Corporate Governance and Financial Stability of Islamic Banks in Asia

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Abstract

An economic system is a means by which societies or governments organize and distribute available resources, services, and goods across a geographic region or country. The Islamic financial system faces a number of challenges as part of its role as a tool for developing economic activities. This study intends to advance research by Lassoued (2018) by expanding the research population to include Islamic banks in Asia and adding new dimensions - the size of the independent commissioner and corporate governance. The population of this study is the 100 largest Islamic banks in Asia. Statistical calculations with the STATA application is used for data analysis. Based on the test results, it was found that the size of the sharia board and the independent board of directors did not affect the financial stability of Islamic banking companies. Another finding is that the size of the independent commissioner affects financial stability. This finding shows that commissioners have played an active role in the company, indicating that if the sharia banking company has an ideal number of independent commissioners, it will be advantageous to the company’s stability and business sustainability.

Keywords: Sharia Banking Financial Stability, Sharia Finance, Sustainability

JEL Classification Code: B26, F36, G21

1. Introduction

Asian countries are an important part of the global economy and Islamic financial system. This is due to the fact that Islam is the largest religion in several Asian countries. Pakistan (96.4 percent), Bangladesh (86.3 percent), Indonesia (87.2 percent), Malaysia (61.4 percent), and India (14.2 percent) are among the Asian countries having a major share of Muslim population. Currently, Islamic banking and Sukuk have dominated the Islamic financial market in Asian countries. In fact, Islamic banking and finance have also experienced rapid growth and development (Ginena, 2014). According to the IFSB (2015), the total indicator size for the Islamic finance sector in Asia in 2014 was more than $419 billion, accounting for 22.4 percent of global Islamic finance assets, with Islamic banking accounting for 48.6% ($203.8 billion), Sukuk (a sharia-compliant bond-like instruments) in circulation accounting for 44.93 percent ($188.4 billion), Islamic funds accounting for 5.5 percent ($23.2 billion), and Takaful (Islamic insurance) accounting for 0.93 percent ($3.9 billion).

As part of the instrument for developing activities in the economic field, various challenges are faced by the Islamic financial system, such as in the theoretical, operational, and implementation aspects (Mansour & Bhatti, 2018). On a theoretical level, profit-loss sharing must be used to create the principles, philosophy, and functions of the financial system. On the operational side, it necessitates a focus on innovation, intermediation, discipline, and risk management, whereas, on the implementation side, it necessitates system applications
that must be adapted to regulations and societal economic conditions (Ginena, 2014). In fact, economic inefficiencies, such as a lack of a solid regulatory framework and thorough financial system regulation, have severely limited Islamic banking activities. This can lead to fiscal and monetary imbalances, and it does not promote efficiency in the development of Islamic banking, resulting in financial disequilibrium. The economic system is important for the economy of a country. The economic system is formed due to various complex factors, such as ideology and belief systems, views of life, geographical environment, politics, socio-culture, and others (Isnurhadi et al., 2021).

The business risks encountered by Islamic banking are becoming increasingly complicated as the environment develops at a faster pace (Allen & Carletti, 2010; Allen & Wood, 2006). As a result, risk management is critical in the banking industry. According to Implementation of Risk Management for Islamic Commercial Banks and Sharia Business Units credit risk, market risk, liquidity risk, operational risk, legal risk, reputation risk, strategic risk, compliance risk, and return on investment risk are among the risks faced by Islamic banking in Indonesia (Ginena, 2014; IFSB, 2015). Prior to the law, Islamic banking risk management was based on traditional banking risk management, which contained eight risks in addition to return and investment risk. Because Islamic banks in Asia face such a wide range of challenges, risk management in Islamic banking must be adapted to the size and complexity of the business, as well as the bank's capabilities (Fajariyah & Khotimah, 2018). Bank governance (corporate governance) is still employed as a metric for measuring the level of risk that banks incur, which has an impact on returns.

