

NEXUS BETWEEN SHARIA GOVERNANCE AND FINANCIAL PERFORMANCE: EVIDENCE FROM INDONESIAN ISLAMIC BANKING

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ABSTRACT – This study critically evaluates the effectiveness of Islamic governance on the financial performance of Islamic banks in Indonesia. Due to the absence of regulations defining optimal Sharia Supervisory Board (SSB) structure and qualifications, the research explores the empirical relationship between SSB characteristics and financial performance. Using a quantitative approach, the study analyzes data from 14 Islamic banks over a seven-year period (2014-2020). Multiple regression analysis reveals that SSB size, educational background, and financial/accounting expertise have minimal impact on financial performance. Interestingly, cross-membership on SSBs is found to have a negative effect. These findings, coupled with the observation of SSBs often lacking banking and finance backgrounds, suggest a potential disconnect between Sharia governance and managerial activities. The study advocates for clear and comprehensive regulations to strengthen SSB composition and competence, ultimately promoting the sustainable development of Islamic banking in Indonesia.

Keywords: Sharia governance, financial performance, Islamic banking, sharia supervisory board, financial sustainability.

ABSTRAK – Hubungan Antara Tata Kelola Syariah dan Kinerja Keuangan: Bukti dari Perbankan Syariah Indonesia. Studi ini secara kritis mengevaluasi efektivitas tata kelola Syariah terhadap kinerja keuangan perbankan syariah di Indonesia. Mengingat belum adanya peraturan yang mengatur struktur minimum dan kualifikasi optimal Dewan Pengawas Syariah (DPS), penelitian ini bermaksud mengkaji secara empiris empiris hubungan antara karakteristik DPS dan kinerja keuangan. Dengan menggunakan pendekatan kuantitatif, penelitian ini menganalisis data dari 14 bank Islam selama tujuh tahun (2014-2020). Hasil analisis regresi berganda menunjukkan bahwa ukuran DPS, latar belakang pendidikan, dan keahlian keuangan dan akuntansi kurang memiliki dampak terhadap kinerja keuangan perbankan syariah. Menariknya, cross-membership pada DPS ditemukan memiliki efek negatif. Temuan ini, ditambah dengan pengamatan terhadap DPS yang seringkali tidak memiliki latar belakang perbankan dan keuangan, menunjukkan potensi keterputusan antara tata kelola Syariah dan aktivitas manajerial. Studi ini merekomendasikan adanya peraturan yang jelas dan komprehensif untuk memperkuat komposisi dan kompetensi DPS, yang pada akhirnya mendorong pengembangan bank syariah yang berkelanjutan di Indonesia.

Kata Kunci: Tata Kelola syariah, kinerja keuangan, perbankan syariah, Dewan Pengawas Syariah, keberlangsungan keuangan.

INTRODUCTION

The Islamic banking industry has emerged as a significant contributor to global economic growth (Anwar et al., 2022; Anwar et al., 2020; Elmawazini et al., 2020; Gani and Zakaria, 2020). In 2019, Islamic banking accounted for 70% of the total global Islamic financial assets, with the remaining 30% comprised of Sukuk (19%), Islamic Funds (4%), and other financial assets (7%) (Dinar Standard, 2020). Despite the challenges posed by the Covid-19 pandemic, the global Islamic finance sector has maintained its growth trajectory, albeit at a slower pace (Itani et al., 2020; Kiss and Österholm, 2020). The success of Islamic banking governance is expected to be a key driver for the development of Islamic finance and the overall economy, particularly during times of crisis.

In Indonesia, the Islamic financial sector, especially Islamic banking, has experienced significant growth. During the national economic recovery period in 2022, Islamic banking financing distribution increased by 21.99% (year-over-year) or 19.25% (year-to-date), outperforming the national banking lending growth of 11.43% (Bank Indonesia, 2023). Moreover, the Capital Adequacy Ratio (CAR) has increased from 23.41% in 2020 to 26.74% in 2023, indicating increased public confidence in Islamic banking. Additionally, the effectiveness of operating costs (BOPO) and Non-Performing Financing have decreased, demonstrating Islamic banks' ability to enhance operational cost-effectiveness and reduce problematic financing (Financial Service Authority, 2023).

Tabel 1. Financial Performance of Islamic Banking in Indonesia

Financial Performance	2020	2021	2022	2023 (July)
Capital Adequacy Ratio	23.41	25.67	25.66	26.74
Earning Asset Quality	26.63	28.67	25.31	21.30
Non-Performing Financing	3.13	2.59	2.63	2.35
Financing To Deposit Ratio	76.36	70.12	73.95	76.73
Operational Efficiency Ratio (BOPO)	85.55	84.33	80.54	77.28
Loan Debt Ratio	75.44	73.67	76.98	76.84
Return on Asset	1.87	1.78	1.59	1.24
Return on Equity	16.40	15.77	15.39	13.28

(Source: Financial Service Authority, 2023)



However, despite these positive developments, Islamic banking in Indonesia still faces challenges. Profitability performance, as measured by Return on Assets (ROA) and Return on Equity (ROE), has shown a downward trend over the last three years. Furthermore, the growth of the Islamic banking market share remains stagnant at 7.31% of the national banking market share in 2023, only a 1.35 point increase from 2018 (Financial Service Authority, 2023). This means that more than 90% of banking in Indonesia is still dominated by conventional banking based on interest. Globally, Indonesia ranks 7th in the Islamic finance sector, far behind Malaysia, which holds the top position (State of the Global Islamic Economy Report, 2023). This is particularly noteworthy given Indonesia's potential to become a leader in the Islamic finance market, supported by its status as the country with the largest Muslim population in the world, with over 240 million Muslims, equivalent to 86.7% of its total population.

