

The Impact of the Sharia Supervisory Board on Islamic Bank Soundness: Does Political System Matter?

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This research aims to examine the impact of the Sharia Supervisory Board (SSB) on the Islamic bank soundness. This research also will test whether the political system of the country is a moderating variable on the relationship of SSB on Islamic bank soundness. The study uses moderated regression analysis with the period 2012-2016 which includes 99 Islamic banks from 17 countries. The political system for this study is measured by the political or legal system implemented, whether this is a democratic system, the legal sharia law system, or a hybrid. Using 384 firm-year, the results show that stronger SSB characteristic only increases the capital adequacy ratio. The strength SSB characteristic does not have an impact on the Islamic bank soundness measurements (asset quality, management efficiency, earning and liquidity). The moderated variable of the Sharia law legal system or hybrid is only proven in the influencing the strength of the SSB characteristic on the capital adequacy ratio model, and not for other ratios. The implication of the research is that a country with a Sharia law legal system or a hybrid is better equipped to increase the qualification of the SSB characteristics to increase their capital.

Key words: *Sharia Supervisory Board, Sharia Law Legal System, Democratic Legal System, Islamic Banking Soundness.*

Introduction

The development of Islamic banking began in Egypt in 1963 and spread to Arab countries in the 1970s (Antonio, 2001; Haron & Shanmugam, 1997). Now, Islamic banks have emerged

and developed in other countries across Asia and Europe. The presence and survival of Islamic banks is motivated by the needs of the Muslim community for usury-free financial transactions and sharia compliance in every aspect. The stakeholders of Islamic banks have a specific interest in obtaining financial services in accordance with sharia. The stakeholder trust will increase if an Islamic bank is more compliant with the sharia rules and principles. Mutual trust of stakeholder and the institution is expected to increase the soundness and stability (Cornell & Shapiro, 1987; Donaldson & Preston, 1995; Freeman & David, 1984; Jones, 1995).

To protect and safeguard sharia compliance assurance, Islamic banks implement sharia or an Islamic governance mechanism that represented by sharia supervisory board (SSB) (AAOIFI, 2010; Ahmed & Chapra, 2002; Al-Nasser Mohammed & Muhammed, 2017; Simon Archer, Abdel Karim, & Al-Deehani, 1998; S Archer & Karim, 2006; Ghayad, 2008; Grais & Pellegrini, 2006; Grassa, 2015; Hasan, 2009; IFSB, 2009; Safieddine, 2009; Sulaiman, Abd Majid, & Mohd Ariffin, 2015). The high trust from a stakeholder will be expected to strengthen the stability of Islamic banks, especially in accordance with sharia compliance. In addition, SSB coordination with other institutions will also be able to produce new creative and halal products that may attract potential funding (Alaeddin et al., 2018).

Previous research investigating the role of the SSB is still limited in the area of financial performance (Abdelaziz, Housseem, Rim, & Houda, 2018; Hakimi, Rachdi, Ben Selma Mokni, & Hssini, 2018; Matoussi & Grassa, 2012; S. Mollah & Zaman, 2015; Nawaz, 2017) and disclosure (Farook, Hassan, & Lanis, 2011; A. A. Rahman & Bukair, 2013; R. A. Rahman, Saimi, & Danbatta, 2016; Sellami & Tahari, 2017; Septyan, 2014; W. A. Wan Abdullah, Percy, & Stewart, 2013). The previous research has not examined the role of SSB in maintaining the soundness and the stability of Islamic banks. Hassan and Aliyu (2018), in their meta-analysis research paper, suggest for the future research to investigate the impact of SSB on efficiency and risk. This is because SSB has an important role equal to the Board of Directors. SSB is one of the governance mechanisms in Islamic banking that also will promote stability and soundness (IFSB, 2009).

The development and growth of Islamic banks may depend on the different political system among the countries. The stakeholder and manager paradigms of Islamic banks may depend on a country's legal system. The use of Arabic terms and the implementation of the sharia law system in a country will impact on more understandability and acceptability of stakeholders to Islamic bank operations. This may also be the reason why the SSB's role in financial performance and the quality of disclosure still yields inconclusive results (Hakimi et al., 2018; S. Mollah & Zaman, 2015; Nawaz, 2017).

The role of the SSB in Islamic banks can depend on the different legal systems of the countries where Islamic banks operate. A country's political system could show the different influence. Bitar, Hassan, and Walker (2017) state that in Arabic countries, Islamic legal law is considered a major force in politics and can play a role in motivating and governing people's decisions. However, countries that implement Islamic banks are not only in Arab countries which mostly apply the sharia law or hybrid with other law as a major force. Countries that follow democratic politics may not be as strong in sharia force compared to countries that follow sharia law. Bitar et al. (2017) examines how the political system impacts the conventional and Islamic bank soundness. Bitar et al. (2017) identifies two different political system, namely countries that implement democratic political systems and sharia-based legal systems. The results show that Islamic banks underperform with conventional counterparts in democratic system countries, but overperform in countries that have a hybrid or sharia law legal system. The sharia law legal system or hybrid countries increase the stability of Islamic banks (Hoomanfard et al, 2018).