Good governance is an effort to protect the interests of stakeholders and improve compliance with applicable laws and regulations as well as ethical values that apply in general to the Islamic banking industry (Muneez & Hassan, 2014; Yussof, 2013). Corporate governance is also part of a mechanism that aims to prove the performance of companies and financial institutions. Corporate governance is linked to various businesses, particularly banking because banking firms have a higher level of information asymmetry than other financial services firms (Karkowska & Acedański, 2020). Banks act as third parties to store consumer funds, allowing the government to impose strict regulations to reduce the risk of bankruptcy. One aspect of implementing Islamic banking risk management is active monitoring from the Board of Commissioners, Board of Directors, and Sharia Supervisory Board.

Most of the funds in the bank are public property that must be protected. This is because Islamic banking is one of the pillars supporting the stability of the national financial system in implementing risk management, sharia compliance, and implementing Good Sharia Governance (Ameer et al., 2012; Mansour & Bhatti, 2018). Banks in the UK used the term financial stability in 1994 when they wanted to denote things not related to stable prices or efficient functioning of the system. This term becomes very important in relation to banks and other public authorities (Allen & Carletti, 2010; Allen & Wood, 2006).

One measure of financial stability is through the z-score (Allen & Wood, 2006). The Z score is a numerical measurement that is used to predict the chances of a business going bankrupt in the next two years. The. Profits can be improvised through increased asset growth, increased savings, and financing (The Islamic Financial Services Industry (IFSI) Stability Report, 2019). The global financial crisis of 2008, as well as the sovereign debt crisis, have highlighted the importance of well-articulated micro and macro safeguard policy frameworks to ensure financial stability, with a focus on financial sector risk assessment, financial stability policy frameworks, and financial stability policy capabilities in crisis resolution (IFSB, 2015). The Basel Committee on Banking Supervision (BCBS), according to the IFSB (2015), is in charge of monitoring financial stability. Corporate governance research in Islam is a productive area of Islamic finance research (Ginena, 2014; Mansour & Bhatti, 2018; Muneeza & Hassan, 2014; Yussof, 2013). As a result, this study will focus on corporate governance and financial stability in Asian Islamic banks.

This study aims to develop research by Lassoued (2018), by adding new dimensions - the size of the independent commissioner and corporate governance, and the expansion of the research population, namely Islamic banks in Asia. In addition, data processing and analysis techniques in this study used Stata. The remainder of this paper is structured as followed; Section 2 contains the literature review, while Section 3 presents the methodology. The results and discussion of the study are contained in Section 4. The study ends with the conclusion and limitations.

2. Literature Review and Hypothesis Development

The big theory related to corporate governance and financial stability is agency theory. Agency theory describes an agency relationship, starting from a contract between one or more people (principal) inviting another person (agent) to perform some services on behalf of the principal (Jensen & Meckling, 1976). Agency theory leads to the mindset that the agent will have more information than the principal and this leads to information asymmetry (Lee & Fan, 2014). To anticipate this information asymmetry, good corporate governance is needed. Corporate governance is also very much needed in disclosing financial stability. In addition to
agency theory, stewardship theory is also an additional theory in this study. Stewardship theory is a theoretical approach to corporate governance. Stewardship theory is a theory that managers, left on their own, will act as responsible stewards of the assets they control. Stewardship theorists assume that given a choice between self-serving behavior and pro-organizational behavior, a steward will place a higher value on cooperation than defection (Donaldson & Davis, 1991). Management theory proves that the interests of shareholders are maximized by the same role holders.

### 2.1. Financial Stability in Islam

Financial system stability is a condition that enables the national financial system to function effectively and efficiently and withstand internal and external shocks (Lassoued, 2018). Financial system vulnerability refers to an imbalance in the financial system (financial imbalances) that occurs due to the risk-taking behavior of economic agents in maximizing their profits or consumption. Allah SWT has explained in His word Al-Quran Surah Al Anbiyaa verse 35, which means: “Every soul will taste death. We will test you with evil and good as a trial (actually) and only to us you will be returned”.

