

DOES SHARIAH COMMITTEE REMUNERATION IMPACT THE PERFORMANCE OF ISLAMIC BANKS IN MALAYSIA?

Nor Izni Bazilah Binti Mohd Zain^{1,a*} and Norhazlina Ibrahim^{1,b}

¹Faculty of Economics and Muamalat, Universiti Sains Islam Malaysia, Nilai, Negeri Sembilan, Malaysia

^aiznibazilah@raudah.usim.edu.my

^bnorhazlina@usim.edu.my

*Corresponding Author: iznibazilah@raudah.usim.edu.my

Abstract: *The purpose of this study is to analyze the relationship between Shariah Committee (SC) remuneration and Islamic banks' (IBs) performance. During a five-year analysis (2019 to 2023), the study used a quantitative research design to analyze secondary data on 15 Islamic banks. The study employed regression analysis by testing how SC remuneration, size, and educational qualification affected two main performance variables represented by Return on Assets (ROA) and Return on Equity (ROE). The results show that a positive impact on the ROE is significant and that SC remuneration positively impacts ROE and that well-paid SC members are more likely to increase shareholder value by stable governance and oversight. Nevertheless, the analysis indicates that SC remuneration does not have significant influence on ROA, thus operational efficiency may not be directly impacted by the governance over Shariah. Moreover, both SC size or educational qualifications indicated no significant correlation with ROA or ROE, showing that structural or demographic characteristics are apparently less decisive than governance incentive. The paper adds to the debate on Shariah governance by confirming that remuneration can be used as a way of motivating SC members and aligning their interests to those of the stakeholders as consistent with agency theory. It highlighted also the need to have a better regulation guideline and more openness in disclosures of SC remuneration to improve the practice of governance. The insights can guide regulators, including Bank Negara Malaysia and Islamic financial institutions, in the development of remuneration system based on integrity and accountability and Shariah compliance. Future research should adopt a broader scope of SC characteristics, apply qualitative methods, conduct cross-country comparisons, and advocate for standardized SC remuneration disclosures to enhance data accuracy and understanding of Shariah governance.*

Keywords: Shariah Committee, remuneration, bank performance

1. Introduction

The history of Islamic banking in Malaysia started with the formation of Tabung Haji in 1963, established to manage Muslim pilgrim savings (Tabung Haji, n.d.). A milestone was the Islamic Banking Act 1983, which made it possible to establish Bank Islam Malaysia Berhad the first Islamic bank in the country (Borhan, 1999). The Takaful Act finally introduced the first Islamic insurance company in 1984 (Sharifuddin et al, 2016). The development of Islamic banking in Malaysia was further promoted when the country adopted the dual bank system in the 1990s

and even set up the Shariah Advisory Council (SAC) in 1997 by Bank Negara Malaysia (BNM), hence, providing a uniform Shariah compliance framework.

Islamic banks function according to Shariah principles that prevent their use of interest payments (*riba*) and abolish uncertainty (*gharar*) and prohibit to invest in haram activities. Islamic banks operate on the basis of different type of contracts such as *mudarabah*, *musharakah* based on the equity-base model, *murabahah* as a form of financing trade, *ijarah* when required to lease assets etc. The rise of Islamic banking serves as example of the desire to incorporate Islamic values into the financial frameworks of Malaysia. The introduction of Islamic Financial Services Act 2013 (IFSA 2013) strengthened Malaysia as an Islamic global financial centre. As such, the Shariah Committees (SC) are of pivotal importance in keeping up with this compliance, providing opinions, and screening the products, and influencing stakeholder confidence. The rising expectations require SCs to execute more complicated tasks, like to be remunerated sufficiently and fairly.

Although SCs play an important role, little research on the effect of SC compensation on the financial performance has been done, particularly in Malaysia. The issue is a shortage of empirical evidence that SC remuneration and Islamic bank performance are connected. In the absence of transparency and direction by policies such as the Shariah Governance Policy Document (SGPD) 2019, inconsistent remunerations can interfere with SC independence, motivation and decision-making processes. This causes knowledge gap that conflicts effective Shariah governance and clarity in regulation.