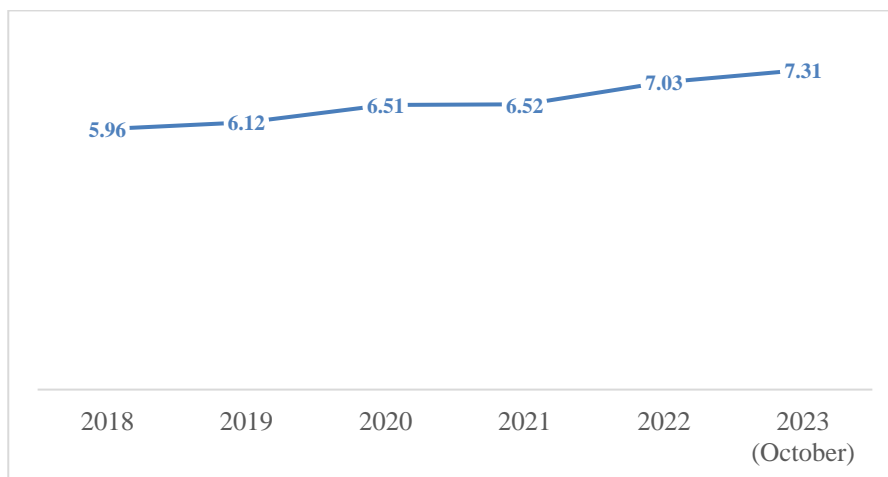


Figure 1. Market Share of Islamic Bank in Indonesia
(Source: Financial Service Authority, 2023)

This indicates that the performance of Islamic banking development in Indonesia is still suboptimal. Several areas require improvement, including the need for increased government support through the formulation of regulations (Gusrianti & Sari, 2023; Indriastuti & Suhendi, 2021), and the image of Islamic banking, which continues to be perceived negatively by the public (Alman, 2012; Rikasari & Hardiyanti, 2022; Saeed et al., 2020). To address these challenges and improve the performance of Islamic banks, the implementation of Good Corporate Governance (GCG) and Sharia governance is crucial. GCG is a mechanism to regulate management performance in relation to stakeholders' interests, aiming to achieve effective and efficient performance



and increase shareholder confidence (Grantham, 2004; Hamsyi, 2019). In addition to GCG, Islamic banking performance must align with economic corridors and Sharia principles (Fahlevi, Irsyadillah, and Randa, 2017). Sharia governance, regulated through Bank Indonesia Regulation (PBI) Number 11/33/PBI/2009 and Bank Indonesia Circular Letter (SEBI) Number 12/13/DPbS, is a vital component of the banking management system, ensuring Sharia compliance and optimal growth.

The Sharia Supervisory Board (SSB) plays a critical role in Sharia governance, distinguishing Islamic banking from conventional banking (Musleh Alsartawi, 2019; Nomran et al., 2018; Hanif, 2018). The SSB is an independent board responsible for supervising and auditing Sharia compliance in all financial transactions conducted by Islamic bank management (Almutairi and Quttainah, 2017). Considering the importance of the SSB's role in influencing Islamic banking's financial performance, it is essential to analyze the structure of the SSB and its impact on bank performance.

Previous studies have examined the role of GCG and Sharia governance in influencing Islamic banking performance in various countries, such as Malaysia and members of the Gulf Cooperation Council (Al-Homaidi et al., 2019; Nurkhin et al., 2018; Al-Malkawi and Pillai, 2018; Mollah et al., 2017; Mollah and Zaman, 2015; Hamsyi, 2019; Nomran et al., 2018). The structure and individual characteristics of Sharia Supervisory Board (SSB) members are crucial for supporting the performance of Islamic banks through the comprehensive implementation of Good Corporate Governance (GCG) (Nomran et al., 2018; Sari & Putra, 2022). Key characteristics include educational background, expertise, size, and composition of the SSB. Previous research suggests a positive correlation between a strong understanding of Islamic principles coupled with expertise in economic and financial management and enhanced Sharia banking performance (Bayu, 2023; Rahman & Haron, 2019; Umar et al., 2023; Kamri et al., 2014). Specifically, Noordin & Kassim (2019) found that relevant expertise among SSB members positively impacts the supervision and implementation of Islamic banking practices. Furthermore, Kok et al. (2022) emphasized the importance of accounting, economics, and financial analysis skills for effective SSB functioning.