According to Sakr and Genedy (2017), the existing process in the Profit and Loss Sharing (PLS) system can protect Islamic banks’ financial balances from degrading due to economic causes. This is because the PLS concept is based on risk-sharing from the asset to the liability side. Many international studies show that the Islamic banking system is more stable than the conventional banking system, demonstrating the stability of Islamic banking. Previous research (Abdelbade & Salama, 2019; Allen & Wood, 2006; Karkowska & Acdański, 2020; Lassoued, 2018; Septriyani & Handayani, 2018; Ameer et al., 2012; Ginena, 2014; Muneea & Hassan, 2014; Yussof, 2013), showed that Islamic banks are more stable than conventional banks because of the underlying system. IFSB (2015) states that the principles of financial stability are:

1. Financial stability covers various aspects of finance and the financial system - infrastructure, institutions, and markets.
2. Financial stability implies that the payment system is related to the economy’s healthy functioning in terms of allocating resources and risks, mobilizing savings, and facilitating wealth accumulation, development, and growth. Or, to put it another way, financial stability is critical for monetary stability.
3. Financial stability refers to a financial system that not only prevents actual financial crises, but also restricts, restrains, and deals with rising imbalances that threaten economic processes.
4. Financial stability is structured as a potential consequence of the real economy.
5. Financial stability is considered an event over time that is consistent over time.

Research on the comparative stability of the banking system has previously been carried out by several international researchers (Ameer et al., 2012). The results of the study show that financial strengths such as income diversity, profitability, asset size, loan asset ratio, and market concentration have a significant effect on bank financial stability. Financial stability can be measured through three proxies, namely the $Z$-index, measuring loan risk (ratio of non-performing loans to total loans), and measuring equity ratio (ratio of equity to assets). Higher financial stability comes from significant equity capital (Hanani & Dharmastuti, 2015; Wirtz et al., 2021).

The company’s financial stability and bankruptcy risk depend on the source of funding, the type and amount of assets owned (Karkowska & Acdański, 2020; Sanjaya & Nurseschafia, 2016; The Islamic Financial Services Industry (IFSI) Stability Report, 2019). Lassoued (2018) stated that one measure of financial stability is through the $Z$-score. $Z$-score compares a bank’s buffers (capitalization and returns) with the volatility of those returns. It captures the probability of default of a country’s banking system, calculated as a weighted average of the $z$-scores of a country’s individual banks (the weights are based on the individual banks’ total assets) (Cho et al., 2012). The higher the $Z$-score, the lower the probability of bankruptcy of financial institutions (IFSB, 2015; The Islamic Financial Services Industry (IFSI) Stability Report, 2019).

### 2.2. Corporate Governance in Islam

Corporate governance in the Islamic banking industry is better known as sharia governance. Islamic corporate governance is a concept that emerged in the nineteenth century after Islamic banks and Islamic financial institutions were born. The increase in the number of companies that comply with sharia provisions has resulted in the formulation of corporate governance in line with Islamic law (The Islamic Financial Services Industry (IFSI) Stability Report, 2019). The main foundation of Islamic corporate governance is found in the Qur’an Surah Ali Imron verse 191:

“Those who remember Allah while standing or sitting or [lying down] beside them and contemplating the creation of the heavens and the earth, [say], “Our Lord, You did not create this without a purpose; Exalted are You [above such a thing]; so keep we are from hell.”
This verse lays out the basic principles of government, stating that Allah created everything for a reason and that humans were created to be the world’s vicegerents. Allah plays an active part in overseeing and being involved in all human affairs by placing trust in humans as representatives, and He knows everything at all times.

The main component in sharia banking, the sharia board, is considered in the sharia governance framework (Hamza, 2013; Muneeza & Hassan, 2014). In Islam, corporate governance primarily relates to adherence to sharia law (Ginena, 2014; Mansour & Bhatti, 2018). Aside from that (Hamza, 2013), it also adds that Islamic banks must assure adherence to sharia principles in terms of products, instruments, operations, practices, and management. Compliance with sharia principles will be achieved through the implementation of an appropriate sharia governance framework. The sharia board is a unique and attractive aspect of sharia banking since it monitors and ensures good sharia governance (Hamza, 2013).

2.3. Corporate Governance and Financial Stability

Corporate governance has a positive effect on financial stability. Corporate governance is measured using 44 attributes and the composition of the board of directors, whereas financial stability is measured using a systematic assessment of a bank’s bankruptcy and bank risk. High asset turnover, low non-performing loans, and a high tangible asset to capital ratio are all indicators of good corporate governance in banking (Mansour & Bhatti, 2018; Muneeza & Hassan, 2014).

