

**CRITICAL FACTORS AFFECTING THE  
SUCCESS OF *SHARĪ'AH* GOVERNANCE:  
INSIGHTS FROM ISLAMIC FINANCIAL  
INSTITUTIONS**

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**Abstract**

This study examines the critical role of *Shari'ah* governance, particularly the impact of *Shari'ah* supervisory boards (SBBs) within the corporate governance framework of Islamic financial institutions (IFIs). SSBs, as critical components of *Shari'ah* governance mechanisms, significantly influence *Shari'ah* compliance processes within IFIs. This study explores the unique systemic risks inherent in the Islamic financial environment, focusing on the complexities and elements defining SSB legitimacy. The IFSB recommends four essential components for *Shari'ah* governance systems, emphasizing the importance of SSBs. However, SSBs face challenges balancing *Shari'ah* adherence and market dynamics, highlighting a conflict between business objectives and *Shari'ah* rules. This study acknowledges the limited strength of *Shari'ah* governance, advocating for universally adopted standards to address issues such as conflicts of interest within SSBs and the need for diversified skill sets. This paper assesses the effectiveness of *Shari'ah* governance and SSBs

in IFIs. For this purpose, a survey was conducted among middle and senior-level managers and employees employed in IFIs or associated regulatory entities across diverse nations. The results highlight the critical role of SSB members, specific standards for board nominations, and the moderate influence of stakeholders' interests on *Shari'ah* governance success. Shareholders' and customers' interests show no significant correlation with *Shari'ah* governance success.

**Keywords:** *Shari'ah governance, Shari'ah supervisory board, Corporate governance, Islamic financial institutions*

## **Introduction**

*Shari'ah* governance is an integral and unavoidable part of the corporate governance framework of Islamic financial institutions (IFIs). Regarding asset value, the Islamic financial services industry has experienced a cumulative annual growth rate of 8.71% from 2020 to 2022, reaching \$3.25 trillion, of which Islamic banking holds a share of 69.3%. Despite unfavourable global economic conditions, the Islamic financial sector demonstrated soundness and resilience during this period.<sup>1</sup> The number of Islamic financial institutions globally reached 1,679 in 2022, and the sector is expected to grow at an average rate of 9% in the coming years.<sup>2,3</sup> With this growth, concerns related to adherence to *Shari'ah* principles arise, facilitating the improvement of *Shari'ah* governance processes in a positive direction.

*Shari'ah* supervisory boards (SSBs) exercise significant impact among *Shari'ah* governance mechanisms, playing a significant role in the *Shari'ah* compliance processes within IFIs. The legitimacy and authenticity of these SSBs are closely linked to the fundamental principles of *Shari'ah* governance in these institutions, which significantly influences the legitimacy and authenticity of the broader Islamic financial system. An example of this may be found in the fact that a fatwa issued by an IFI's SSB has the power to drastically alter public opinion and possibly cause a decline in the industry's reputation. This complex feature captures a distinct type of systemic risk specific to the Islamic financial environment, supplemented by several additional elements that define and impact the legitimacy and dependability of SSBs.

Before 2009, a universally accepted description of *Shari'ah* governance within the Islamic finance sector was absent. It was in 2009 that the Islamic Financial Services Board (IFSB) formulated a comprehensive definition of *Shari'ah* governance as a set of institutional processes. These processes enable IFIs to ensure rigorous and autonomous supervision of *Shari'ah* compliance concerning formulating and disseminating pertinent *Shari'ah* guidelines to the

IFI's relevant bodies. *Shari'ah* compliance is verified through internal reviews and annual *Shari'ah* assessments.<sup>4</sup>

Before a clear definition of *Shari'ah* governance was established, the term was frequently used to describe the systems and procedures that stakeholders of the IFIs had implemented to guarantee adherence to *Shari'ah* laws and principles. The IFSB subsequently clarified it as a framework of institutional and structural setups employed by IFIs. This framework aims to ensure robust independent supervision of *Shari'ah* compliance over specific structures and processes, encompassing the issuance of pertinent *Shari'ah* guidelines and internal and annual reviews for *Shari'ah* compliance.<sup>5</sup> *Shari'ah* governance enhances the prevailing governance, control, and compliance mechanisms within IFIs.

The IFSB recommends four essential components integral to *Shari'ah* governance systems, which are the issuance of *Shari'ah* pronouncements, continuous monitoring of daily adherence to *Shari'ah* principles, internal assessments and audits of *Shari'ah* compliance, and annual audits to verify the effectiveness of internal *Shari'ah* compliance reviews. To facilitate these functions, the IFSB identifies distinct *Shari'ah* governance bodies, comprising an internal unit or department for *Shari'ah* compliance, an internal unit dedicated to reviewing and auditing *Shari'ah* compliance, and an SSB.<sup>6</sup> The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) characterizes the SSB, in its governance standard for SSB released in 1997, as an autonomous body comprising specialized jurists in *Fiqh Al-Mu'āmalāt*. However, the SSB might include a member who does not specialize explicitly in *Fiqh Al-Mu'āmalāt* but possesses expertise in Islamic financial institutions and a comprehensive understanding of *Fiqh Al-Mu'āmalāt*. The primary responsibility of the SSB involves overseeing, assessing, and supervising the operations of the IFI to ensure adherence to *Shari'ah* rules and principles.<sup>7</sup> The AAOIFI's governance standards regarding *Shari'ah* governance include *Shari'ah* review, internal *Shari'ah* review, independence of SSB, a central *Shari'ah* board, *Shari'ah* compliance function, and internal *Shari'ah* audit. These standards were released in 1998, 1999, 2005, 2019, 2018, and 2019 respectively.