Bitar et al. (2017) argue that Islamic law may translates into regulatory authorities better understanding the specifications of Islamic bank, therefore leading to a better adapted standard and guideline for Islamic banks. This possibly influences the SSB's role in providing stability to Islamic banks. The sharia law legal system may influence the role and effectiveness of the SSB in maintaining stability of Islamic bank. The political system could influence the point of view and the stakeholder actions to Islamic bank transaction. Stakeholders in the democratic system may misunderstand and mistrust Islamic bank due to issues regarding extremism. Based on this argument, the research question is what is the role of the political legal system in the influence of the SSB on the stability of Islamic banks?

This research will contribute an investigation of the strength SSB characteristic on stability and soundness of Islamic bank. S. Mollah and Zaman (2015), Nawaz (2017), and Hakimi et al. (2018) found inconclusive evidence regarding the relationship between the SSB and Islamic banks performance as one of soundness measurements. These results are the motivation to reinvestigate the strength of the SSB's characteristics by examining not only its impact on financial performance, but its impact on the soundness of the Islamic bank. Previous studies (Hakimi et al., 2018; S. Mollah & Zaman, 2015; Nawaz, 2017) have investigated and measured the SSB from one or several characteristic independently. The Islamic governance is the mechanism as a whole, including all characteristic of the SSB which cannot be separated. The study uses the measurements from W. A. Wan Abdullah (2013) that examine SSB's strength with the score of characteristic of SBB. The measurement is expected to give a more comprehensive way of describing SSB of Islamic bank.

This research also contributes an investigation of the moderating effect of political legal systems in countries that Islamic banks operate. Bitar et al. (2017) examine political system that is divided into democratic and sharia law legal system for both conventional and Islamic banks. The different political systems are expected to influence the relationship of the SSB and Islamic banks. La Porta, Lopez-De-Silanes, Shleifer, and Vishny (2002) along with other previous researcher examine civil and common law in other aspects of industry, such as of environmental control. The implementation of sharia law in the countries that Islamic banks operate could increase the stability of Islamic banks. However, this still requires an investigation because several countries that Islamic bank operate also have a set of regulations for Islamic banking which protect the stakeholder.

Literature Review and Hypothesis Development

Sharia Supervisory Board and Soundness of Islamic Bank

Islamic banking is an institution which either directly or indirectly has a social contract with the public. All products, operations, and activities of Islamic banking relate to the branding image of religion. The stakeholders, especially Muslims communities, will monitor and assess Islamic banks information for guaranteed sharia compliance. To safeguard and protect the stakeholder interest of sharia assurance, Islamic banks have to implement a sharia governance mechanism. The Islamic Financial Service Board (IFSB) defines the sharia governance system as a unit formed by Islamic financial institutions to ensure effective oversight from independent parties regarding sharia compliance. The IFSB also mentions that the enhancing structure in sharia governance is the existence of a sharia board (IFSB, 2009).

Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) states:

A sharia supervisory board is an independent body of specialised jurists in fiqh muaamalat (Islamic commercial jurisprudence). However, the Sharia supervisory board may include a member other than those specialised in fiqh muaamalat, but who should be an expert in the field of Islamic Financial institutions and with knowledge of fiqh muaamalat (AAOIFI, 2010).

IFSB defines the members of the sharia board as “The category of Shari`ah scholars, or ulama, who are equipped with not just general knowledge of Shari`ah or other disciplines, but more importantly have reached a specialised level of being learned and expert in Fiqh al-Muamalat” (IFSB, 2009). Simon Archer, Karim, and Al-Deehani (1998) state that SSB is one of the important roles in conducting supervision of Islamic banks in order to convince stakeholders that Islamic banks have operated in accordance with sharia.

According to the 13th principle of IFSB, Islamic financial institutions have to appoint at least three members of SSB to supervise, monitor, and collaborate with audit and management committees. Governance standards from AAOIFI also mention a minimum of 3 sharia member board. However, IFSB 10 also stated that the SSB model cannot be compared to one place with another.

Farook et al. (2011) measures the Islamic Governance by scoring of the characteristics of the SSB that derived from the number of SSB, cross-membership, secular education, and reputable scholar. Wan Abdullah et al. (2013) develops Islamic governance strength (IG_Strength) from Farook et al. (2011). Both measurements describe Islamic governance from the strength of various characteristics of SSB. The stronger Islamic governance is expected affecting to soundness of Islamic bank.