Implicit assumptions in governance, strategic leadership, and performance are linked, and this can be an option in the governance structure, with leadership linked to performance. As a result of this link, company leaders are under pressure to restore the company’s financial stability (Khediri et al., 2021; Lassoued, 2018).

In a bank, governance necessitates professional consideration, particularly good communication between directors in attaining objectives. This professional relationship is a key factor in a bank’s financial stability. Bank financial stability uses two indicators, namely credit risk which is calculated by the ratio of non-performing assets to total loans, and bankruptcy risk using the Z-Score. The Z Score is calculated as follows: \( \frac{\text{ROA} + \text{CAR}}{\text{\sigma}} \), where \( \text{ROA} \) represents profit divided by assets, \( \text{CAR} \) represents the ratio of capital to assets, and \( \text{\sigma} \) represents the standard deviation of ROA. If the Z-Score has a high value, it indicates that the bank has sufficient profits to cover debt and if it is low, it will experience financial difficulties or bankruptcy (Abdelbadie & Salama, 2019). Corporate governance has an effect on financial stability. Corporate governance is proxied by the size of the sharia board, the percentage of independent directors, and the size of independent commissioners (Alnasser & Muhammed, 2012; Lassoued, 2018). Islamic corporate governance in Islamic financial institutions will promote financial system stability and support the growth and resilience of the Islamic financial industry (Mansour & Bhatti, 2018).

A company’s ability to protect stakeholder interests depends on its corporate governance. The existence of Islamic corporate governance might help stakeholders feel more confident that their financial business is handled in accordance with sharia principles. Furthermore, good corporate governance will provide stakeholders confidence that the company will protect its financial interests and prove to be a reliable, stable, and trustworthy financial service provider. The combination of sharia compliance and business performance, in particular, can make overcoming agency issues more difficult (Yussof, 2013).

2.4. The Size of the Sharia Board on Financial Stability

The sharia supervisory board is a board tasked with providing advice to the Board of Directors and supervising bank activities in accordance with Sharia principles (The Islamic Financial Services Industry (IFSI) Stability Report, 2019). The corporate governance structure of Islamic banks requires banks to establish sharia boards and support internal controls (Alnasser & Muhammed, 2012). The purpose of an independent sharia board is to provide sharia guidance to executive officers and directors. A sharia audit must be carried out by the company, by being accountable for the company’s operations to God, shareholders, stakeholders, and to the community (Al Mubarak et al., 2019; Muneeza & Hassan, 2014). The sharia board is made up of experts (Foukahas) in Islamic fiqh or Muamalat Fiqh and has adequate capabilities in contemporary finance. The sharia board’s primary responsibility is to issue fatwas and oversee the review process in fields such as economics, finance, and banking (Hamza, 2013).

Differences between the sharia board, executive management, and the board of directors may be caused by the ethical implications of financial performance (Hamza, 2013). The sharia board does not only focus on the consistency of sharia business to what is required by sharia but also on the nature of sharia.

**H1**: The size of the sharia board affects financial stability.

2.5. Percentage of Independent Directors on Financial Stability

By using internal and external corporate governance mechanisms, the theory of corporate governance attempts to
resolve economic conflicts of interest among all stakeholders and lower agency costs. The board of directors is considered an effective and important mechanism in the company’s internal governance structure (Bukair & Abdul Rahman, 2015). Lassoued (2018) stated that corporate governance that uses the dimension of the percentage of independent directors to the total directors has a positive effect on financial stability. Independent members will contribute to reducing agency conflicts in improving financial information. The size of the board of directors affects the performance and risk of Islamic banks. The large size of the board of directors where Islamic banks lack experience will be a strategy and control in competing with conventional banks. The composition of the board of directors is generally related to the presence of independent members (Lassoued, 2018). Karkowska and Acedański (2020) showed a negative relationship between the board size and bank stability and demonstrate that an independent board may have constrained rather than encouraged risk in banks. Hence, strong corporate governance ensuring bank stability means small boards and more independent directors. Bukair and Abdul Rahman (2015) revealed that the classical problems of corporate governance such as compensation for upper management, the composition of directors and independent directors, agency theory, or correction value are the issues that need to be considered for analysis, and how they affect financial stability.