The confidence of stakeholders in Islamic financial products and the overall integrity of the Islamic financial sector predominantly rely on the efficacy of SSBs. However, SSBs encounter a dual challenge in maintaining strict adherence to *Shari'ah* principles while also addressing the dynamic requirements of the market. They are pressured to balance their need to maintain their reputation by strictly adhering to *Shari'ah* and business viability. This conflict between business objectives and the rigorous application of *Shari'ah* rules

highlights the difficulty and complexity SSBs encounter in managing their diverse responsibilities within the Islamic financial sector. Ullah et al. asserted that an inherent conflict exists between *Shari'ah* bodies' objectives and bank managers' objectives. The former emphasizes fiqh and prioritizes profit, leading to an underlying power struggle.<sup>8</sup> Therefore, the independence and objectivity of the SSBs regarding demonstrating their unwavering commitment to *Shari'ah* compliance should be preserved to maintain their integrity and credibility in the Islamic financial industry.

As CIBAFI & WorldBank (2017) indicated, *Shari'ah* governance presents a sphere of limited strength, partly due to the absence of universally implemented standards across jurisdictions; those lacking such standards should adopt them. These standards should enforce effective *Shari'ah* governance within individual IFIs, encompassing issues such as preventing conflicts of interest within SSBs. Moreover, at the IFI level, there should be a diversification of skill sets within SSBs, potentially leading to an increased frequency of meetings for many SSBs.<sup>9</sup> Therefore, this study aims to measure the success of *Shari'ah* governance and SSBs in IFIs. We surveyed IFI personnel from many nations to achieve this goal, and the results showed the elements that are seen to be successful in *Shari'ah* governance. This study is organized as follows: The next section presents relevant literature and principles as stated in international standards. Following this, the research methodology, design, and details regarding data and participants are explained in subsequent sections. After presenting the research findings, a discussion is conducted, insights from the results are drawn, and the study concludes.

## Background

Each organization needs to be overseen and regulated by established governance standards. Similarly, oversight and regulation of IFIs are necessary to improve and reinforce their operations. The existing corporate governance framework needs to fulfill this requirement within IFIs.<sup>10</sup> *Shari'ah* governance is an integral and unavoidable part of the corporate governance framework of IFIs. The definition of an efficient *Shari'ah* governance system is subject to debate. Examining the practices in various countries and institutions makes it clear that diverse systems are in operation. This diverse approach offers advantages because the legal landscapes in which Islamic financial institutions function vary, not only concerning the prominence of *Shari'ah* but also based on whether countries follow common or civil law. Additionally, there are differences in client expectations regarding what qualifies as acceptable and effective *Shari'ah* governance.<sup>11</sup>

IFIs typically include a religious board, often in the form of an SSB, to instill confidence in their Muslim clients. The primary objective of establishing SSBs in financial institutions is to supervise *Shari'ah* compliance with the business activities of IFIs.<sup>12</sup> The SSB is a crucial component of the corporate governance structure of IFIs, exerting a profound influence on daily financial practices by offering advisory and consultative services.<sup>13</sup> *Shari'ah* governance plays a crucial role in guaranteeing adherence to *Shari'ah* principles in the products, practices, and management of IFIs. The responsibility of *Shari'ah* governance extends to enhancing transparency and disclosure and strengthening oversight within these institutions.<sup>14</sup> The legitimacy and authenticity of these SSBs are closely linked to the fundamental principles of *Shari'ah* governance in IFIs, which significantly influences the legitimacy and authenticity of the broader Islamic financial system.

The effectiveness of SSBs is a crucial factor influencing stakeholders' trust in Islamic financial products and the overall integrity of the Islamic financial industry. However, SSBs face the difficulty of adhering strictly to *Shari'ah* principles while meeting the market's dynamic expectations. To preserve their reputation, they must balance the imperative to uphold *Shari'ah* compliance and business viability. According to Alkhamees, there are reservations regarding the practicality of establishing a robust and influential *Shari'ah* governance culture in IFIs. Skepticism is primarily tied to the ambiguous roles and legal frameworks of SSBs, insufficient accountability and transparency, conflicts of interest, the absence of independence in SSBs, and the insufficient training and qualifications of SSB members. The prevalence of these significant governance challenges significantly diminishes the degree of *Shari'ah* compliance within the Islamic finance industry.<sup>15</sup>