IFSB states that strong governance structures, processes, and the structure of Islamic financial institutions are in line with the mandate to promote soundness and stability. The SSB is a unit of governance that functions in the Islamic Bank and has a role in maintaining and improving Islamic bank soundness (IFSB, 2009). The supervision of sharia and giving opinions on the development of new products will help Islamic banks maintain their sustainability and improve their soundness and stability.

Several studies have conducted research examining the role of SSB in bank performance, which is one indicator of the soundness of Islamic banks. Nawaz (2017) found that the size of SSB has a negative effect on financial performance. S. Mollah and Zaman (2015) found that SSB had a positive influence on financial performance only when SSB had a role as a supervisory role. However, some studies found no evidence that the number and expertise of SSB on performance is one of the measurements of the soundness of Islamic banks (Grassa, 2015; Hakimi et al., 2018; Matoussi & Grassa, 2012).

Wan Abdullah (2013) Attributes of SSB characteristics include number, expertise, education, and cross-membership. The greater the characteristics attribute of SSB, the better it is able to supervise better because it is more able to discuss and decide on problems appropriately and more creatively (Hakimi et al., 2018; Matoussi & Grassa, 2012; S. Mollah & Zaman, 2015; S. H. Mollah, M. K; Al Farooque, O; Mobarek, A, 2017).

W. A. Wan Abdullah (2013) measured sharia governance sharia with several attributes of SSB characteristics to form SSB-STREGHT. The greater the characteristics of SSB supervises the better. This is because it is more able to discuss and decide the problems appropriately and more creatively (Hakimi et al., 2018; Matoussi & Grassa, 2012). Better SSB can also improve operational quality, have better performance, capital, liquidity, and good asset quality. SSB is an organ that can contribute to improving social justice (S. Mollah

& Zaman, 2015). Good supervision can increase sharia compliance and can be more creative to develop products according to sharia. This can attract funds from the community which will ultimately improve the soundness of Islamic banks. Based on these arguments, we purpose the hypothesis as follows:

H1: “SSB strength influence on Islamic bank soundness”

Sharia Supervisory and Soundness of Islamic Bank: The Moderation Effect of Political System

The legal system and its enforcement are the controls for the executives or stakeholders of the company, even though they do not directly affect the company. In addition to internal supervision at the firm level, investors gain protection from the legal system of the country. Strong law and enforcement will give investors’ confidence in dealing with Islamic banking. La Porta et al. (2002) also argues that the main key in corporate governance mechanisms is the protection of investors through the legal system and its enforcement. La Porta et al. (2002) divides the legal system based on legal origin that is divided into common law and civil law.

Some Islamic banks are domiciliated in the democratic system of the country. The characteristic of the democratic legal system is represented by freedom of opinion, expression, and choosing leaders. According to Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2003), democracy is symbolized by the presence of a private and competitive media which is considered to be “the fourth estate” along with the executive, the legislature, and the courts (Bitar et al., 2017). The autocratic system is opposite the democratic system. The sharia law legal system is characterized by the implementation of Islamic law. Saudi Arabia and Sudan are the countries that apply the sharia legal law system as a mono-system. However, some countries apply not only the sharia law system, but also another system.

Regarding the development of Islamic banks, the application of Islamic legal traditions will accelerate the understanding of the people and perpetrators of Islamic banks towards transactions. The countries that do not implement Islamic principles have a need for additional special rules related to financial transactions in Islamic financial institutions. Bitar et al. (2017) argue that sharia law is more recognized by governments, the general public, depositors, and all stakeholder and will therefore be more familiar with the product Islamic bank offer. Bitar et al. (2017) examine the differences in a country's political system against the soundness of the Islamic banks. They divide the political system into two categories, namely, the sharia law legal system and the democratic legal system.

Research from Hakimi et al. (2018) and Matoussi and Grassa (2012) did not find any influence of the number and expertise SSB on the financial performance of Islamic banks. Nawaz (2017) found a negative influence of SSB on performance. Whereas, Mollah and Zaman (2015) found a positive influence for SSB as supervisory role on performance. Mollah and Zaman (2015) did not find evidence regarding the influence of SSB as advisory role on performance. Inconclusive findings of previous research demonstrates that the influence of SSB on the Islamic bank soundness depends on the political system of the country.