The contribution of this research is to investigate the impact of SC remuneration on the performance of the bank (ROA and ROE) in Malaysia in 2019 to 2023. It can provide empirical data to help regulators like the BNM to come up with transparent and fair remuneration systems. The findings can also assist Islamic banks in coming up with remuneration policies that will increase compliance and financial performance, and yet uphold ethical governance in keeping with Islamic principles.

2. Literature Review

Several studies have examined the role of the SC in influencing the performance of Islamic financial institutions (IFIs), with a specific emphasis on SC remuneration as part of Shariah governance. In the agency theory perspective, remuneration serves as a tool to align the interests of SC members with those of the bank, thereby enhancing accountability and oversight Tursunov and Muhammadkarim (2024). Md Amin et al. (2021) utilized SC remuneration as an indicator to measure Shariah governance effectiveness Waemustafa and Abdullah (2015). found that enhanced SC remuneration positively affects the financial performance of Islamic banks in Malaysia, suggesting that good remuneration encourages diligence and accountability among SC members.

However, Haron et al. (2021), in a study spanning from 2010 to 2018, discovered a significant negative relationship between SC remuneration and bank performance, specifically ROA. The authors argued that bonuses and financial incentives do not necessarily enhance the effectiveness of Shariah board members and may instead compromise their objectivity. This contradicts agency theory, implying that SC members prioritize religious and ethical obligations over financial gains.

Nomran et al. (2017, 2018) investigated the impact of SC characteristics such as size, qualifications, reputation, and composition changes on bank performance. The results showed that SC size, cross-membership, and educational qualifications significantly affected performance. Aisyah et al. (2022) found that larger and more qualified SCs positively influenced ROA, enhancing Shariah compliance and stakeholder trust. Regular meetings were also found to contribute to better governance. On the other hand, Abdul Hamid et al. (2023) found that SC characteristics did not significantly affect financial performance in Southeast Asian companies.

Isa and Lee (2020) explored gender diversity and experience among SC members. Their study found that qualifications in finance or banking correlated with better financial performance. Although gender diversity reduced risk-taking behavior, it had no meaningful impact on financial outcomes. Similarly, Abdul Rahim et al. (2023, 2024) emphasized that key SC attributes such as expertise, audit, and Shariah risk management significantly influence accountability, transparency, and financial results.

Other studies agree that SCs contribute to financial performance through improved Shariah governance. Researchers such as Masruki et al. (2018), Abdallah and Bahloul (2021) and Md Zain and Shafii (2019) found a positive relationship between SC presence and IB performance, especially in ROA and ROE. Their findings underline the value of well-functioning Shariah committees in enhancing institutional outcomes. These studies help regulators and policymakers better understand how to optimize Shariah governance structures in Malaysia Nomran et al. (2018).

Despite the available literature, most researchers have focused more on SC characteristics such as size, qualification, and meeting frequency, while remuneration often receives limited attention. Therefore, this study incorporates insights from Board of Directors (BOD) remuneration literature to fill this gap.

In terms of BOD remuneration, Eklemet and Gyamera (2024) analyzed data from 20 banks in Ghana (2012–2023) and concluded that board size, gender diversity, and remuneration positively influence performance. Their findings support agency theory by indicating that well-structured remuneration aligns board behavior with shareholder interests. Similarly, Bashir et al. (2019) found a significant positive relationship between BOD remuneration and both ROA and ROE in Islamic and conventional banks in Pakistan. They argued that better pay motivates BOD members to contribute effectively to strategic outcomes.

In contrast, Billah (2019) argued that higher remuneration did not always lead to better performance in Islamic banks. The study highlighted differences between conventional and Islamic models, indicating that ethics and religious values may outweigh monetary incentives in influencing governance behaviors. Marzuki and Shukri (2019) studied state-owned enterprises in Malaysia and found that higher BOD remuneration was linked to improved performance. However, when boards had political ties or were too large, performance declined, suggesting inefficiencies and agency issues.