However, analysis of the current composition of SSBs within Indonesian Islamic banks reveals a lack of adherence to these ideal criteria (Bayu, 2023; Gati & Basuki, 2020; Septiani et al., 2022; Serly & Oktamirza, 2022). This



imbalance in educational background and expertise is mirrored in other jurisdictions like Bahrain, where Hakimi et al. (2018) found no standardized criteria for SSB membership. Similarly, Indonesian regulations (Bank Indonesia Regulation No 6/24/PBI/2004, No 11/33/PBI/2009, and POJK No 59/POJK.03/2017) lack specific requirements for educational background and expertise for SSB members. The optimal size and composition of SSBs also remain debated. While AAOIFI standards recommend a minimum of three SSB members (Gati & Basuki, 2020; Nomran & Haron, 2020), research offers mixed perspectives on the impact of size on performance (Nomran & Haron, 2020; Rahman & Haron, 2019; Umar et al., 2023). Similarly, the practice of SSB cross-membership (SSBCM), where members serve on multiple SSBs, elicits varied opinions regarding its impact on governance and performance (Rahman & Haron, 2019; Gusrianti & Sari, 2023; Muhammad et al., 2021; Alman, 2012).

This study aims to address this research gap by examining the structure of SSBs and their impact on the financial performance of Islamic banking in Indonesia. The study focuses on the educational background, expertise, size, and cross-membership of SSB members, providing a holistic approach to understanding their influence on Islamic banking performance using CAMEL framework. The findings of this study are expected to contribute to the development of appropriate regulations and programs for the formation of SSBs in Islamic banking, promoting the growth of the Islamic economic ecosystem.

The remainder of this paper is structured as follows: Section 2 reviews the relevant literature, Section 3 presents the research design and methodology, Section 4 discusses the empirical results and analysis, and Section 5 concludes the study with a summary of the findings and recommendations for policymakers.

LITERATURE REVIEW

Sharia Governance

Sharia governance (SG) is a system that ensures compliance with Sharia rules through the supervision of the Sharia Supervisory Board (SSB), also known as the Sharia Board (SB) (Grassa, 2013; Yadiat et al., 2017). The SSB holds the highest authority in overseeing the business operating system of an Islamic organization and is responsible for formulating policies to achieve Sharia objectives. The main functions of the SSB include serving as consultants, controllers, and guarantors (Ajili and Bouri, 2018). These functions work



together to ensure compliance with Islamic regulations in the management of Islamic banks. The components of the Sharia supervisory board include the existence of the SSB, SSB size, SSB cross-membership, SSB educational qualification, SSB expertise, and independence of SSB members to minimize conflicts of interest (Ajili and Bouri, 2018; Farook, Hassan, Lanis, and Lanis, 2011; Hanif, 2018; Nomran et al., 2018; Rahman and Bukair, 2013).

In Indonesia, the SSB is regulated by Bank Indonesia Regulation No. 11/33/PBI/2009 concerning the Implementation of Good Corporate Governance for Sharia Commercial Banks and Sharia Business Units and Law No. 21 of 2008 concerning Islamic banking. These regulations state that the SSB is tasked with overseeing the bank's operations and products to ensure they do not deviate from Sharia principles. Additionally, the SSB is authorized to request data and information related to Sharia aspects from the bank's work unit in the context of carrying out its duties.

Islamic Banking Performance

The CAMEL measurement system approach is widely used in banking industry to analyze the financial performance. This ranking system represents a company's performance by considering several aspects (Beaver, 1966). Altman (1968) initiated the CAMEL attribute by including financial ratios to represent bank financial performance. The disclosure of performance can be evaluated through various ratios achieved by the financial institution, providing an interpretation of its current condition and health (Lahrech et al., 2014). The CAMEL measurement system was first implemented as a standard for measuring banking performance by the Federal Financial Institution Examination Council in the United States in November 1979 and the National Credit Union Administration in October 1987 (Council, 1996). The literature demonstrates the CAMEL measurement system approach as the basis for measuring bank performance (Rozzani and Rahman, 2013; Bastan et al., 2016; Masood et al., 2016; Saeed et al., 2019). The International Monetary Fund (IMF) also recommends utilizing the CAMEL ranking system to assess the financial stability system (IMF, 2006).

The CAMEL parameters can serve as a foundation for a rating system that financial institutions can use to assess the financial health of the banking sector (Antoun et al., 2018; Fahlevi et al., 2017; Hazman et al., 2018; Hosen & Muhari, 2018; Keffala, 2020; Saeed et al., 2019; Sahyouni et al., 2021).



CAMEL measurement system considers five dimensions: Capital (Capital Adequacy Ratio), Assets Quality (Asset Quality Ratio), Management (Cost to Income), Earning Capital (Return on Assets and Return on Equity), and Liquidity (Loan to Deposit Ratio) (Lahrech et al., 2014). Capital is an essential element in bank financing that can affect the financial health of the banking system. Capital measurement is determined by the ratio of capital against risk-weighted assets, known as the Capital Adequacy Ratio (Ledhem & Mekidiche, 2020). This ratio indicates the bank's ability to manage its capital resources to pay its current liabilities and minimize risk. According to Misra and Aspal (2013), the value of capital can reflect the bank's ability to cover unexpected losses in the future.

Asset quality is described by the early identification of bank financial instability conditions arising from high non-performing loans. The asset quality ratio is derived by dividing non-performing loans (NPL) by total loans (Keffala, 2020). The IMF also uses the NPL ratio as a proxy in assessing the quality of assets in the loan portfolio (IMF, 2006). Management quality is essential due to its role in supporting the company's overall performance. It shows the company's ability to minimize costs and optimize revenue (Saeed et al., 2019). The management quality ratio is calculated by dividing operating expenses by operating revenues (Keffala, 2020; Sahyouni et al., 2021).