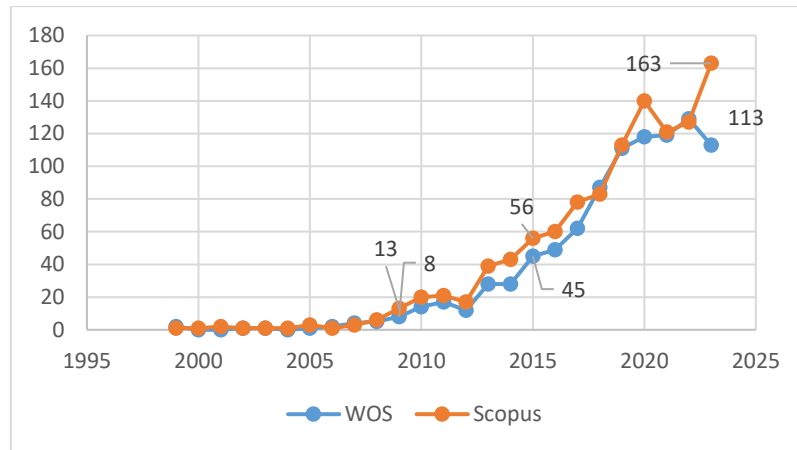
An SSB comprises scholars who are well-versed in *Fiqh Al-Mu'āmalāt* and *uṣūl-i-fiqh*. The composition of the SSB varies among IFIs, with many appointing three to six members to the SSB. Each IFI has its unique procedures for the SSB. To fulfill its responsibilities, the SSB requires a clear framework and structure to ensure independence and effectiveness. However, appointing an effective and independent SSB per fit and proper criteria is just one of the essential requirements within the *Shari'ah* governance framework that IFIs must satisfy.<sup>16</sup> Other requirements encompass holding executive management accountable for the implementation of governance frameworks, establishing a mechanism for reviewing *Shari'ah* compliance, creating a *Shari'ah* compliance unit to act as a liaison between the SSB and the management of the IFI, setting up an independent *Shari'ah* audit unit, and conducting external *Shari'ah* audits.<sup>17</sup>

As per the governance standards established by the AAOIFI, the distribution of *Shari'ah* supervision within the organizational hierarchy should be divided between shareholders and the BOD. This division is crucial to safeguard the independence of *Shari'ah* supervision from the influence of other governance bodies. Additionally, *Shari'ah* scholars are prohibited from assuming any executive position or obtaining substantial ownership in the institution. This independence instills confidence among stakeholders regarding the decisions made by *Shari'ah* scholars and the overall transactions conducted by the IFI.<sup>18</sup> Typically, to ensure the independence of the SSB, its members are nominated either by shareholders during the annual general meeting or by the BOD. The AAOIFI standard specifies that the authority to appoint SSB members lies with the shareholders, not the BOD. When appointments are made by the annual general meeting following recommendations from the BOD, the SSB is permitted to participate in Board of Directors meetings to deliberate on the religious aspects of the decisions.<sup>19</sup>

The supervisory functions of an SSB encompass issuing fatwas and decisions prior to the execution of transactions, endorsing new products and contracts, auditing the processes for introducing new products with the help of *Shari'ah* internal auditors, auditing financial statements at the end of the fiscal year, and approving the distribution of net income between investors and shareholders.<sup>20</sup> The issuance of *fatāwā* and decisions entails obtaining *Shari'ah* approval, a document confirming that certain or all operations, products, and services comply with *Shari'ah* principles and do not contravene any *Shari'ah* norms. The certification of Islamic products and services is achieved through receiving *Shari'ah* approvals. The *Shari'ah* approvals granted by the SSB play a crucial and indispensable role in promoting, overseeing, and regulating the progress of the Islamic finance industry.<sup>21</sup> Therefore, a *fatwā* issued by an SSB of an IFI holds the potential to significantly influence public perception and potentially lead to a decline in the industry's reputation. This intricate characteristic represents a unique systemic risk inherent in the Islamic financial environment. It is complemented by various additional elements that collectively shape and affect the legitimacy and reliability of SSBs.

### Literature Review

*Shari'ah* governance is the most vital process that distinguishes IFIs from their conventional counterparts. Especially after the standards of standard-setting organizations such as AAOIFI and IFSB, it has attracted more attention to IFIs and has found more space in academic studies.



**Figure 1:** Number of publications in indexed journals  
**Source:** Authors.

*Shari'ah* governance has garnered escalating academic and practical interest since the initial standard was published in 1997. The amplified attention on IFIs, particularly following the Global Financial Crisis, has significantly impacted the *Shari'ah* governance mechanisms within these institutions. The number of publications has notably surged post-2009. In 2009, 21 papers were published in Web of Science (WoS) and SCOPUS, the two most reputable indexes; however, this figure ascended to 101 and 276 in 2015 and 2023, respectively. In the early years, the topic was primarily studied in the context of corporate governance and Islamic law. However, in recent years, the scope has expanded to encompass the entire IFI. This surge in publications indicates the burgeoning interest in *Shari'ah* governance.