Faccio (2006), dan Li, Meng, Wang, and Zhou (2008) state that the political environment tends to be more important in emerging markets that are characterized by the lack of law enforcement and political institution. Faccio (2006), Li et al. (2008) and Bitar et al. (2017) use political institutions and rules of law as a proxy for political environmental measurement. Most of the countries where Islamic bank operates are developing countries that have emerging markets. Khafagy (2017) explains that autocratic political systems tend to show opportunistic behaviour by exploiting the resources and economic output of their countries, especially in underdeveloped countries. Previous studies found evidence that the political environment affects the soundness and financial ratio (Abdelsalam, Mollah, & Tortosa-Ausina, 2017; Bitar et al., 2017; Nys, Tarazi, & Trinugroho, 2015). Abedifar, Molyneux, and Tarazi (2013) and also S. H. Mollah, M. K; Al Farooque, O; Mobarek, A (2017) found that Islamic bank in Muslim majority and sharia law system countries are less stable and less profitable. Therefore, political environment may affect the impact of SSB on Islamic bank soundness.

Bitar et al. (2017) found that Islamic banks appear to be financially stronger and have more stability in countries with legal system with a hybrid of sharia law more than democratic countries. Bitar et al. (2017) also argue that sharia law may enhance people's confidence and the public's trust, which will make a difference in the decisions by the SSB and the stakeholders. Some countries where Islamic banks stand apply different political systems. The country with a democratic system needs the SSB to increase compliance with sharia. As for the legal sharia law system, compliance with sharia can at least be protected by a system of punishment for a country. Therefore, when the country follows the legal sharia law system, the role of the SSB can be more effective so that it will strengthen the influence of the soundness of Islamic banks.

H2: "Sharia based, or a hybrid legal system has moderate effect of the influence of SSB-STRENGTH on soundness of Islamic bank"

Research Method

The research uses purposive sampling of Islamic banks around the world. The sample is Islamic banks that publish annual reports in English and disclose SSB characteristics data. The research sample has financial ratio data needed for this study. The countries sampled also have macroeconomic data such as inflation and GDP. Palestine and Syria do not have macroeconomic data so they are excluded from the sample. Based on the sample selection, there were 385 bank-years with the 2012-2016 period from 17 countries, that are: Bahrain, Bangladesh, Egypt, Indonesia, Jordan, Kenya, Kuwait, Malaysia, Oman, Pakistan, Qatar, Saudi Arabia, Sudan, Turkey, Union Emirates Arab, United Kingdom, Yemen.

Sharia board information is obtained from annual reports or financial statements that are located on Islamic banking websites. The disclosure about SSB information varies between each country. If the information of characteristic SSB could not be found easily from annual report or financial statement, the information was obtained from various sources, such as Islamic banking websites, www.bloomberg.com, www.islamicmarket.com, www.islamicfinance.com. Financial data is obtained from the Orbis Database. Macroeconomic data is from the world bank development indicator. The researchers have followed Bitar et al.'s (2017) model in obtaining the political system variable data. The researchers gain the information about political system from the political regime characteristic and Transitions of Polity IV Project, the Political Constraint Dataset, the World Bank's database on Political Institution (DPI) and various source that mention about Islamic law around the world.

The research model is as follows:

$$SOUND_{i,t} = \alpha_0 + \alpha_1 SSBSCORE_{i,t} + \alpha_2 DSHA_{i,t} + \alpha_3 DSHA_{i,t} * SSBSCORE_{i,t} + \alpha_4 SIZE_{i,t} + \alpha_5 INF_{i,t} + \alpha_7 LNGDP_{i,t} + \alpha_{8-n} SOUNDCONTROL_{i,t} + \varepsilon_{i,t}$$

The research equation model is with the dependent variable of soundness measured by using accounting ratios in the form of CAMEL ratios (Bourkhis & Nabi, 2013). The dependent variable is the SSB characteristic score, dummy for political system, and the interaction variable of SSBscore and dummy and the control variable. The other soundness also has to be a controlled variable (Klomp & Haan, 2012).

Bank soundness (SOUND) is defined as the ability of banks to remain stable in adverse events, shocks, regulatory changes, natural disasters, and economic liberalization (Bourkhis & Nabi, 2013; Lindgren, Garcia, & Saal, 1996). This study uses CAMEL ratios to measure the soundness of Islamic banks (Bitar et al., 2017; Bourkhis & Nabi, 2013; Čihák & Hesse, 2010; Johnes, Izzeldin, & Pappas, 2014; Klomp & Haan, 2012). Measurement CAMEL ratio

is suggested by International Monetary Fund (IMF) and commonly used. In this project, the researchers use total equity to total asset for capital, loan to total asset for asset quality, cost to income ratio for management efficiency, return on average asset for earning/profitability and liquid asset to total deposit for liquidity. The measurements are commonly used in the previous research. Another reason is the measurement of variable is more available than other ratios in the Orbis database. The measurement also has a high eigenvalue on Bitar et al. (2017) research that performs the analysis factor for camel ratio of Islamic banks.