Earnings describe the bank's ability to achieve growth and help reach the sustainability of bank income (Council, 1996). Earnings ratios, such as Return on Assets (ROA) and Return on Equity (ROE), are commonly used to measure bank profitability (Erol et al., 2014; Wanke et al., 2016). ROA examines the bank's ability to generate income relative to average total assets, while ROE checks the effectiveness of banks in using their shareholder equity (Elgattani & Hussainey, 2020). Liquidity is examined through the Loan on Deposit Ratio (LDR) (Lahrech et al., 2014; Saeed et al., 2019). This credit ratio shows the bank's ability to repay all debts to debtors. Liquidity is one of the essential factors that affect a company's performance (Elgattani & Hussainey, 2020).

The CAMEL calculation is obtained after calculating each aspect and assigning a certain weight to each element. This calculation provides an assessment of the financial performance of Islamic banking. The CAMEL calculation is then classified according to Table 2.



Table 2. CAMEL Calculation

No.	Rating	Description
1.	Between 1.0 and 1.4	The value of CAMEL indicates a sound financial performance
2.	Between 1.6 and 2.4	The value of CAMEL indicates satisfying financial performance.
3.	Between 2.5 and 3.4	The value of CAMEL indicates satisfying financial performance with some categories of concern.
4.	Between 3.5 and 4.4	The value of CAMEL indicates marginal financial performance with a relatively low risk of failure.
5.	Between 4.5 and 5.0	The value of CAMEL indicates unsatisfying financial performance with a high degree of failure.

(Source: Authors' compilation)

SSB Educational Qualification and Expertise

The educational background of Sharia Supervisory Board (SSB) members demonstrates their qualifications and levels of education. It indirectly illustrates the quality of the supervisory board and their ability and skills acquired through their education. Scholars with doctoral education qualifications in economics and business are considered more informed and capable in their capacities as members of Sharia supervisory boards for Islamic financial institutions (Farook et al., 2011; Rahman and Bukair, 2013). The educational background helps boost the reputation of Sharia supervisory board members, which plays a significant role in building the reputation of the Islamic bank. SSB's educational background represents their industry ability, which contributes to promoting the financial performance of Islamic banking (Kok et al., 2022; Nomran & Haron, 2019).

SSB expertise refers to the skills of SSB members to make direct contributions to Islamic bank management. Being a Sharia supervisory board member is a complex process that requires mastery of Sharia laws related to banking and financial management, as well as an understanding of accounting and finance practices. The knowledge possessed by the SSB in accounting and finance can positively impact the financial performance of Islamic banks when linked with expertise in Islamic law. This helps the SSB improve the financial performance of Islamic banking (Matoussi & Grassa, 2012a; Muhammad et al., 2021; Nomran et al., 2018b).



The influence of SSB education and expertise on the financial performance of Islamic banking in Indonesia has been confirmed by Setiawan (2020), but the study only focused on the level of education, proving that SSBs with a Ph.D. education will be more beneficial to banking performance. Additionally, research conducted by Afiska et al. (2021) only focused on education and experience in the economic and financial fields, which have a positive impact on the performance of the bank itself. In contrast, this study will provide a perspective that observes these variables simultaneously, considering not only the field of concentration but also the level of education, especially at the Ph.D. level.

Based on the arguments presented, we hypothesize that:

H1: SSB educational background positively affects the financial performance of Islamic banks.

H2: SSB expertise positively affects the financial performance of Islamic banks.

The Relationship between Size and Islamic Banking Performance

The size of the Sharia Supervisory Board (SSB) is one factor influencing the quality and structure of Sharia boards in Islamic banking. A larger SSB size provides various educational, skills, and experience backgrounds, which can improve Sharia board performance (Hamza, 2013). A conforming Sharia board performance can encourage Islamic banking to achieve organizational goals and financial performance. Research has proven the impact of SSB size on the financial performance of Islamic banks, showing that SSB size significantly influences the profitability of Islamic banking (Matoussi and Grassa, 2012; Mollah and Zaman, 2015; Nomran et al., 2018). Recent studies have found that the ideal SSB size is not less than three and not more than six, and a proportional number of SSB members can positively impact the financial performance of Islamic banking (Nomran and Haron, 2020).

Research conducted by Dewindaru et al. (2019) investigated the effect of total SSB on financial performance but only focused on the assessment of profitability, namely ROA and ROE. In contrast, this study will use CAMEL proxies that not only measure profitability but also asset quality, management, and financing performance of Islamic banks using the latest data. As more recent studies indicate the vital role of SSB size in affecting the financial performance of Islamic banks, we hypothesize that:



H3: SSB size positively affects the financial performance of Islamic banks.

SSB Cross-Membership

SSB cross-membership refers to a situation where a supervisory board member serves as a supervisor in more than one Islamic bank. Holding a supervisory board position in multiple Islamic banks is considered advantageous as it provides more experience and knowledge compared to a board member serving in only one Islamic bank. SSB cross-membership in Islamic banking increases the diversity of knowledge and expertise in implementing Sharia governance, thus encouraging financial performance growth in Islamic banks (Amalina Wan Abdullah, Percy, and Stewart, and Stewart, 2013; Farook et al., 2011; Nomran et al., 2018).