In the relevant literature, *Shari'ah* governance is often discussed within the institutional context, encompassing Islamic banks and non-banking IFIs, within the country-specific context, and the theoretical and jurisprudential perspectives.

- *Institutional context:* Many studies deliberate *Shari'ah* governance concerning the suitability of products and services offered by Islamic banks, which hold the largest share among IFIs, and the management of their processes. Meanwhile, non-banking IFIs such as Islamic insurance (*takāful*) and other Islamic fund management companies discuss *Shari'ah* governance regarding their products and services.  
22;23;24;25;26;27;28;29;30;31;32;33;34
- *Country-specific context:* Within the literature, several studies compare *Shari'ah* governance frameworks across different countries at the national level. These studies classify countries into centralized, semi-centralized, and decentralized categories

based on the presence or absence of a central SSB. For instance, the Gulf Cooperation Council (GCC) countries typically follow a decentralized model, whereas countries like Malaysia adhere to a centralized model.<sup>35;36;37;38;39;40;41;42;43;44;45;46;47;48;49</sup>

- *Theoretical and jurisprudential context:* The jurisprudential foundations, components, and the process of *Sharī'ah* governance are examined through theoretical frameworks. Very few studies in this framework focus more on applications in the Islamic finance industry.<sup>50;51;52;53;54;55;56;57</sup>

The SSB constitutes the most crucial functional component within the *Sharī'ah* governance framework. It is responsible for making *Sharī'ah* decisions while concurrently ensuring *Sharī'ah* compliance with IFIs.

The AAOIFI released a standard for establishing the independence of SSBs, defining independence as a mindset that prevents one's perspectives and decisions from being unduly influenced or controlled by conflicting interests. This independence is attained through both organizational positioning and a commitment to objectivity. The significance of SSB members' independence within an IFI lies in boosting public trust in the IFI's adherence to *Sharī'ah* rules and principles and facilitating the core objectives of the IFI through the reinforcement of both independence and objectivity within its SSB.<sup>58</sup> Independence emphasizes furnishing the SSB with comprehensive, sufficient, and prompt information, enabling the Board to make impartial judgments effectively. The Board of Directors (BOD) guarantees the SSB's independence in rendering objective decisions regarding matters presented to them.<sup>59</sup>

According to the AAOIFI's delineation, objectivity embodies an independent mindset that SSB members are obliged to uphold during their execution of *Sharī'ah* supervision. To maintain objectivity, SSB must carry out *Sharī'ah* supervision in a way that shows their sincere confidence in their duties. SSBs should stay out of situations that could hinder their ability to make impartial professional decisions, whether these situations are anticipated or actual.<sup>60</sup> Additionally, to ensure the independence and objectivity of the SSB, the AAOIFI recommends that SSB members refrain from holding employment positions within the same IFI. SSB members, either individually or collectively, should refrain from any form of involvement related to managerial decisions or operational responsibilities within the IFI in instances where SSB members have had affiliations as officers of a client or as employees of an IFI, either during an ongoing engagement or immediately preceding it, a prescribed period of no less than three years should precede or follow these associations.<sup>61</sup>

While numerous studies exist on the performance of IFIs, there remains a need for more research on the performance, effectiveness, and success of *Shari'ah* governance systems or SSBs.<sup>62</sup> The effectiveness of SSBs in this research significantly depends on several factors, including the presence and caliber of the Board,<sup>63</sup> well-defined and enforceable guidelines<sup>64</sup>, the availability of national *Shari'ah* authorities<sup>65</sup>, and the equitable balance of rights among stakeholders and owners.<sup>66</sup> Additionally, good governance within the institutions and transparent public disclosure practices can influence the success of SSBs.<sup>67</sup>

IFSB Standard 10 offers guiding principles for the *Shari'ah* governance systems within IFIs. The foremost principle emphasizes that each country and institution may establish its own *Shari'ah* governance mechanism, rejecting a singular, universal approach as it should cater to specific contexts rather than adopting a one-size-fits-all model. The subsequent principles encompass the establishment of SSB, emphasizing the competence and proficiency of its members, their independence, maintaining confidentiality, and ensuring consistency in implementing *Shari'ah* decisions.<sup>68</sup> If we categorize these principles into internal and external competencies, the SSB's competence, capability, and adherence to a code of conduct fall under internal competencies. At the same time, the engagement level of stakeholders can be regarded as external competencies. In this context, the effectiveness of the *Shari'ah* governance mechanism can be assessed based on three parameters:

- *The competencies and skills of the SSB (internal competencies):* SSB members' competence and expertise in Islamic finance products and industry have the potential to impact the effectiveness of SSBs, consequently affecting the overall performance of SG.
- *The Code of Conduct of the SSB (internal competencies):* The transparency and public accessibility of guidelines regarding the frequency and location of meetings, the procedures for obtaining *fatāwā*, the mechanism for disseminating them to relevant departments, as well as the comprehensive process for staff training, ensuring compliance, and facilitating reporting, all play a crucial role in influencing the effectiveness of the SSB. Consequently, these factors can significantly impact the overall performance of SG.
- *The level of stakeholder interest (external competencies):* Stakeholders across various levels, ranging from institutional to national, including owners and regulatory authorities, possess the potential to exert both direct and indirect influences on the effectiveness of SSBs and the success of SG.