Sharia supervisory board characteristic (SSBSCORE) is an inherent characteristic of the sharia board that can reflect the quality of supervising. This includes boards, board expertise, cross-membership, education covering doctoral, economics/ business/ accounting, and sharia. In this study, Sharia supervisory board characteristic is measured by using score-SSB adopted from Farook et al. (2011) and W. A. Wan Abdullah (2013).

Political system is measured by dummy variable (DSHA). Dummy 1 is given for country that apply sharia law legal system or hybrid and does not follow the western democratic system. Only Saudi Arabia apply a sharia law legal system for mono-system for this research. However, for another countries apply hybrid legal system, not only sharia law legal system.

The researchers apply a firm level and economic control variable. The size of Islamic bank (SIZE) is measured by logarithm natural of total asset (Bitar et al., 2017). The researchers also follow Klomp and Haan (2012) and assign the non-dependent variable of CAMEL ratios for the control variables. Inflation rate (INF) and logarithm natural of gross national product (LNGDP) are used as variable control for macroeconomic level (Bitar et al., 2017; Bourkhis & Nabi, 2013; Čihák & Hesse, 2010; Koopman, Kräussl, Lucas, & Monteiro, 2009). The inflation rate could result in charging a customer more, resulting in higher profit (Lee & Hsieh, 2013). According to Koopman et al. (2009), charging customers more might be followed by less demand for financing and more expensive financing reimbursement that could lead to a higher default rate. A higher inflation rate indicates that the country may have an undeveloped market and banking system (Chortareas, Girardone, & Ventouri, 2012). Logarithm natural of GDP per capital is control variable for country development of economics that will influence of operation, lending, and deposit of the bank.

Statistic Descriptive

Table 1 presents the statistical description of the variables. The standard deviation of bank soundness ratio variables (CAR, AQ, MEF, EAR, LIQ) is high. This is because the sample of this study is an Islamic bank across countries that have different regulations, economics conditions, and environments. Capital adequacy ratio (CAR) variable has the negative minimum value. It indicates that any sample of Islamic bank has suffered cumulative loss.

Asset quality (AQ) and profitability (EAR) also has negative minimum value to support of indication cumulative loss of the sample of Islamic bank. Management efficiency (MEF) measured by cost to income ratio has a mean value of 73.35%. It indicates that the sample has not enough efficient in managing their cost. However, if the cost is allocating for Islamic bank customer, it is the positive sense of Islamic bank which give the high return to its customer. The mean and minimum value of liquidity ratio shows the normal value of liquidity risk. But the maximum value indicates that there is some Islamic bank that has problem with their liquidity.

Dummy variable of political system (DSHA) measured by dummy 1 for sharia law legal system or hybrid and 0 for democratic system shows the mean value of 59.9%. This value indicates that Islamic banks in the countries with sharia law legal systems or hybrid slightly dominate the sample. It is because that sample of Islamic banking dominate from middle east that apply Islamic law or hybrid.

Table 1: Descriptive Statistics

variable	N	Mean	Sta_Dev	Min	Median	Max	skewness
car	384	17.006	21.086	-97.270	12.110	98.300	0.0406
aq	384	55.312	24.111	-35.280	62.325	149.500	-0.5782
mef	384	73.350	57.575	18.530	60.525	638.710	5.5461
ear	384	0.774	3.110	-30.880	1.030	21.390	-3.0724
liq	384	39.427	55.301	3.290	29.125	784.050	8.5935
size	384	14.755	1.755	9.490	14.840	18.320	-0.3710
inf	384	6.059	8.742	-0.870	2.885	37.390	2.7094
lngdp	384	26.131	1.233	24.150	26.420	28.740	-0.0336
dsha	384	0.599	0.491	0	1	1	-0.4038
ssbscore	384	4.156	1.738	0	5	6	-1.0330
dsha* ssbscore	384	2.708	2.510	0	3	6	0.0286
nssb	384	3.714	1.502	0	3	8	0.0138
repssb	384	0.951	1.019	0	1	5	1.0909
crossb	384	2.404	1.456	0	2	6	0.2013
docssb	384	2.893	1.494	0	3	7	0.1782
ecossb	384	1.078	1.084	0	1	5	0.9298
shassb	384	3.326	1.523	0	3	7	0.0624

car= Capital Adequacy Ratio (total equity to total asset); aq= Asset Quality (loan to total asset); mef= management efficiency (cost to income); ear=earning/profitability (return to total average asset); liq=liquidity (liquid asset to total deposit); size= size of Islamic bank (ln Total Assets); inf=inflasi; lngdp= ln GDP Riil; dsha=Dummy 1 for countries with Sharia Law