In Indonesia, SSB members are predominantly involved in cross-membership, where one member or chairman of the SSB can simultaneously serve as an SSB member in other banks or financing institutions. This unique characteristic can affect the overall banking performance. Gusrianti & Sari (2023) prove that cross-membership has a positive influence on the growth of banking assets. However, since their study compares Malaysia and Indonesia, it requires more in-depth exploration by observing phenomena and factual data on cases occurring in Islamic commercial banking in Indonesia. Meanwhile, Bayu (2023) did not consider cross-membership variables when evaluating SSB characteristics in banks in Indonesia.

To enhance recent research, we hypothesize that:

H4: SSB cross-membership positively affects the financial performance of Islamic banks.

METHODOLOGY

This study investigates the structure of the Sharia Supervisory Board (SSB) and its impact on the financial performance of Islamic banking in Indonesia. It analyzes the role of educational background, size, cross-membership to other Islamic banks, and expertise of SSB on financial performance. The financial performance of Islamic banks is measured using the CAMEL approach, which is calculated as follows:

$$CAMEL = \frac{CAR + AQ + MQ + EQ + Liquidity}{5} \quad (1)$$



This study employs a panel regression analysis using the common effect model approach based on test results. It is a multivariate analysis that examines the relationships between the variables in the model and is used to test the developed hypotheses. The results of the test comparisons are presented in Table 3.

Table 3. Test Comparison

Test	Comparison	Significant Model
Chow Test	CEM vs REM	Common Effect Model
Hausman Test	FEM vs REM	Random Effect Model

Data were obtained from annual reports and financial statements of 14 Islamic banks registered with the Financial Services Authority for 2014-2020, with a total of 98 observations. The variables studied include Sharia Governance (X) as the independent variable, Islamic bank financial performance (Y) as the dependent variable, and Leverage and Size of the bank (Z) as control variables. Leverage indicates the risk-taking characteristics of the Islamic Bank in relation to its financial performance (Mollah et al., 2017). The research variables are presented in Table 4.

Table 4. Research Variables

No.	Variable	Proxy	Sources
1.	<i>Sharia governance</i>	<i>SSB Size (Total SSB)</i>	(Alman, 2012; Mollah & Zaman, 2015a; Noordin & Kassim, 2019)
		<i>SSB Cross (% SSB in Other Islamic banking)</i>	(Amalina Wan Abdullah et al., 2013; Rahman & Haron, 2019)
		<i>SSB Edu (Dummy S3)</i>	(Ajili & Bouri, 2018; Farook et al., 2011; Rahman & Haron, 2019)
		<i>SSB Exp (Dummy Finance Background)</i>	(Ajili & Bouri, 2018; Nomran et al., 2018a)
2.	<i>Leverage</i>	$DER = \frac{Debt}{Equity}$	(Hakimi et al., 2018; Matoussi & Grassa, 2012b)
3.	<i>Size</i>	Log Natural Total Assets	(Hakimi et al., 2018; Nawaz, 2017; Shittu et al., 2016a)
Camel			
4.	<i>Capital Adequacy Ratio</i>	$CAR = \frac{Equity\ Capital}{Total\ Asset}$	(Erina & Damayanti, 2019; Ledhem & Mekidiche, 2020)
5.	<i>Asset Quality</i>	$AQ = \frac{Non\ Performing\ Loans}{Total\ Loans}$	(Fahlevi et al., 2017; Keffala, 2020; Masood et al., 2016)



No.	Variable	Proxy	Sources
6.	Management Quality	$MQ = \frac{\text{Personnel Expenses}}{\text{Average Assets}}$	(Saeed et al., 2019; Sahyouni et al., 2021)
7.	Earning Quality	$ROA = \frac{\text{Earning Before Tax}}{\text{Total Assets}}$ $ROE = \frac{\text{Earning Before Tax}}{\text{Total Equity}}$	(Al-Homaidi et al., 2019; Elgattani & Hussainey, 2020; Musleh Alsartawi, 2019; Wanke et al., 2016)
8.	Liquidity	$Liquidity = \frac{\text{Net Loans}}{\text{Deposit \& Short Term Funding}}$	(Lahrech et al., 2014; Saeed et al., 2019)

(Source: Authors' compilation)

The model estimation in this study is as follows:

$$FP = \alpha + \beta 1.SSBSize_{it} + \beta 2.SSBCross_{it} + \beta 3.SSBEdu_{it} + \beta 4.SSBExp_{it} + \beta 5.Levit + \beta 6.Size_{it} + \varepsilon \quad (2)$$

where FP represents Islamic bank financial performance, SSB represents the Sharia Supervisory Board, and the other variables and subscripts are as defined in the original passage.

Robustness Tests

Normality and multicollinearity tests were conducted to assess the robustness of the results. The Kolmogorov-Smirnov test yielded a p-value greater than 0.5, indicating that the data were normally distributed. The variance inflation factors (VIF) were less than 10 and the tolerance values were greater than 0.1, indicating the absence of multicollinearity between the independent variables. The results of the multicollinearity test are presented in Table 5.