## Methodology and Research Design

In order to measure the success of *Shari'ah* governance and SSBs in IFIs, a survey was conducted among middle and upper-level managers and employees working in Islamic financial institutions or related regulatory bodies in different countries. A total of 120 managers or employees from 26 different countries participated in the survey. The survey asked respondents to assess the effectiveness of *Shari'ah* governance and the effectiveness of *Shari'ah* supervisory boards in the context of their institution and regulatory framework.

### Stepwise Regression

Stepwise regression is a statistical method used in multiple linear regression analysis to identify a subset of independent variables that best predicts the dependent variable. In multiple linear regression, you specify a model that includes all the independent variables you want to consider. On the other hand, stepwise regression is an automated procedure for variable selection within the context of multiple linear regression. It involves iteratively adding or removing variables based on specific criteria (such as p-values) to improve the model fit.<sup>69</sup> Stepwise regression can be computationally more efficient than exhaustive search methods in cases with many potential predictor variables. It systematically explores different combinations of variables and selects those that contribute the most to the model. Also, the resulting model from stepwise regression may be more straightforward and more interpretable, especially when dealing with many potential predictors.

### Data and Participants

The data obtained were analyzed using correlation and regression analyses to reveal the factors considered adequate in *Shari'ah* governance. Here, the data of 6 respondents who left most of the questions in the questionnaire blank and did not provide sufficient opinions were not included in the analyses, and the analyses were carried out with the data obtained from 114 respondents in total. The country distribution of the participants who responded to the survey is shown in Table 1.

Country	Number of Participants	%
Türkiye	18	12,5%
Jordan	12	8,3%
Sudan	11	7,6%
Malaysia	9	6,3%
Indonesia	7	4,9%
Nigeria	7	4,9%
UAE	6	4,2%

Afghanistan	5	3,5%
Kuwait	5	3,5%
United Kingdom	5	3,5%
Algeria	3	2,1%
Pakistan	3	2,1%
Palestine	3	2,1%
Others	20	14%

**Table 1: Number of Participants**

Within the scope of this study, participants were asked to evaluate their organizations under three main headings: the expertise and abilities of SSB members within their institution, the stakeholders' degree of interest in *Shari'ah* compliance, and the code of conduct observed by the SSB in the institution. The questions and related coding are shown in Table 2:

Comp_1	Do you think that the members of the SSB possess the required and sufficient capabilities?
Comp_2	Do you think that the selection of SSB members is determined by their competencies, skills, and expertise, assessed by a committee of experts?
Comp_3	Do you think that there is a suitable and formal set of criteria and procedures for the selection and appointment of SSB members?
Int_1	Specify the extent of shareholders' interest in adherence to <i>Shari'ah</i> compliance.
Int_2	Specify the extent of the management's or the Board of Directors' interest regarding the adherence to <i>Shari'ah</i> compliance.
Int_3	Specify the extent of SSB members' interest regarding the adherence to <i>Shari'ah</i> compliance.
Int_4	Specify the extent of employees' interest in adherence to <i>Shari'ah</i> compliance.
Int_5	Specify the extent of the central bank's interest in adherence to <i>Shari'ah</i> compliance.
Int_6	Specify the extent of customers' interest in adherence to <i>Shari'ah</i> compliance.
CCD_1	Do you think that the IFI releases a chart detailing its governance structure, encompassing the SSB?
CCD_2	Do you think that the IFI possesses a documented policy outlining <i>Shari'ah</i> review procedures, quality assurance, and reporting?
CCD_3	Do you think that the SSB has a well-defined and documented code of conduct that outlines the responsibilities, appointment, composition, the selection of SSB members?

CCD_4	Do you think the credibility of the SSB is established through the enforcement of its code of conduct?
CCD_5	Do you think the SSB adheres to the code of ethics outlined by standard-setting bodies like IFSB and AAOIFI?
CCD_6	Do you think the SSB adheres to global or conventional ethical standards alongside the institution's specific code?
Succ	How would you rate your opinion on the success of the overall <i>Shari'ah</i> Governance within your institution??

**Table 2: Survey Questions**

The study examined the relationships between the participant's perceptions of the level of success of the institutions they are affiliated with in *Shari'ah* governance, the expertise, and abilities of SSB members, stakeholders' interest in the level of *Shari'ah* compliance, and the quality of institutions' codes of conduct.

### Findings

Correlation analysis was performed to determine the relationships between the abovementioned variables. The results obtained are shown in Table 3.

