

ASSESSING THE IMPACT OF SHARIAH COMMITTEE CHARACTERISTICS ON THE FINANCIAL PERFORMANCE OF MALAYSIAN ISLAMIC BANKS (2019-2023)

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Abstract: *The Shariah Committee plays a key role in the Shariah governance framework of Islamic banks. This study aims to assess the impact of Shariah Committee characteristics on the financial performance of Islamic banks in Malaysia, from the perspective of Agency Theory. To achieve this, regression analysis was conducted using data from 15 Islamic banks covering the period from 2019 to 2023. The findings reveal that only the frequency of Shariah Committee meetings has a positive and significant impact on the financial performance of Islamic banks. In contrast, the size of the committee, the number of members holding PhD degrees, and the remuneration of the Shariah Committee do not significantly influence financial performance. This result remains consistent across the pre-COVID-19, during COVID-19, and post-COVID-19 periods. This research contributes to both academic knowledge and practical insights for Islamic banking practitioners. However, the study has some limitations. It uses only ROA and ROE as performance indicators, while other important measures, such as Zakat-based performance metrics are not considered. Exploring additional metrics such as ZOA and ZOE ratios could provide deeper insights into performance. Therefore, future research should consider including these metrics.*

Keywords: *Shariah Governance, Shariah Committee, Performance.*

1. Introduction

Shariah Committee (SC) plays a key role in the Shariah governance framework, alongside the Shariah Risk Management Control Function, Shariah Review Function, Shariah Research Function and Shariah Audit Function (Shariah Governance Framework, 2010 (SGF 2010)). The stability of Islamic banks (IBs) largely depends on effective functioning of the Shariah Committee.

Bank Negara Malaysia (BNM) introduced a Shariah governance framework to strengthen the role of the SC. The Shariah Governance Policy Document 2019 (SGPD 2019), issued on 20 September 2019, outlines the roles and responsibilities of the SC, including guidelines on the number of members to be appointed, frequency meetings, and minimum educational qualifications. Under SGPD 2019, SC must have at least 5 members, 6 meetings per year, and a minimum educational qualification of a bachelor's degree. Although SGPD 2019 didn't mention on the SC remuneration, the earlier SGF 2010 states that the Board of

Directors (BOD) of IBs must remunerate SC based on advised from the Remuneration Committee.

Several previous studies have investigated the impact of SC characteristics on the financial performance of 15 IBs in Malaysia. However, most of data used in these studies ended before 2019, which limits their relevance to the current Islamic banking context. For example, Nomran et al. (2018) analyzed data from 2008 to 2015, while Haron et al. (2021) focused on the period from 2010 to 2018. Since none of these studies include data beyond 2019, they do not account for the effects of significant events such as the COVID-19 pandemic.

Therefore, the objective of this study is to build on existing literature by providing updated empirical evidence on the impact of SC characteristics on the financial performance of IBs in Malaysia across the pre-COVID-19, during COVID-19, and post-COVID-19 periods. This research aims to contribute to both academic knowledge and practical insights for IB practitioners.

This paper is organized into four sections. The first section reviewed the relevant literature and developed the hypothesis. The second section presented data and research methodology. The final section discussed empirical results and concluded the study.

2. Theoretical Framework, Literature Review and Hypotheses Development

Agency Theory underscores the importance of the SC in mitigating conflicts between management and stakeholders in IBs. In this context, customers act as principals, while bank management serves as agents. Agency problems may arise if a bank engages in investments that are not Shariah-compliant, as customers expect their funds to be utilized in accordance with Islamic principles (Chapra & Ahmed, 2002). Safieddine (2009) highlighted that IBs face more complex agency issues due to the separation of ownership, management, control, and cash flow. To address these challenges, the SC plays a pivotal role within the Shariah governance framework. It ensures compliance with Shariah principles, reduces agency problems, and contributes to enhancing the financial performance of IBs (Nomran et al., 2018).