Table 5. Multicollinearity test

Variabel	Collinearity test	
	Tolerance	VIF
SSBSize	0.337	2.966
SSBCross	0.437	2.290
SSBEdu	0.559	1.790
SSBExp	0.243	4.108

RESULT AND DISCUSSION

The descriptive statistics presented in Table 6 demonstrate that each variable has a smaller standard deviation than its mean value, indicating that the data in this study are normally distributed. The average financial performance of



Islamic banks, measured by the CAMEL ratio, is 2.52, which suggests a satisfactory performance with a relatively low risk of failure. The average SSB size of 2.3 indicates that Islamic banks have met the minimum requirement of two Sharia supervisory board members. The mean values of SSB Cross-Membership and SSB Education are 0.58 and 0.59, respectively, indicating that 58% of SSB members hold supervisory board positions in other financial institutions, while 59% possess doctoral qualifications. SSB Expertise has an average of 0.29, signifying that 29% of the total SSB members have expertise in finance and accounting. The average leverage of Islamic banks is 6.79, which reveals an imbalanced debt-to-capital ratio, as most Islamic banking operations are financed through third-party funds, resulting in a significant additional burden and risk.

Table 6. Descriptive Statistics

Descriptive Statistics					
Variable	Obs v.	Minimum	Maximum	Mean	Std. Deviation
SSBSize	98	1	5	2.295918	0.54127
SSBCross	98	0	1	0.581633	0.424915
SSBEdu	98	0	1	0.595238	0.344321
SSBExp	98	0	1	0.351701	0.347899
FP	98	1.4	3.2	2.515306	0.459123
LogSIZE	98	9.7929	13.9927	12.8195	0.972148
Lev	98	0.1398	30.4712	6.9927	4.77215

(Source: Authors' calculation)

The panel regression results presented in Table 7 show an R-square value of 0.169, indicating that the independent variables in this model explain only 16.9% of the variation in the financial performance of Islamic banks, while the remaining variation is influenced by factors not included in the model.

Table 7. Regression result

Variable	Unstandardized Coefficients		Standardized Coefficients	t-value	p-value	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	3.687	0.628		5.874	0		
SSBSize	0.085	0.088	0.100	0.960	0.340	0.842	1.187
SSBCross	0.263	0.106	0.243	2.485	0.015	0.956	1.047
SSBEdu	0.162	0.140	0.122	1.155	0.251	0.825	1.212



SSBExp	0.024	0.142	0.018	0.169	0.866	0.792	1.262
LogSIZE	-0.130	0.052	-0.275	-2.519	0.014	0.765	1.307
Lev	0.006	0.010	0.064	0.643	0.522	0.933	1.072

(Source: Authors' calculation)

The empirical findings reveal that SSB Size does not significantly influence the financial performance of Islamic banks, contradicting previous studies that found either a negative correlation or a positive impact of SSB Size on performance. This finding contradicts previous research, which found a negative correlation between SSB Size and the performance of a sample of Malaysian Islamic banks, as measured by Earnings per Share (EPS) (Shittu et al., 2016). It also opposes earlier studies that demonstrate the potential for larger supervisory boards to enhance the financial performance of Islamic banking (Grassa, 2013; Mollah & Zaman, 2015b; Nomran et al., 2018b).

This lack of influence may be attributed to the fact that most Islamic banks in Indonesia adhere to the minimum requirement of two SSB members, as stipulated by the Financial Services Authority's Letter No. 10/SEOJK.03/2014. Consequently, the role of SSBs in affecting financial performance becomes less impactful. Nomran & Haron (2020) argue that having three to five members is the ideal size for a supervisory board to effectively support the financial performance of Islamic banking. Similarly, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) recommends an ideal number of three SSB members for Islamic banks (Jaffer, 2014). In light of these findings, the government, particularly the Financial Services Authority, should consider reviewing the minimum number of SSB members, as the optimal size for Islamic banks should range between three and five members.

Several factors contribute to the lack of influence of SSB size on Sharia banking performance. Farook, as cited in Nomran & Haron (2020), suggests that an SSB that is too small may be more susceptible to intervention by the board of directors, compromising the SSB's independence as a Sharia compliance monitor and potentially impacting financial performance. Conversely, Kok et al. (2022) argue that an excessively large SSB can hinder effective communication and decision-making processes, such as the launch of new products or services that could improve the company's financial performance. In the context of this research, banks have between one and five SSB members, indicating the presence of both undersized (less than three) and oversized (exceeding AAOIFI recommendations) SSBs. Therefore, it is crucial to



determine the precise number of SSB members that can positively influence banking performance while considering factors such as communication effectiveness, decision-making processes, Sharia compliance implementation, and good corporate governance (GCG), all of which require close supervision from an appropriately sized SSB.

The findings reveal that the lack of significant impact of SSB size on the performance of Islamic banking in Indonesia can be attributed to several factors. First, there is limited variation in SSB sizes across Islamic banks, making it challenging to identify the effects of these variations. Second, studies focusing solely on SSB size may overlook other contextual factors, such as the regulatory environment, market characteristics, or bank management strategies. Other aspects of Sharia governance in Islamic banking may have a more substantial impact on performance, rendering SSB size less influential. Moreover, differences in the interpretation or implementation of SSB roles among Islamic banks may affect research outcomes. Finally, external factors, such as market or economic conditions, may have a greater influence on Islamic banking performance than SSB size. Thus, the absence of a significant relationship between SSB size and the performance of Islamic banking in Indonesia can be attributed to these factors. Further research is needed to broaden the scope of variables and consider the complex dynamics of Sharia governance in Islamic banking.