The correlation analysis results showed that the success level of the participants' organizations in the context of *Shari'ah* governance is related to all variables analyzed except the customers' and shareholders' level of interest in *Shari'ah* compliance.

Accordingly, there is a robust linear relationship between the members of the SSB having adequate and necessary skills, their selection based on their skills and expertise, and their appointment based on the proper and adequate criteria and the success of the institutions in *Shari'ah* governance. This demonstrates the importance of the members of the SSB in *Shari'ah* governance. Ensuring members have the necessary qualifications and being objectively selected based on predetermined criteria can be seen as the first step to achieving success in *Shari'ah* governance.

In addition, stakeholders' interest in *Shari'ah* compliance is moderately related to the success of institutions in *Shari'ah* governance. Accordingly, the interest shown by management and the BOD, members of the SSB, and employees in *Shari'ah* compliance enable institutions to be successful in *Shari'ah* governance. In addition, the interest of central banks as a regulatory body in *Shari'ah* compliance may also affect the success of *Shari'ah* governance. On the other hand, the level of shareholders' and customers' interest in *Shari'ah* compliance does not have a relationship with the success of

**Table 3: Correlation Coefficients**

	Succ	CCD <sub>6</sub>	CCD <sub>5</sub>	CCD <sub>4</sub>	CCD <sub>3</sub>	CCD <sub>2</sub>	CCD <sub>1</sub>	Int_6	Int_5	Int_4	Int_3	Int_2	Int_1	Com <sub>n3</sub>	Com <sub>n2</sub>	Com <sub>n1</sub>	
																	Com
															1,00	1,00	Com
															0,83*	0,70*	Com
															0,66*	0,66*	Com
													1,00	0,07	0,15	0,23*	Int_1
												1,00	0,52*	0,36*	0,43*	0,42*	Int_2
											1,00	0,51*	0,16	0,46*	0,43*	0,52*	Int_3
										1,00	0,25*	0,46*	0,37*	0,39*	0,37*	0,33*	Int_4
									1,00	0,53*	0,30*	0,34*	0,13	0,42*	0,45*	0,39*	Int_5
									1,00	0,17	0,24*	0,22*	0,20*	0,10	0,19*	0,17	Int_6
							1,00	0,07	0,31*	0,33*	0,37*	0,36*	0,39*	0,40*	0,43*	0,52*	CCD
							1,00	0,62*	0,30*	0,27*	0,48*	0,34*	0,18	0,62*	0,49*	0,53*	CCD
							1,00	0,77*	0,44*	0,40*	0,57*	0,52*	0,24*	0,64*	0,55*	0,48*	CCD
							1,00	0,87*	0,43*	0,28*	0,51*	0,42*	0,21*	0,61*	0,52*	0,46*	CCD
							1,00	0,73*	0,34*	0,31*	0,43*	0,38*	0,21*	0,50*	0,33*	0,35*	CCD
							1,00	0,67*	0,32*	0,26*	0,30*	0,36*	0,25*	0,27*	0,23*	0,31*	CCD
1,00	0,27*	0,44*	0,52*	0,55*	0,53*	0,36*	0,19	0,51*	0,33*	0,44*	0,36*	0,01	0,61*	0,56*	0,54*	Succ	

\* Valid at 5% significance level

\*\* Valid at 1% significance level

*Shari'ah* governance. Thus, it is understood that the attitudes of shareholders and customers must be sufficiently effective in the *Shari'ah* governance of institutions.

Finally, the code of conduct in the institution or the relevant field was also found to be related to the success of institutions in *Shari'ah* governance. Accordingly, publishing a chart that details its governance structure, encompassing the SSB; having a documented policy outlining *Shari'ah* review procedures, quality assurance, and reporting; having a well-defined and documented code of conduct that outlines the responsibilities, appointment, composition, the selection of SSB members are moderately related to the success of the institution in *Shari'ah* governance. Additionally, SSB follows a Code of Ethics published by standard-setting bodies such as IFSB and AAOIFI. SSB following an international/conventional code of ethics in addition to the institution's specific code is also related to the success of *Shari'ah* governance. So, the rules that determine the actions and responsibilities of the employees of the organizations and SSB members are influential on the success of *Shari'ah* governance. Here, it is necessary for organizations to first determine the relevant codes of conduct based on the standards published by the relevant national and international institutions and then implement them effectively to be successful in the context of *Shari'ah* governance.

A multiple regression analysis was conducted to identify the predictors of success of institutions in *Shari'ah* governance. Here, the aim is to determine the variables that can explain the success of institutions. Since there are many variables within the scope of the study, the stepwise method was chosen as the regression method. The results of the analysis are presented in Table 4.