3.1 Committee Size

Some scholars argue that a larger SC brings diverse skills and expertise, which can improve product understanding, innovation, risk management, and overall performance (Abdallah & Bahloul, 2021). A larger committee may also reduce agency costs by enhancing oversight (Almutairi & Quttainah, 2017). Conversely, others suggest that a smaller committee can improve communication and decision-making efficiency (Quttainah et al., 2013). However, an excessively small board might lead to weak oversight, risking issues like Gharar, inattention, and lack of transparency (Haddad & Souissi, 2022). Empirical studies have yielded mixed results. For instance, Nomran et al. (2018) reported a positive link between SC size and bank performance, whereas Kateb et al. (2025) found that larger boards may negatively impact financial performance.

3.2 Meeting Frequency

The frequency of SC meetings is another critical factor. Shittu et al. (2016) posited that more frequent meetings enable the SC to address issues promptly, thereby enhancing the bank's financial performance. Conversely, Awingburi and Prince (2019) reported a negative correlation between the frequency of meetings and financial performance. Similarly, Cornett et al. (2009) and Hsu and Petchsakulwong (2010) found that increased Audit Committee (AC) meeting frequency negatively impacted financial performance efficiency.

3.3 Educational Qualifications

The educational qualifications of SC members are vital in assessing the board's quality. The success of a company's performance is positively linked with the presence of qualified board members (Kakabadse et al., 2010; Haniffa & Cooke, 2002; Cheng et al., 2010). According to Agency Theory, SCs have technical implications regarding their independence, as they formulate religious opinions based on interpretations of the Quran and Hadith. Karim (1990) explains this opinion process, emphasizing that when the Quranic text contains an explicit answer, the SC makes decisions accordingly. In the absence of clear guidance, the SC adopts its opinion, guided by moral beliefs and obligations to peers, while respecting Shariah requirements.

3.4 Remuneration

The remuneration of SC members can influence their independence and objectivity. Grais and Pellegrini (2006) argued that SCs may not remain independent if they receive remuneration from the same institutions they oversee. Similarly, Alman (2012) identified potential conflicts of interest, as SCs might be influenced by the tension between ensuring Shariah-compliant governance and supporting the bank's profitability.

Based on the reviewed literature, this study proposes four hypotheses:

H1: The size of Shariah Committee has a positive impact on the Islamic bank's financial performance.

H2: The frequency of Shariah Committee meetings has a positive impact on the Islamic bank's financial performance.

H3: The educational qualifications of Shariah Committee members have a positive impact on the Islamic bank's financial performance.

H4: The remuneration of Shariah Committee members has a positive impact on the Islamic bank's financial performance.

3. Methodology

3.1 Sample Selection

In this study, regression analysis was conducted using data from 15 Islamic banks covering the period from 2019 to 2023. The data were collected from the published annual reports of the respective Islamic banks, which are publicly available on their official websites. The statistical analysis was performed using IBM SPSS Statistics Version 31.

3.2 Variables Description and Measurement

In this study, the independent variable is the SC characteristics, while the dependent variable is the financial performance of IBs. The SC characteristics and financial performance were measured using the following metrics:

- SC size is defined as the total number of members on the SC of each IB at the end of the year.
- SC frequency meeting is defined as the total number of SC meetings of each IB throughout of the year.
- SC educational qualification is defined as number of SC members holdings a PhD degree.
- SC remuneration is defined as the total remuneration paid to SC members in RM'000.
- Financial performance is measured using Return on Assets (ROA) and Return on Equity (ROE). Return on Assets (ROA) is calculated as profit after tax divided by total assets and Return on Equity (ROE) is calculated as profit after tax divided by total equity.

3.3 Regression Equation

To test the hypotheses and assess the impact of the independent variable on the dependent variables, the following regression equations were employed.

$$Performance = \beta_0 + \beta_1 SC_SIZE + \beta_2 SC_MEET + \beta_3 SC_EDU + \beta_3 SC_REM + \varepsilon$$

Performance = performance of Islamic banks, SC_Size = SC size, SC_MEET = SC frequency meeting, SC_EDU = SC educational qualification, SC_REM = SC remuneration, ε : error term.