SSB Cross-Membership shows a positive influence on the financial performance of Islamic banks, indicating that a higher level of cross-membership can reduce performance. This finding contradicts Nomran et al. (2018b) but supports Alman (2012) and Nathan Garas (2012), who demonstrate that cross-membership can reduce the efficiency of the Sharia supervisory board in carrying out its functions and responsibilities and may lead to conflicts of interest. This empirical finding supports the agency theory and aligns with the results of Al-Nasser Mohammed & Muhammed (2017). The SSB should be an independent body focused on ensuring the company's compliance with Sharia rules and improving the financial performance of Islamic banks. Multi-membership can burden SSB members with additional responsibilities, decreasing their effectiveness in supporting economic performance. Interestingly, more than half of SSB members hold cross-memberships in other financial institutions (see Table 8). This empirical findings suggest that higher cross-membership negatively affects the financial performance of Islamic banks.



To ensure compliance with Islamic principles, Sharia banks should limit the number of cross-membership positions in SSBs. This limitation allows SSBs to work more focused and professionally (Noordin & Kassim, 2019). Additionally, Gati & Basuki (2020) reveal that the simultaneous membership of SSB members in multiple institutions raises concerns about the disclosure of confidential information between competing institutions, particularly when SSB members supervise various financial organizations. However, these concerns may not materialize, as SSB members with dual membership tend to be very busy and may struggle to address issues at each bank due to their hectic schedules. Busy board members can negatively impact financial performance, similar to how a busy CEO can lead to a decline in company performance (Antoun et al., 2018; Muhammad et al., 2021).

SSB Education illustrates the quality of the Sharia supervisory board, which can contribute to the implementation of efficient Islamic banking governance (Kakabadse, Yang, and Sanders, 2010). The level of education can provide additional knowledge for the supervisory board to carry out its duties and functions, particularly if the education is in a relevant field. The results show that SSB Education does not significantly influence the financial performance of Islamic banks, which is consistent with Nomran et al. (2018). This lack of influence may be attributed to the fact that most doctoral degrees held by SSB members are not in finance and accounting. Farook and Lanis (2007), Farook et al. (2011), and Rahman and Bukair (2013) have emphasized the importance of educational background in deriving the financial performance of financial institutions, suggesting that SSB members with doctoral degrees in finance and banking possess more opportunities to support Islamic banking.

SSB Expertise in finance and accounting also does not significantly contribute to the financial performance of Islamic banks. This finding aligns with previous research and suggests that the lack of experienced SSB members' ability prevents them from executing well-informed decisions on financial products and activities. The dominance of SSB members with work and religious educational backgrounds, rather than practical banking expertise, may hinder their ability to address the managerial and operational aspects crucial to the CAMEL approach used to measure banking performance. This finding aligns with Nomran et al. (2018), who found that competence in finance and accounting does not significantly contribute to the performance of Islamic banking. The financial and accounting expertise of SSB members has failed to effectively support the development of Islamic banks' financial performance.



The lack of experienced SSB members' ability prevents them from making well-informed decisions on financial products and activities (Ginena and Hamid, 2015).

In the context of Sharia banking in Indonesia, an interesting phenomenon can explain why Sharia supervisory expertise does not always significantly influence Sharia banking performance. One factor that might cause this is the dominance of members of the Sharia Supervisory Board (SSB) by individuals with work and religious educational backgrounds. While these individuals may have a deep understanding of Sharia principles, their expertise does not always align with the practical needs of banking. When the SSB is dominated by individuals with religious expertise and educational backgrounds, they tend to focus more on theological aspects rather than managerial and operational aspects of banking (Darwanto & Chariri, 2019). In relation to the CAMEL approach used to measure banking performance, managerial and operational aspects are crucial. Expertise that is more theological may be less able to address the practical challenges and dynamics that occur in the modern banking environment. SSBs with predominantly religious and theological scientific backgrounds tend to prioritize compliance with Sharia principles without sufficiently considering management aspects, which also have a major influence on banking performance (Kachkar & Yilmaz, 2023). Therefore, although a Sharia supervisor's expertise in terms of theological understanding can provide added value in ensuring compliance with Sharia principles, a lack of expertise in managing operational and managerial aspects of banking can hinder overall performance.

Based on Bank Indonesia Regulation No. 6/24/PBI/2004 concerning Commercial Banks Carrying Out Business Activities Based on Sharia Principles, the educational background of the Sharia Supervisory Board should be in Sharia muamalah, banking, or finance in general, or at least they should have attended both formal and non-formal education regarding Sharia banking. Thus, SSB education in banking and finance is still limited (Munifatussa'idah, 2021). Moreover, the educational background of DPS at Sharia banks in Indonesia is Sharia muamalah education but is not specific to Sharia banking, let alone contemporary Sharia financial practices. In fact, DPS members with better knowledge will encourage improvements in the supervisory function. Likewise, with the expertise of SSB members, there are no regulations that explicitly require qualified experience and expertise in Sharia finance and banking as a requirement for SSB. Noordin & Kassim (2019) found that board



members with expertise relevant to their duties and responsibilities as SSBs will positively impact the supervision and implementation of Islamic banks more effectively. Research conducted by Septiani et al. (2022) emphasizes that many DPS members were appointed only because of their charisma and popularity in society, not because of their scientific competence in economics and Sharia banking.