Legal System or Hybrid; ssb score = score of SSB; $dsha * ssb$ score = moderating effect; $nssb$ = size of SSB; $repssb$ = size of reputable SSB; $crossb$ = cross membership SSB; $docssb$ = SSB that have doctoral education; $ecosb$ = SSB that have economic/business/ accounting education; $shassb$ = SSB that have sharia education

SSB score indicates a mean of 4.156 with a minimum of 0, a maximum of 6 and median of 5. The mean value of SSB score illustrates that SSB implemented well. Median value is 5, indicating that most of sample of Islamic bank has high score of strength of SSB characteristic. It shows that most of the sample of Islamic banking implemented SSB with the high standard. Sharia or Islamic Governance standard of IFSB and AAOIFI suggests that members of a sharia board has a minimum of 3 members. The mean value of size of SSB ($nssb$) meets and above the values required by the standard. The descriptive statistic also shows median value of 3. One of six characteristic SSB, reputation of SSB ($repssb$) has the highest skewness value. There are a sample of Islamic banks that have a reputation in Islamic accounting, business and economic institutions, but most of sample has lack of those reputations. Cross-membership of SSB ($crossb$), doctoral degree of SSB member, education in business and economics of SSB member have small mean value. Meanwhile, sharia education ($shassb$) has mean value above of 3. The results of descriptive statistics indicate that SSB member of the sample dominate the characteristic of sharia. It supports the standard that SSB is sharia expert, that sometimes has economics and business expert (AAOIFI, 2010; IFSB, 2009).

The interaction variable of dummy political system and score of SSB ($dsha * ssb$ score) shows the mean value of 2.708. It indicates that Islamic bank in the country that applied sharia law implemented lower quality SSB. It may the country with Islamic law is enough to have a Shariah compliance protection mechanism from the implemented legal system.

Univariate Results

Table 2 reports the univariate correlation that is derived from the Pearson correlation for the variables of the research. The table shows that the dummy variable of sharia law legal system or hybrid ($dsha$) has correlation with car , aq , $size$, inf and $lngdp$. The univariate indicates that Islamic banks in the sharia law system country are more financially sound than Islamic bank in the democratic country. Negative value of asset quality means that Islamic Bank in the sharia law system has more qualified asset than democratic. $dsha$ also relates to size with positive value that means that Islamic banks in countries that implement sharia law system have higher in asset.

Table 2: univariate correlation result of the variables

	car	aq	mef	ear	liq	inf	size	lngdp	dsha s	sbsco ~2	dshas sb
car	1										
aq	-0.038	1									
mef	0.094	-0.188*	1								
ear	-0.040	0.156*	-0.576*	1							
liq	0.411*	-0.326*	0.141*	-0.161*	1						
inf	-0.023	-0.185*	-0.105*	0.221*	-0.030	1					
size	-0.330*	0.377*	-0.363*	0.115*	-0.212*	-0.349*	1				
lngdp	-0.118*	0.222*	-0.042	0.102*	-0.173*	-0.244*	0.152*	1			
dsha	0.139*	-0.148*	-0.063	0.013	0.093	0.216*	0.141*	-0.608*	1		
ssbscore	0.127*	0.112*	-0.120*	-0.047	0.021	-0.320*	0.434*	-0.186*	0.258*	1	
dshassb	0.206*	-0.078	-0.07	-0.0161	0.103*	-0.013	0.248*	-0.508*	0.884*	0.543*	1

car= Capital Adequacy Ratio (total equity to total asset); aq= Asset Quality (loan to total asset); mef= management efficiency (cost to income); ear=earning/profitability (return to total average asset); liq=liquidity (liquid asset to total deposit); size= size of Islamic bank (ln Total Assets); inf=inflasi; lngdp= ln GDP Riil; dsha=Dummy 1 for countries with Sharia Law Legal System or Hibrid; ssbscore= score of SSB; dsha* ssbscore= moderating effect

The variable ssbscore in table 2 indicates that has correlation with car, aq, mef, inf, size, lngdp, and dsha. Univariate correlation shows that the good characteristics of SSB in the Islamic bank have a high car, low asset quality, and more efficient. A good SSB in Islamic banking also has positive relation with size. It means the Islamic bank which has a good SSB is the bigger Islamic bank.

Moderating effect is shown with the variable dshassb has correlation with car, liq, ln gdp, and size. For the soundness variable, a good SSB of Islamic bank in the country that implemented sharia law has a financially better than democratic, in term of car and liq. Islamic bank in the sharia law system country and implemented more Islamic governance has relation with bigger asset.

Hypothesis Testing

Table 3 illustrate the result of hypothesis testing. The research uses a General Least Square (GLS) model because the model does not free from heteroskedastic issue. The selected model

has F-statistic of 0.000 that means the model meet the goodness-fit test for all of model. The models also do not contain multicollinearity. The R-square shows the degree of explanation by independent variables of 33.14%, 18,80%, 13.01%, 27.91%, 19.07% respectively for capital, asset quality, management efficiency, earning and liquidity. The capital model is the highest R-Square.