4. Results

4.1 Descriptive Statistics Analysis

This study analyzes 75 observations comprising 15 Islamic banks in Malaysia over a five-year period from 2019 to 2023 (15 Islamic banks x 5 years = 75 samples). The results of descriptive statistics for the variables are shown in Table 1.

The mean ROA and ROE are 0.6573% and 8.4036%, respectively. The highest ROA of 1.68% was recorded by HSBC Amanah Malaysia Berhad in 2023, while the lowest ROA of -0.62% was reported by Kuwait Finance House (Malaysia) Berhad in 2019. The maximum ROE of 23.16% was achieved by Maybank Islamic Berhad in 2019, whereas the lowest ROE of -3.29% was also recorded by Kuwait Finance House (Malaysia) Berhad in 2019.

Among selected IBs in Malaysia, Maybank Islamic Berhad stands out in terms of SC characteristics. It reportedly appointed the highest number of members (8), convened the most meetings in a financial year (30), had the highest number of members with PhDs (7), and paid the highest SC remuneration (RM 1,218,000).

On average, a Shariah Committee in this study has the following characteristics: SC_Size: 5.36 members – approximately 5 members per bank, SC_Meet: 11.85 meetings per year – about 12 meetings annually, SC_Edu: 3.92 a PhD-qualified members – roughly 4 members holds PhDs, and SC_Rem: RM515,000 total annual remuneration.

Table 1: Descriptive Statistics

<i>Variable</i>	N	Min	Max	Mean
ROA	75	-0.62	1.68	0.6573
ROE	75	-3.29	23.16	8.4036
SC_Size	75	3	8	5.36
SC_Meet	75	6	30	11.85
SC_EDU	75	2	7	3.92
SC_REM	75	199.0	1,218.0	515.320

The descriptive statistics from this study were also compared with those reported by Nomran et al. (2018) and Haron et al. (2021), which used the same sample of 15 IBs in Malaysia. The mean SC size in this study is 5.36, with a range of 3 to 8 members, compared to 4.82 in Nomran et al. (2018)'s study, with a range of 3 to 9 members and 5.20 in Haron et al. (2021) with the same range of SC members. This suggests that, on average, IBs in Malaysia have approximately 5 SC members.

4.2 Regression Analysis Results

Table 2 presents the regression results assessing the impact of SC characteristics on the financial performance of IBs. The results indicate that only the SC frequency meeting has a positive and significant impact on financial performance of IBs, with a p-value 0.031 for ROA, and <0.01 for ROE, both below the 0.05 significant level. This suggests that other SC characteristics do not have a statistically significant impact on the financial performance of IBs, whether measured by ROA or ROE.

Table 2: Regression Analysis

<i>Variable</i>	ROA		ROE	
	Coefficient (β)	p-value	Coefficient (β)	p-value
SC_Size	-0.036	0.821	0.105	0.428
SC_Meet	0.302	0.031	0.501	<0.001
SC_EDU	0.047	0.749	0.059	0.629
SC_REM	-0.035	0.802	0.080	0.484

4.3 Hypothesis Testing Outcome

The analysis reveals that only the SC frequency meeting has a positive and significant impact on financial performance of IBs. Thus, the H2 is accepted while the H1, H3, and H4 are rejected.

5. Discussion and Conclusion

The empirical evidence documented in this study highlights that only the SC frequency meeting has a positive and significant impact on financial performance of IBs in Malaysia. This result remains consistent across the pre-COVID-19, during COVID-19, and post-COVID-19 periods. This study has certain limitations. It uses only ROA and ROE as performance indicators, while other important measures, such as Zakat-based performance metrics are not considered. Exploring additional metrics such as ZOA and ZOE ratios could provide deeper insights into performance. Therefore, future research should consider including these metrics. Therefore, it is recommended that future research should take these factors into consideration.

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