GCC. Another finding also challenged the effectiveness of large boards, disagreeing those problems such as poor communication and coordination of tasks for a larger board will hinder effective decision making [42]. On the contrary, Belkhir [33] discovers a favourable relationship between performance and board size in subsamples of financial institutions such as banks and savings and loan holding companies, demonstrating that

TABLE 3: Multivariate regression result.

ROA					ROE				
Variables	Coef.	Std. Err.	T	P> t	Variables	Coef.	Std. Err.	T	P> t
BFSIZE	-0.3096***	0.1363	-2.27	0.024	BFSIZE	-1.2495***	0.6938	-1.80	0.074
SBSIZE	0.4879***	0.2729	1.79	0.076	SBSIZE	1.8295***	1.3895	1.32	0.190
SAUC	1.0349***	0.4337	2.39	0.018	SAUC	0.0037*	2.2081	0.00	0.999
SIZE	0.8226***	0.3502	2.35	0.020	SIZE	1.9059***	1.7831	1.07	0.287
AGE	0.05321*	0.01649	3.23	0.002	AGE	0.2162***	0.0839	2.57	0.011
GDP	-0.0704**	0.0892	-0.79	0.431	GDP	-1.2791***	0.4542	-2.82	0.005
_cons	-9.9807	4.2415	-2.35	0.020	_cons	-0.9972	21.5975	-0.05	0.963
Obs Parms	168				Obs Parms	168			
RMSE	4.0650				RMSE	20.6987			
R- squared	0.1638				R- squared	0.1333			
F	5.2548				F	4.1272			
P-Value	0.0001				P-Value	0.0007			

Note: \*, \*\* and \*\*\* represent statistical difference at 10%, 5% and 1% respectively.  
Source: STATA Result (2021)

board size affects performance in both savings and commercial banking. Shari’ah board size shows a coefficient of 0.4879 for ROA and 1.8295 for ROE with P-values of 0.076 and 0.190, respectively. This implies a significant positive connection between shari’ah board size and Islamic banks performance in Africa, which is like the results of Aslam and Haron [50], which asserts that the Shariah board have a positive effect on IBs performance. This indicates that the larger Shari’ah board positively influences Islamic banks’ performance because shari’ah is a strong pillar in establishing Islamic banks, hence the strong positive relationship. More so, the Shari’ah audit reported a coefficient of 1.0349 and 0.0037 for ROA and ROE and a P-value of 0.018 and 0.999. The Shari’ah audit committee positively impacts Islamic bank performance, Aslam and Haron had comparable outcome [50].

A number of control factors that could affect performance are also included in the regression equations. Bank size reported a coefficient of 0.8226 for ROA and 1.9059 for ROE, with P-values of 0.020 and 0.287, respectively. At the same time, bank age shows a coefficient of 0.0532 for ROA and 0.2162 for ROE, with P-values of 0.002 and 0.011, respectively whereas GDP has a coefficient of -0.0704 and -1.2791 for ROA and ROE, respectively, with P-values of 0.431 and 0.005. This demonstrates that the performance of Islamic banks is significantly positively impacted by bank size and bank age. Similar to Bukair and Abdul Rahman’s findings, they contend that bigger banks have more resources and know-how to invest in order to generate greater profits than smaller

banks [31]. This implies that with the existence of economies of scale, larger banks outperform smaller banks. Meanwhile, the result of this study shows the relationship between GDP and performance to be negative. This contradicts another finding, which shows a positive relationship and assert that high GDP increases demand for financing and improves Islamic banks' performance [44].

## 5. Conclusion

This study empirically examined how Shari'ah governance affects Islamic banks performance in Africa. Based on the results, the study concludes that both Shari'ah board size and Shari'ah audit committee size positively and significantly affect the performance of Islamic banks in Africa. This is because Shari'ah is a strong pillar in executing Islamic banking activities. However, the performance of Islamic banks is significantly impacted negatively by the size of the board, because a larger board size might bring coordination challenges which might hinder effective decisions, and the Shari'ah board carries out most decisions. Therefore, making large board sizes is not too significant in Islamic banks. More so, the findings assert that the size and age of banks positively and significantly affect the performance of Islamic banks. This is because bank assets (size) and age allow for more experience and improvement as the bank attains economy of scale.

Due to the financial and long-term costs associated with using items that violate Shari'ah principles, Shari'ah non-compliance can negatively impact the income and profitability of IBs. This means that functional SSBs are a key component of good CG, which is necessary for the IBs to succeed. However, numerous SSB features, particularly the SSB size, affect how well the SSB performs its responsibilities. In practice, IBs employ various SSB sizes in accordance with the various legislation in each jurisdiction, therefore there is no one-size-fits-all SSB. In fact, it is still debatable whether using small or big SSB sizes is favorable for strengthening IBs' performance or whether there is an ideal SSB size that can do so and then be suggested to IBs.

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