In summary, existing literature affirms the relevance of SC remuneration in influencing financial performance, though mixed results suggest that financial incentives must be balanced

with ethical and religious responsibilities. A clear research gap remains in studying SC remuneration specifically in Malaysia, which this study aims to address.

3. Research Methodology

This study uses a quantitative approach based on secondary data from 15 Islamic banks in Malaysia over a five-year period (2019–2023). Descriptive statistics were employed to examine trends in SC remuneration, while regression analysis was conducted to test the relationship between SC characteristics (remuneration, size, educational qualification) and bank performance indicators (ROA and ROE). The regression equations were structured as follows:

Table 1. Regression Equations

| No | Model | Equations |
|----|-------|--|
| 1 | ROA | $ROA_{i,t} = \beta_0 + \beta_1 SC_Rem_{i,t} + \beta_2 SC_Size_{i,t} + \beta_3 SC_Edu_{i,t} + \varepsilon_{i,t}$ |
| 2 | ROE | $ROE_{i,t} = \beta_0 + \beta_1 SC_Rem_{i,t} + \beta_2 SC_Size_{i,t} + \beta_3 SC_Edu_{i,t} + \varepsilon_{i,t}$ |

The study defines SC remuneration as the total financial remuneration including fixed salaries, allowances, and honorariums. SC size is measured by the number of members, and educational qualification is measured by the percentage of members holding a PhD. The data were sourced from annual financial reports, specifically the notes to the financial statements and SC profiles. Two regression models were developed to test the impact of SC variables on ROA and ROE respectively.

4. Finding and Analysis

The results using the multiple regression analysis as shown in Table 2 and 3 indicate that, out of the three SC characteristics that were investigated, only the remuneration proves to have a significant positive impact; however, only when it concerns ROE. The remaining two variables, SC size and education, are not significantly related with ROA or ROE.

Table 2. Regression Analysis for ROA

| (1) ROA | | |
|----------|---------|-------|
| Variable | β | p |
| SC_Rem | 0.075 | 0.546 |
| SC_Size | (0.008) | 0.948 |
| SC_Edu | (0.061) | 0.614 |

Table 3. Regression Analysis for ROE

| (2) ROA | | |
|----------------|---------|-------|
| Variable | β | p |
| SC_Rem | 0.333 | 0.006 |
| SC_Size | 0.036 | 0.760 |
| SC_Edu | (0.105) | 0.356 |

The results indicate that SC remuneration has a significant positive correlation with ROE. This fact shows that the remuneration given to SC members is statistically significant in the effect it has on the returns provided by banks to their shareholders. The fact contributes to the fact that effective and equitable remuneration systems can not only increase the level of diligence and the motivation of members of SC but also increase shareholder value.

The results of the analysis reveal that, in the event where SC members are duly compensated, their likeliness to dedicate time, efforts and professional expertise towards the work is more likely to occur. Consequently, Shariah compliance of the bank is maintained, the governance is empowered, and all-round performance improves. These results are also supported by other studies like Waemustafa and Abdullah (2015) which argued that higher SC remuneration would have a positive influence on bank performance.

The Agency Theory that proposes that alignment of the interests of the agents (SC members) and the principals (shareholders) through suitable incentives reduce agency costs and enhance performance is also validated by the positive correlation found between SC remuneration and ROE. Those members of SC have a dual role, being advisers regarding religious issues, and agents of governance; hence, their fees have to consider induced complexity and accountability which relate to their positions.

In contrast, as regards the regression findings, the compensation package of SCs did not significantly affect ROA. This implies that although SC pay influences shareholder-related financial performance (by ROE), it might not necessarily affect the efficiency of asset management at the banks (by ROA). Since ROA is a measure of the effectiveness of utilizing assets to create profit, it could have a closer association with the operational strategies instead of roles like Shariah compliance instead of functions of governance.