By establishing an independent agency structure, the goal of financial stability can be achieved (Lassoued, 2018). In his research, Tran (2019) showed that the proportion of independent directors has a significant effect on company investment. Independent directors help companies reduce excess investment and improve investment efficiency. Kapoor and Goel (2019) showed that the size of the independent board of directors indirectly impacts financial stability. They stated that diligent independent directors have a significant effect on earnings management. Their findings support agency theory and provide evidence that independent boards of directors play a role in limiting earnings management. This is very important because by limiting earnings management, the resulting financial reports will be of high quality (Kapoor & Goel, 2019). If the financial statements presented are of high quality, it will have an impact on shareholder confidence in the company. Therefore, it is assumed that the percentage of independent directors has an effect on financial stability.

\[ H2: \text{The percentage of independent directors affects financial stability.} \]

2.6. The Size of the Independent Commissioner on Financial Stability

A member of the board who is not related to the firm’s controlling shareholder, director, or other commissioners, and does not serve as a director in another company associated with the firm is known as an independent commissioner (Hanani & Dharmastuti, 2015). It is advised that independent commissioners make up the majority of the board of commissioners so that they can be more effective in carrying out their duties, which include protecting shareholders (Ames et al., 2018). The company’s management supervision mechanism will be improved with a higher number of boards. From the viewpoint of resource dependence, a large number of boards of commissioners benefit the company (Abdelbadie & Salama, 2019; Amor & Kooli, 2017). Hanani and Dharmastuti (2015) investigated the impact of corporate governance on the risk of bankruptcy, and the findings showed that independent commissioners had an impact on the company’s risk of bankruptcy. Financial performance can be defined as the company’s stability in managing and controlling its resources (Fajariyah & Khotimah, 2018).

As one of the proxies in a good corporate governance framework, the Independent Commissioner has an impact on financial performance. The efficacy of the board of directors’ supervisory duty necessitates a high level of independence. According to agency theory, managers see independent commissioners as always ready to face agency problems, since independent commissioners are completely dedicated to overseeing management performance. This behavior also helps independent commissioners strengthen their reputation as decision-makers (Mahrani & Soewarno, 2018). A high level of good corporate governance, the proportion of independent commissioners, managerial and public ownership will increase the value of the company (Suhadak et al., 2019). Therefore, it is assumed that the number of independent commissioners will affect financial stability.

\[ H3: \text{The size of the independent commissioner has an effect on financial stability.} \]

3. Research Method

This research method uses quantitative methods. The object of this research is Islamic banks in Asia. The population of this study is the 100 largest Islamic banks in Asia. The scope of the research is:

1. Independent Variables are Sharia Board Size, Percentage of Independent Directors, Size of Independent Commissioners.
2. The dependent variable is Financial Stability.

The method of data collection used in this study was library research. In this study, data was collected from the World Bank and the websites of each Islamic bank in Asia.
between 2015 and 2018. Purposive sampling using the following criteria was used as the sampling method:

2. Published in the World Bank.
3. Issued on the respective bank’s website.
5. Complete financial report data.

The method of data analysis in this study uses statistical calculations with the STATA application (Table 1).

4. Results

The collected data was tabulated and statistically tested using Stata. The following are some of the findings.

4.1. Descriptive Statistics

Table 2 explains that the financial stability variable has a minimum value of −9.16 and a maximum value of 8.083, with a mean of 0.52 and a standard deviation of 1.80. The sharia board size variable has a minimum value of 0 and a maximum of 12, with a mean of 4.16 and a standard deviation of 2.45. The variable percentage of independent directors has a minimum value of 0 and a maximum value of 9, with a mean of 2.68 and a standard deviation of 2.62. The independent commissioner size variable has a minimum value of 0 and a maximum value of 2.75, with a mean of 0.325 and a standard deviation of 0.823.

4.2. Data Feasibility Test

Table 3 shows the results of the multicollinearity test of the variables used in this study. The results of the multicollinearity test above show that the variables sharia board, the percentage of independent directors, the size of the independent commissioner have a Tolerance value > 0.10. The results of the calculation of the VIF value < 10, so it can be concluded that there is no multicollinearity.