The descriptive statistics presented in Table 8 provide further insights into the composition and qualifications of SSB members in Indonesian Islamic banks from 2014 to 2020. The data reveals that the percentage of SSB members with cross-membership in other financial institutions has remained relatively stable, ranging from 53% to 60%. This high level of cross-membership may contribute to the negative impact on financial performance, as discussed earlier.

Table 8. Composition and Qualifications of SSB members

Year	N	Cross-Membership		Have Doctoral Degree		Have Competency in Finance and Accounting	
		n	%	n	%	n	%
2014	33	18	55	22	67	7	21
2015	33	16	55	22	67	12	36
2016	33	12	55	19	58	12	36
2017	31	22	58	19	61	11	35
2018	31	21	58	11	35	11	35
2019	34	18	53	17	50	15	44
2020	30	19	60	12	40	10	33

(Source: Authors' Compilation)

Regarding educational qualifications, the percentage of SSB members holding doctoral degrees has decreased from 67% in 2014 to 40% in 2020. While a higher level of education is generally considered beneficial, the lack of influence on financial performance suggests that the specific field of study and its relevance to Islamic finance and banking may be more important than the degree itself. Similarly, the percentage of SSB members with competency in finance and accounting has fluctuated over the years, with a peak of 44% in 2019 and a low of 21% in 2014. The relatively low proportion of SSB members with relevant expertise may explain the insignificant impact on financial performance, as they may lack the necessary skills to effectively guide and monitor the operational and managerial aspects of Islamic banks.

Overall, this study confirms that there is still a need for regulatory review regarding the membership of DPS that is professional and experienced in the



Islamic banking financial and services sector, especially contemporary practices that are relevant to today's financial complexity. Regulators need to carefully consider the characteristics of SSBs that have an important role in improving the performance of Islamic banking in the long term. Affirmation regarding educational background and professional experience in the Islamic banking sector is necessary and urgent. It is considered that the implementation of good corporate governance must be supported by qualified and professional resources and a comprehensive understanding ranging from muamalah law to supervising its practices in the field to improve optimal performance in Islamic banking.

Therefore, this research encourages a review of Bank Indonesia Regulation No. 6/24/PBI/2004 concerning Commercial Banks Conducting Business Activities Based on Sharia Principles, Law No. 21 of 2008 concerning Islamic banking, and Bank Indonesia Regulation No. 11/33/PBI/2009 concerning the Implementation of Good Corporate Governance for Sharia Commercial Banks and Sharia Business Units to explicitly include the ideal requirements and criteria for DPS members in Islamic banking. Moreover, this study can also be a reference to update the existing regulations to enhance the terms and requirements of SSB, including specific education and expertise background. Thus, juridically, the Sharia Supervisory Board (SSB) in banking institutions occupies a strong and more impactful position, because its existence is very important and strategic.

This study emphasizes the necessity of determining the ideal number of SSBs, as it has a positive effect on banking performance. Not only does this involve the fulfillment of member standards, but the diversity in the number of board members across various Islamic banks also yields different results at certain numbers. Thus, this research indicates that at the practical level, Islamic bank stakeholders must determine the ideal proxy to achieve this. Likewise, the extent of cross-membership needs to be carefully determined to avoid ineffectiveness in decision-making, transparency, accountability, and professionalism of DPS members with cross-membership status.

CONCLUSION

The existence of a Sharia Supervisory Board (SSB) distinguishes the governance of Islamic banks from that of conventional banks. The SSB serves as a support system for Islamic banking to ensure the continuous



implementation of Islamic principles in its operations. However, the results of this study reveal that SSB Size, Education, and Financial Expertise do not significantly contribute to the development of the financial performance of Islamic banking. Conversely, the cross-membership of SSB members in other financial institutions demonstrates a detrimental effect on the performance of Islamic banks. Despite these findings, Islamic banks generally display satisfactory financial performance with a relatively low risk of failure. This study identifies key areas for enhancing Sharia governance in Indonesian Islamic banking. Regulations require revision to prioritize Islamic finance expertise over solely academic credentials or religious background for Sharia Supervisory Board (SSB) members. Furthermore, the optimal SSB size should be determined, potentially ranging from three to five members to balance oversight and efficiency. Finally, limiting cross-membership between institutions and prioritizing expertise in appointments will mitigate conflicts of interest and enhance SSB effectiveness.

This research has several limitations that should be acknowledged. Firstly, the analysis is limited to direct effects and does not consider the proxy limitations in total SSB members and the ideal SSB presentation in encouraging the improvement of Islamic banking performance. Secondly, this research has not succeeded in proving the influence of SSB size, education, and expertise on Sharia banking performance, indicating the need for other proxies and variable considerations, such as board composition, ownership, external economic factors, regulatory changes, or internal managerial factors that are not directly related to SSB. Lastly, this research uses data from the 2014-2020 period, which may not reflect the current conditions of Islamic banking in Indonesia.

Future research should employ critical mass theory to explore the exact number of SSB members that have a positive and significant impact on banking performance. Additionally, further research should conduct robustness tests to validate the findings using the same variables. Integrating the perspectives of other stakeholders, such as customers and regulators, could provide a more holistic understanding of the factors influencing Islamic banking performance. Moreover, future research could consider the impact of technology and the digital revolution in the context of Islamic banking, given the rapid development of fintech in Indonesia. This will offer insights into how adaptation to digital trends can impact Islamic banking performance and SSB structures.



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