As a result of the analysis, three valid models were obtained. First, having a well-defined and documented code of conduct that outlines the responsibilities, appointment, composition, the selection of SSB members was included in the model as a predictor of success in *Shari'ah* governance. This shows that this variable is the most important predictor. The variable of central banks' level of interest in *Shari'ah* compliance is added to the next model. Finally, the final model is constructed by adding the variable that institutions have documented policies outlining *Shari'ah* review procedures, quality assurance, and reporting. Thus, as predictors of the success of institutions in the context of *Shari'ah* governance, the presence of correct and appropriate criteria for the selection of *Shari'ah* supervisory board members, central banks' level of interest in *Shari'ah* compliance, and institutions' having written rules on *Shari'ah* control processes and quality assurance were identified. These three variables can explain about 50% of the variability in the success of *Shari'ah* governance. Of these variables, having the

suitable and appropriate criteria for selecting the members of the *Shari'ah* supervisory board is more critical than the other variables. In addition, central banks' interest level in *Shari'ah* compliance is more explanatory than having written rules on *Shari'ah* control processes and quality assurance.

**Table 4: Multiple Regression (Stepwise)**

	F	R <sup>2</sup>	Variable	Coefficient	Standardized Coefficient	t Value
Mode 11	51,437**	0,372	Constant	1,589		5,660**
			Comp_3	0,549	0,610	7,172**
Mode 12	36,933**	0,462	Constant	1.090		3,725**
			Comp_3	0,416	0,462	5,248**
			Int_5	0,278	0,335	3,804**
Mode 13	28,211**	0,499	Constant	0,720		2,248*
			Comp_3	0,294	0,326	3,222**
			Int_5	0,265	0,319	3,715**
			CCD_2	0,238	0,240	2,501*

\* Valid at 5% significance level

\*\* Valid at 1% significance level

\*\*\* Valid at 1% significance level

## Discussion

According to the correlation analysis, the level of interest among shareholders and customers, categorized as external competencies, might not exhibit a direct correlation due to several reasons:

- Shareholders and customers often assume that products and services offered by institutions comply inherently with *Shari'ah* principles. Hence, they might believe that their engagements naturally align with Islamic values. Impressions of the customers and the community can be shaped by the IFIs' consistent practices and the products they supply. This also contributes to determining stakeholders' credibility and confidence in the industry.<sup>70</sup>
- Immediate financial needs for customers and profit maximization for shareholders might take precedence, relegating their interest in *Shari'ah* compliance to a secondary consideration. In such instances, customers or shareholders might engage in 'fatwa shopping,'<sup>71</sup>i.e., the endeavour to find products with *fatāwā* to achieve their goals, mirroring institutional behavior.

- A lack of information or technical knowledge regarding the subject could also be a factor. If customers or shareholders possess lower levels of Islamic financial literacy (which has yet to be measured in available data), their understanding might be limited. Several studies indicate that Islamic financial literacy positively impacts the selection of Islamic banks and products. The higher the literacy level, the greater the inclination towards choosing *Shari'ah*-compliant products.<sup>72;73</sup>

The study's findings indicate that the success of SG and SSBs predominantly relies on several internal competencies, including the expertise of the SSB, transparent appointment criteria, and established codes of conduct. This reinforces findings similar to those of Hamza (2013)<sup>74</sup>, who, while elucidating the connection between *Shari'ah* supervision and compliance, identified the significance of independence and consistency in SSBs for effective *Shari'ah* governance. Another study revealed a diverse range of evidence concerning the independence of *Shari'ah* Supervisory Board (SSB) members and its influence on *Shari'ah* governance. It highlighted instances where SSBs needed more authority in certain Islamic Financial Institutions (IFIs) and where members were perceived as lacking independence due to their selection and appointment by the Board, leading to dependency on management for implementing *Shari'ah* governance strategies. Conversely, the study underscored the importance of SSB independence for the success of *Shari'ah* governance. Furthermore, the authors emphasize that the need for more independence of SSBs in their functions contradicts agency, stakeholder, and legitimacy theories. They suggest SSB members should be recruited by the Annual General Meeting of the relevant Islamic bank or the central bank. Given that Islamic banks are committed to providing services according to *Shari'ah* principles, it is imperative to prioritize the independence of SSBs. Policymakers, such as the central bank, can establish an independent *Shari'ah* rating agency and take various steps to ensure that actual practices align with *Shari'ah* compliance.<sup>75</sup>

Furthermore, another study corroborates our findings by identifying additional critical outcomes of *Shari'ah* Supervisory Boards (SSBs) that contribute to the success of *Shari'ah* governance. It reveals that three key characteristics of the SSB—namely, size, educational level, and expertise—significantly influence the strategic market positioning of Islamic banks. This reinforces the notion that the success of *Shari'ah* governance plays a crucial role in determining market positioning.<sup>76</sup>

Another study investigated the influence of SSBs on banks' risk-taking behaviour, with results that align surprisingly well with both the previous study and the findings of this study. It reveals that

the size of SSBs and the proportion of active members positively and significantly affect Islamic banks' asset returns and insolvency risks. Moreover, foreign members are more effective in monitoring banks' *Shari'ah* compliance, possibly due to their greater concern for job security and reputation.<sup>77</sup>