The findings also revealed that SC size as well as educational qualification did not play any significant role in determining ROA and ROE. What this means is that the number of SC members as well as the percentage number of the PhD-holding scholars made no significant difference in the financial performance aspect of this research. Though other previous authors like Nomran et al. (2018) and Aisyah et al. (2022) established that SC size and qualifications could be influencing the banking performance, the results obtained in the present study indicated that remuneration may have a better role in the Malaysian case.

Such insignificance in SC size and qualification reminds of the fact that institutional structures, internal governance mechanisms, and incentive policies can play a greater role in bank outcomes than demographic features of SC members. It can also point to the fact that the

performance of SC members is not focused on the academic formation or their amount but on ways of encouraging them to better conduct their duties in a manner that is integrity and independence.

5. Discussion and Conclusion

As a major observation of the research, the SC remuneration has a variable positive influence on ROE. This means that SC members who get proper remuneration will be more willing to work actively and diligently to their duties especially to make sure that the banking institution is Shariah compliant. Such finding is consistent with the claim that remuneration should be used as a source of motivation and compliments with the Agency Theory stating that suitable funding can make the interests of the governance agents aligned with those of the stakeholders. Once SC members are remunerated appropriately, they will be more committed to their work, and the quality of their Shariah oversight will improve, hence, resulting in higher shareholder returns.

Nevertheless, the results of the analysis showed that the SC remuneration was not significantly related to ROA. ROA usually shows the efficiency with which the bank uses its assets to make profits. The nonexistent correlation indicates that although SC pay can transform governance and moral monitoring, it does not have an immediate effect on operational efficiency. This could be related to the fact that how well an asset performs relates much more to management, processes, and business strategy than to the functions of governance like Shariah compliance.

In addition, the study established that SC size and educational qualification did not influence ROA or ROE significantly. This is a necessary observation in the sense that it implies that the structure features such as the number of members in the committee or the availability of PhD holders do not alone have the power to determine the financial results. This means that the value and character of governance processes particularly the way the SC members are motivated are more important than the demographic or academic qualifications. This observation criticizes the previous studies, which focused mainly on qualifications and size as indicators of performance by implying that effectual governance mechanisms and forms of accountability are more important.

Following the findings, several issues were brought up. Such problems include the absence of transparency in terms of disclosure of SC remuneration. Even though the SGPD 2019 contains detailed guidelines on the roles of the SC members, it does not obligate the remuneration disclosure. Consequently, the reporting practices of Islamic banks concerning SC remuneration differ significantly, which causes inconsistencies and unclarity when assessing governance standards. This may hamper the trust among stake holders and enable the regulators and researchers to evaluate the efficiency of Shariah governance models.

The other issue is the possibility of overcompensation. Although the proper payment level is needed to assure motivation and commitment, the financial incentives may exceed the level that would undermine the independence and objectivity of the SC members. An important concern raised by the study is how remunerations must be planned where they are adequate to capture the complexity and significance of the job but do not pose conflicts of interest. This

issue is especially topical with regard to the SC as advisors to the religious and executors of the state power whose integrity and objectivity are paramount.

On the basis of the findings, various recommendations were ventured. The regulators, like the BNM, should consider releasing more detailed guidelines on the SC remuneration policies, and more disclosure and benchmarking expectations. It would foster uniformity within the industry as well as improve quality of governance. Moreover, by harmonizing SC remuneration practices with performance results alongside independence, there would be a boost in the integrity of Islamic finance institutions. It is also proposed that IBs incorporate SC remuneration structures into the larger governance approach making sure that the compensation incorporates accountability and duties complexity.

In sum, the paper highlights that SC remuneration is significant in improving the financial performance of Islamic banks, specifically, in terms of ROE. Although SC qualification and size did not impose significant effect, the positive impact of remuneration helps in achieving the opinion that adequate compensation serves in attracting commitment, advancing governance, and developing trust among the stakeholders. Looking ahead, there is a need to have more transparent regulatory guidelines and institutionalized procedures that will need to re-enforce independence, accountability, and shariah compliance through SC compensations schemes in Islamic financial system.

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