Table 3: Result for Relationship of sharia supervisory, Political System and Soundness of Islamic Bank

Variable	Capital		Asset Quality		Management Efficiency		Earning		Liquidity	
	Coeff	P-Value	Coeff	P-Value	Coeff	P-Value	Coeff	P-Value	Coeff	P-Value
ssbscore	2.319***	0.003	-0.950	0.319	-0.521	0.798	-0.029	0.960	-2.293	0.297
dsha	3.747	0.479	-10.927*	0.092	10.924	0.431	7.020**	0.006	-9.344	0.533
dsha*ssbscore	1.831*	0.084	0.109	0.934	-0.041	0.988	0.042	0.954	0.165	0.956
car			0.316***	0.000	-0.171	0.200	-0.005	0.871	1.129***	0.000
aq	0.209***	0.000			0.032	0.771	0.005	0.758	-0.734***	0.000
mef	-0.025	0.200	0.007	0.771			-0.030***	0.000	0.009	0.874
ear	0.188	0.586	0.637	0.132	-9.550***	0.000			-1.320	0.176
liq	0.141***	0.000	-0.138***	0.000	0.007	0.874	0.010**	0.018		
size	-6.933***	0.000	6.187***	0.000	-12.867***	0.000	0.494	0.471	3.211	0.138
inf	-0.248**	0.044	-0.074	0.628	-0.869***	0.007	0.065	0.117	-0.404	0.247
lngdp	2.546***	0.007	-0.499	0.670	3.825	0.124	1.168	0.409	-6.045**	0.024
_cons	21.983	0.385	-13.209	0.672	172.514	0.009	-39.968	0.305	188.950	0.008
F-Stat	0.0000		0.0000		0.0000		0.0000		0.0000	
R-Squared	33.14%		18.80%		13.01%		27.91%		19.07%	

* : Significant in 10%; **: Significant in 5%; ***: significant in 10%

car= Capital Adequacy Ratio (total equity to total asset); aq= Asset Quality (loan to total asset); mef= management efficiency (cost to income); ear=earning/profitability (return to total average asset); liq=liquidity (liquid asset to total deposit); size= size of Islamic bank (ln Total Assets); inf=inflasi; lngdp= ln GDP Riil; dsha=Dummy 1 for countries with Sharia Law Legal System or Hibrid; ssbscore= score of SSB; dsha* ssbscore= moderating effect.

Table 3 presents the significance of ssbscore for score of characteristics of SSB. The results illustrate that ssbscore is the only influence of capital adequacy ratio. Dummy sharia law legal system or hybrid influences only two models, asset quality and earning. Interaction variable of dsha dan ssbscore only influence on capital in significance of 10%.

Findings and Discussion

The objective of the research is to investigate the influence of SSB strength on Islamic bank soundness and whether political system of the country affects the relationship. The result shows that stronger characteristic of SSB (ssbscore) only impacts on capital adequacy ratio. A strong characteristic of SSB could give the assurance for sharia compliance (AAOIFI, 2010; Abdullah, 2013; IFSB, 2009; A. W. Wan Abdullah, Percy, & Stewart, 2015). The SSB could give assurance to the shareholders to invest their funds into Islamic banks to strengthen the Islamic bank capital. The investor trust of Islamic bank that operate by sharia compliance and give the sharia assurance through strong SSB could increase their fund for the Islamic bank capital. The soundness through strong capital will help Islamic banks to operate better and face financial risks more easily. This makes the bank grow and has a continuity in their sustainability.

SSB does not play role for others measurement like asset quality, management efficiency, earning, and liquidity. The number, reputation, education and experience of SSB does not matter for soundness of Islamic banking. The result support the research of Hakimi et al. (2018) and contrast the research of Abdelaziz et al. (2018) and S. Mollah and Zaman (2015). However S. Mollah and Zaman (2015) found that when SSB acts as a supervisory and not an advisory, it does not affect profitability. It is also possible that SSB has no effect on asset quality, management efficiency, profitability and liquidity since it does not become the main concern of SSB, since the basic purpose of Islamic banks not only increases the wealth of owners but the interests of all stakeholders. In addition, Karim (2001) stated that SSB is one of the important roles in conducting supervision of Islamic banks in order to convince stakeholders that Islamic banks have operate in accordance with sharia.