In a study investigating the duties and function of SSBs in governance, the findings underscore the vital role played by SSBs in the success of *Shari'ah* governance. It can be inferred from this study that a clearly defined mandate and the careful selection of SSB members can positively contribute to the success of *Shari'ah* governance.<sup>78</sup>

Furthermore, studies demonstrate that the presence and effectiveness of *Shari'ah* Supervisory Boards (SSBs) significantly impact Islamic banks' corporate social responsibility (CSR) initiatives. This indicates that SSBs serve as essential indicators for Islamic Financial Institutions (IFIs), influencing the success of *Shari'ah* governance and CSR practices.<sup>79</sup>

External competencies, particularly the level of interest among customers and shareholders, exhibit varying degrees of effectiveness. The BOD and management play moderately influential roles, while the shareholders' and customers' interest levels are deemed ineffective.

There are studies indicating that the objectives of BOD and SSBs may diverge. One study suggests that joint meetings between BOD and *Shari'ah* board members could compromise the financial soundness of Islamic banks. According to the findings, this relationship increases conflicts of interest and agency costs. However, the presence of a *Shari'ah* scholar at Board meetings and a manager at SSB meetings only significantly affects the financial soundness of Islamic banks.<sup>80</sup> *Shari'ah* Supervisory Boards (SSBs) indirectly influence the practices, decision-making processes, and functions of the Boards of Directors (BOD), management, and other activities. Despite ethical and moral standards advising against such influence, this study reveals that BOD acknowledges its occurrence. Furthermore, BOD emphasizes its utilization of SSBs as a showcase and rubber stamp to achieve its objectives.<sup>81</sup> This suggests partial support for the findings of this study within the existing literature.

A robust *Shari'ah* governance framework is crucial for IFIs, shareholders, and customers. *Shari'ah*-compliant products are vital for customers and shareholders to align with their worldview. While indirect evidence of this exists in one study<sup>82</sup> Our study needs to yield more results on this matter. Research suggests, albeit lacking direct evidence, that various stakeholders such as the CEO, blockholders,

owners, BOD members, and *Shari'ah* boards may impact the credit ratings of Islamic banks. According to this research, there is a negative correlation between the number of blockholders owning at least 5% of Islamic banks' shares and credit ratings and foreign ownership. Conversely, there is a positive correlation with the percentage of seats on the *Shari'ah* board.<sup>83</sup>

Nevertheless, it should not be inferred those shareholders and customer have no impact on the success of SG. The implicit influence of customers and shareholders, or the demand for *Shari'ah*-compliant products/services, could render the supply of such products and services crucial for IFIs. This intriguing result warrants further exploration in subsequent studies.

### **Conclusion**

The *Shari'ah* governance framework within IFIs involves organizational arrangements ensuring comprehensive oversight, responsibility, and accountability across the BOD, management, and the SSB. SSBs assume a pivotal role within IFIs, overseeing and supervising operations to ensure stringent compliance with *Shari'ah* principles, significantly impacting the institution's compliance procedures. The credibility of SSBs is deeply rooted in the core principles of *Shari'ah* governance in IFIs. Hence, safeguarding the independence and objectivity of SSBs, as they demonstrate steadfast commitment to *Shari'ah* compliance, becomes imperative to maintain their integrity and credibility in the Islamic financial sector. This emphasis on the independence and objectivity of SSBs upholds the fundamental values of *Shari'ah* governance, ensuring the trust and reliability of IFIs within the industry.

This study sought to evaluate SSB performance and *Shari'ah* governance in Islamic financial institutions using a comprehensive survey. It emphasizes the relevance of specific components in determining the degree of success of *Shari'ah* governance. Notably, the study showed how crucial it is to have a robust and transparent code of conduct that describes the roles, responsibilities, and nominations of members of the SSB as an essential requirement for establishing effective *Shari'ah* governance.

The results highlight how vital SSB members are to the efficient operation of *Shari'ah* governance in IFIs. It emphasizes how crucial it is to choose eligible board members according to specific standards to implement *Shari'ah* governance successfully. Additionally, stakeholders' interest, including management, the BOD, and employees, moderately affects *Shari'ah* governance success. Notably, central banks' interest in *Shari'ah* compliance also plays a role. However, shareholders' and customers' interests show

no significant correlation with *Shari'ah* governance success. This suggests that although the attention of regulatory agencies and the involvement of stakeholders are essential, the attitudes of shareholders and customers have little influence on *Shari'ah* governance in these institutions.

Despite the authors' efforts to offer a comprehensive and engaging exploration of *Shari'ah* governance success, the study encountered several research limitations. Firstly, while ample literature exists on SG, research on the determinants of *Shari'ah* governance success is scarce. Secondly, there is limited evidence regarding the impact of other stakeholders, such as shareholders, customers, etc., whom we categorize as external competencies, on SG's success. We propose that further investigation into these and other determinants of SG success should be pursued in future studies. This constitutes an essential agenda for countries and IFIs to establish a robust *Shari'ah* governance framework.

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