Table 1: Operational Definition of Research Variables

<table>
<thead>
<tr>
<th>Variables</th>
<th>Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Dependent Variables</strong></td>
<td></td>
</tr>
<tr>
<td>Financial Stability</td>
<td>( Z \text{ Spring (Spring Model)} )</td>
</tr>
<tr>
<td></td>
<td>( Z = 1.03A + 3.07B + 0.66C + 0.4D )</td>
</tr>
<tr>
<td></td>
<td>( Z &lt; 0.862 ) : The company is classified as “failed”</td>
</tr>
<tr>
<td></td>
<td>A = Working Capital/Total Assets</td>
</tr>
<tr>
<td></td>
<td>B = Net profit before interest and taxes/Total Assets</td>
</tr>
<tr>
<td></td>
<td>C = Net profit before tax/Current Liabilities</td>
</tr>
<tr>
<td></td>
<td>Sales/Total Assets because the sample is a bank, sales are replaced with income</td>
</tr>
<tr>
<td><strong>Independent Variables</strong></td>
<td></td>
</tr>
<tr>
<td>Sharia Supervisory Board Size</td>
<td>Number of sharia supervisory boards</td>
</tr>
<tr>
<td>Percentage of Independent Directors</td>
<td>Number of Independent Directors/Number of Directors</td>
</tr>
<tr>
<td>Independent Commissioner Size</td>
<td>Number of Independent Commissioners</td>
</tr>
</tbody>
</table>

Table 2: Descriptive Statistics Results

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>Min</th>
<th>Max</th>
<th>Observations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Y</td>
<td>0.52</td>
<td>1.80</td>
<td>−9.16</td>
<td>8.08</td>
<td>100</td>
</tr>
<tr>
<td>X1</td>
<td>4.16</td>
<td>2.45</td>
<td>0.00</td>
<td>12</td>
<td>100</td>
</tr>
<tr>
<td>X2</td>
<td>2.67</td>
<td>2.62</td>
<td>0.00</td>
<td>9</td>
<td>100</td>
</tr>
<tr>
<td>X3</td>
<td>0.32</td>
<td>0.82</td>
<td>0.00</td>
<td>3</td>
<td>100</td>
</tr>
</tbody>
</table>
4.3. Regression Test

Based on Table 4. above, it is found that the p-values $X_1 = 0.829, X_2 = 0.423, X_3 = 0.000$. Hence, it is concluded that $X_1$ has no effect on $Y$ ($0.829 > 0.05$), $X_2$ has no effect on $Y$ ($0.423 > 0.05$), while $X_3$ has an effect on $Y$ ($0.000 < 0.05$). The size of the sharia board has no effect on financial stability. The percentage of independent directors has no effect on financial stability. The size of the independent commissioner has an effect on financial stability.

4.4. Hausman Test

The Hausman test sees which model is the best, Fixed Effect or Random Effect. Hausman test is also to compare between random effect and fixed effect models. To determine which model is better, it can be seen from the value of prob > chi2. If the prob value > chi2 is smaller than the 0.05 significance level, then the fixed effect model is better and the random effect is not good. The result is prob > chi2 = 0.0000, which means that the fixed effect is better than the random effect.

Table 3: Multicollinearity Test Results

<table>
<thead>
<tr>
<th>Variables</th>
<th>VIF</th>
<th>1/VIF</th>
</tr>
</thead>
<tbody>
<tr>
<td>$X_1$</td>
<td>1.29</td>
<td>0.77</td>
</tr>
<tr>
<td>$X_2$</td>
<td>1.19</td>
<td>0.84</td>
</tr>
<tr>
<td>$X_3$</td>
<td>1.12</td>
<td>0.896</td>
</tr>
<tr>
<td>Mean VIF</td>
<td>1.20</td>
<td></td>
</tr>
</tbody>
</table>