IFSB 10 (2009) state that “The category of Shari`ah scholars, or ulama, who are equipped with not just general knowledge of Shari`ah or other disciplines, but more importantly have reached a specialised level of being learned and expert in Fiqh al-Muamalat”. The SSB is specialized in sharia that does not know about financial matters. In the descriptive statistics, it shows that SSB that has reputation and economic background only 0.95 and 1.078. The value indicates that lack reputation and economics background of SSB will not concern about finance soundness. The result support some studies that found no evidence that the number and expertise of SSB on performance is one of the measurements of the soundness of Islamic banks (Grassa, 2015; Hakimi et al., 2018; Matoussi & Grassa, 2012).

The second hypothesis is the moderating effect of the sharia law legal system or hybrid of the influencing SSB strength on soundness of Islamic banks. Table 3 presents interaction variable (dsha*ssbscore) only influencing on capital adequacy ratio in significance only 10%. Bitar et al. (2017) state that sharia law is more recognized by governments, general public, depositor

and all stakeholder that will be more familiar with the product Islamic bank offer. Sharia legal law system or hybrid will strengthen the role of SSB to capital adequacy ratio only, and not for other soundness ratios. In the sharia law legal system or hybrid country, the influence of SSB on capital adequacy ratio is stronger than democratic system. Democratic political countries which has dual banking system also have SSB regulatory framework both nationally and institutionally are that will have both sharia rules and also comply with international regulation (Bitar et al., 2017). However, the sharia legal law system or hybrid will more easily adapted with Islamic economic standard and regulation like from IFSB or AAOIFI. This is supported that SSB and the stakeholder more understand the specifics of Islamic bank.

Based on market discipline, SSB in the country with a sharia legal law system or hybrid will consider dealing with Islamic and transaction because stakeholder with better understanding of sharia will be easily punish Islamic bank if they find that Islamic bank is less accordance with sharia compliance (S Archer & Karim, 2006; Ariffin, Archer, & Karim, 2007; Bliss, 2004; Bliss & Flannery, 2002; Flannery, 2001; Nier & Baumann, 2006; Wu & Bowe, 2010). Stronger SSB in the country with sharia law will be more encouraging to increase capital buffer to anticipate bank run of customer when there are mistakes related to conformity with sharia. Bitar et al. (2017) explain the democratic countries are relatively stable and thus SSB of Islamic bank in the democratic country does not suggest holding high capital buffer. To strengthen the financial and soundness condition, the Islamic bank will further increase CAR ratio in order to guard against acts of punishment from stakeholders. The result also indicates that stronger SSB of Islamic in the country with sharia legal law system or hybrid are stronger and higher capital than in democratic system. The countries with sharia law are mostly the country that get benefit from oil revenue to increase capital ratio (Bitar et al., 2017).

The sharia law legal system or hybrid does not affect in managing other soundness ratio. Islamic bank in the democratic system countries have regulated the Islamic banking standard or adopted standard from IFSB and AAOIFI (Bitar et al., 2017). It may the reason why the country with sharia law legal system or hybrid does not affect the relationship of SSB on Islamic bank soundness.

The descriptive statistic shows that interaction variable has mean value of 2.078. This value indicates that SSB characteristics in country that has sharia law or hybrid has a weaker SSB than democratic. The small mean value also indicates that SSB could not give suggestion and motivating in every aspect, especially for financial performance. The other organisations or corporate governance in sharia legal law or hybrid country also can give sharia assurance because some of them are also well versed in sharia compliance. Another finding also shows



that Islamic banking in country that has sharia law system is more qualified asset and better performance than democratic system.

The result finds that larger of Islamic bank are less capitalized, less management efficiency, and better asset quality. The inflation rate of the country decreases capital and management efficiency, but increase asset quality. Islamic bank in country with higher GDP per capital are more capitalised and less liquid. GDP per capital show the economics condition of country.

Conclusion

The objective of this study is to examine the impact of the characteristics of the Sharia Supervisory Board (SSB) on the Islamic bank soundness. This study also investigates whether a country's political system is a moderating variable in the relationship of the characteristics of SSB and Islamic bank soundness. The political system in this study uses the system of democracy and the legal sharia law system. Using 384 firm-years, the results show that the strength of SSB characteristic affects only the capital adequacy ratio and not for the other Islamic bank soundness measurements. The impact of the legal system sharia law moderation is only found in the capital adequacy ratio model. The implication of this result is that the strength of SSB can only influence on CAR and it will be even better if Islamic banks are in countries with legal system and hybrid sharia law.

This research has some limitations. First, measurement of CAMEL ratio has derived only from one ratio, not like Bitar (2016) that use principle component analysis. The future research may apply principle component analysis for CAMEL measurement with some ratios. The Second limitation is in our sample. The researchers do not use any robustness or additional test because the sample is still small. We suggest for future research to investigate for long period sample. We do not classify SBB into advisory and supervisory role in this research. The future research suggested add the investigation with the classification of SSB role.

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