Table 4: Regression Test Results

<table>
<thead>
<tr>
<th>$Y$</th>
<th>Coef.</th>
<th>Std. Err.</th>
<th>$t$</th>
<th>$P &gt; [f]$</th>
</tr>
</thead>
<tbody>
<tr>
<td>$X_1$</td>
<td>0.033</td>
<td>0.152</td>
<td>0.22</td>
<td>0.829</td>
</tr>
<tr>
<td>$X_2$</td>
<td>0.092</td>
<td>0.114</td>
<td>0.81</td>
<td>0.423</td>
</tr>
<tr>
<td>$X_3$</td>
<td>−4.351</td>
<td>0.667</td>
<td>−6.52</td>
<td>0.000</td>
</tr>
<tr>
<td>$F$</td>
<td>19.57</td>
<td>5.49</td>
<td>0.000</td>
<td></td>
</tr>
</tbody>
</table>

Table 5: Hausman Test Results

<table>
<thead>
<tr>
<th></th>
<th>$b$ (Fixed)</th>
<th>$B$ (Random)</th>
<th>$b-B$ (Difference)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$X_1$</td>
<td>0.033</td>
<td>−0.070</td>
<td>0.103</td>
</tr>
<tr>
<td>$X_2$</td>
<td>0.092</td>
<td>−0.081</td>
<td>0.174</td>
</tr>
<tr>
<td>$X_3$</td>
<td>−4.351</td>
<td>−0.701</td>
<td>−3.649</td>
</tr>
</tbody>
</table>

$\chi^2(3) = (b-B)(\nu_b^\nu_B)^{(*)1}(9b-B) = 46.35$

Prob > $\chi^2 = 0.0000$

5. Discussion

The Effect of Sharia Board Size on Financial Stability

Based on the results of the fixed effect test, the size of the sharia board has no effect on financial stability. The findings of this study are not in line with Lassoued (2018) who stated that a large sharia board will assure the bank’s credibility and that compliance with Islamic sharia will be reflected in performance. Meanwhile, the board of directors and management will have a lot of power over a small number of sharia boards. These results indicate that the size of the sharia board as part of governance does not affect financial stability.

The Influence of the Percentage of Independent Directors on Financial Stability

Based on the results of the fixed effect test, the independent board of directors has no effect on financial stability. The findings of this study are not in line with Lassoued (2018) who stated that corporate governance has a positive effect on financial stability. Karkowska and Aceański (2020) showed a negative relationship between board size and bank stability and demonstrate that an independent board may have constrained rather than encouraged risk in banks. Hence, strong corporate governance ensuring bank stability means small boards and more independent directors. Acero and Alcalde (2020) revealed that classical problems of corporate governance such as compensation for upper management, the composition of directors and independent directors, agency theory, or correction value are the issues that need to be considered for analysis, and how they affect financial stability. Kapoor and Goel (2019) showed that the size of the independent board of directors indirectly impacts financial stability.

The Influence of Independent Commissioner Size on Financial Stability

Based on the results of the fixed effect test, the size of the independent commissioner has an effect on financial stability. This means that the size or number of independent commissioners has an impact on a company’s ability to continue operating. Commissioners have an effective role in the company. The number of commissioners is beneficial to the company. The results of this study are supported by previous research (Abdelbadie & Salama, 2019; Armstrong et al., 2010; Hanza, 2013). Hanani and Dharmastuti (2015) stated that independent commissioners have an effect on the company’s bankruptcy potential.

6. Conclusion

Based on the results of the tests that have been carried out, it is found that the size of the sharia board has no
effect on financial stability. This means that a large sharia board is unable to guarantee the bank’s credibility and compliance with Islamic laws. This can be seen from its reports and performance activities. The independent board also does not affect financial stability. This finding means that the current independent board of directors has problems that need to be analyzed as well as how it affects financial stability in the future (Acero & Alcalde, 2020; Alam et al., 2020). Another finding is that the size of the independent commissioner affects financial stability. This finding demonstrates that the commissioners’ performance has had a positive impact on the company, indicating that if the sharia banking company has the right number of independent commissioners, it will be very beneficial to the company, particularly in terms of maintaining stability and sustainability of its operations (Bonn & Fisher, 2011; Van Essen et al., 2012; Karkowska & Acecański, 2020; Kim et al., 2014; Saona et al., 2020).

Due to the limitations encountered during this research, such as the acquisition of data and its translation into the Indonesian national language, the tabulation process of the data is lengthy. Further researchers can improve the presentation of research results with several inputs, such as adding mapping research and the latest international sharia regulations, so that they can be useful for stakeholders in the future.

References


