



THE ROLE OF THE SHARIA SUPERVISORY BOARD AND THE SIZE OF ISLAMIC BANK ON THE PERFORMANCE OF SHARIA BANKS IN INDONESIA

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Article Info	Abstract
<p>Article History</p> <p>Received: 10 May 2023</p> <p>Accepted: 10 June 2023</p> <p>Published: 30 June 2023</p>	<p><i>This study aims to examine the role of the Sharia Supervisory Board and the size of Islamic banks on the performance of Islamic Commercial Banks in Indonesia. The characteristics of the Sharia Supervisory Board (SSB) are proxied by the variables of the size of the SSB, Concurrent Positions of the SSB, the Meetings of the SSB and the Educational Background of the SSB. This study used panel data of Islamic commercial banks from 2015 to 2020 using purposive sampling. The data analysis technique used panel data regression through the common effect model using the software views. The test results show that the variables of SSB concurrent positions, SSB meetings, educational background SSB and the size of the bank significantly affect the performance of Islamic commercial banks. Meanwhile, the size of the SSB have no effect on the performance of Islamic commercial banks. Multiple positions have a positive effect on the direction of the relationship, while the SSB meeting and SSB educational background have a negative effect on the performance of Islamic commercial banks.</i></p> <p>Keywords: <i>Characteristics of SSB, size of SSB, Concurrent Position of SSB, SSB Meetings and Educational Background of SSB, Size of Islamic Banks, Performance of Islamic banks.</i></p>

INTRODUCTION

The development of Indonesia's total sharia financial assets has increased quite significantly in recent years, reaching US\$99 billion. This number of assets makes the total assets of Islamic finance in Indonesia the seventh largest in the world (LPKSI, 2020). During the Covid-19 pandemic, the performance of Islamic Commercial Banks (ICB) during 2020 showed a significant decline where in 2019 the ROA value decreased from 1.73 to 1.4 in 2020. The trend of Islamic bank performance based on ROA can be seen in the following graph of Islamic banks.

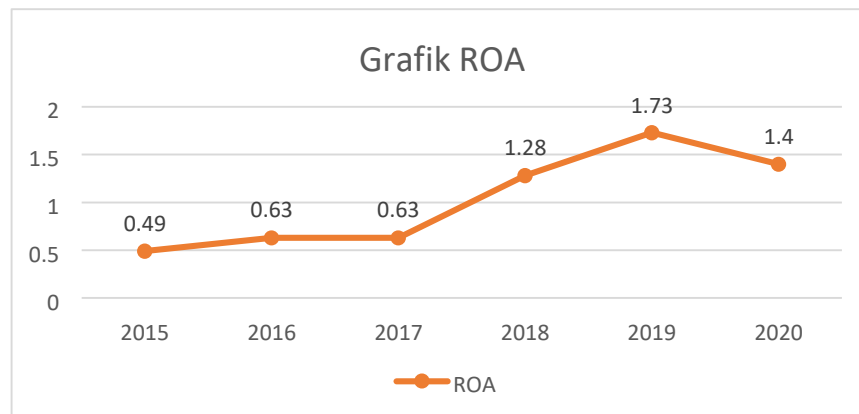


Figure 1. Graph of ROA 2015-2020
Source: Financial Services Authority (2020)

From the graph above, it can be seen that there is an increasing trend from 2015 to 2019, but in 2020 it decreases. The decline in 2020 is more due to the covid 19 pandemic. This development cannot be separated from the role of the Sharia Supervisory Board. Baklouti (2020) reveals that strong SSB in Islamic banks can be an alternative mechanism that protects depositors from excessive institutional risk-taking behaviour. For this reason, depositor confidence in Islamic banks through strong Sharia Supervisory Board vigilance is an important element in Islamic finance, as it can reduce liquidity risk.

The Sharia Supervisory Board (SSB) is the most important element of corporate governance used by Islamic banks as a legal control body to ensure compliance with Sharia; SSB has supervisory and consultative responsibilities (E. R. Ahmed et al., 2013). The main function of SSB is to conduct independent audits and monitor (ex-post) bank operations and prove (ex-ante) that they are free from actions that are prohibited by Sharia. (E. R. Ahmed et al., 2013).

According to Han *et al.*, (2020), the efficiency of the Sharia Supervisory Board as a mechanism for influencing management decisions, refers to agency theory. In fact, the former assumes that the SSB reduces coordination and communication problems between members, implying more effective management control. Kasim *et al.*, (2013) argues that SSB independence is very important to build stakeholder trust in Islamic banks in terms of compliance with Sharia rules and principles so as to improve performance.

The quality of the Sharia Supervisory Board is determined in the literature by various variables such as size, reputation, education, experience, and information disclosed (Rahman & Bukair, 2013). In the SSB context, it is easier for directors and management to control smaller SSB in Islamic banks compared to larger SSB. Larger SSB imply SSB members are moslem scholars

with various skills from various schools of *fiqh* and with rich experience, leading to better interpretation of products and operations and in fact better performance (Hamza, 2015).

However, several empirical studies have examined the impact of SSB size on Islamic bank performance such as the studies of Aisyah *et al.*, (2022) and Mollah and Zaman, (2015) they find that SSB size has a significant impact on Islamic bank profitability. Meanwhile, multiple SSB positions may have a negative impact on board effectiveness, and then lead to conflicts of interest because they have access to proprietary information (Garas & Pierce, 2010). However, several other researchers argue that cross-membership exposes SSB members to more debate regarding the practice of sharia law in the sharia banking industry, which in turn can support their knowledge of the application of sharia rules (Farook & Lanis, 2011). Banaga *et al.*, (1994), state that one of the SSB functions is to hold regular meetings to discuss all questions received from the whole community. Previous studies on Sharia governance have shown that there is a positive and significant relationship between the frequency of SSB meetings and the performance of the SSB as measured by issued instruction (Garas, 2013). There is, however, research suggesting that regular meetings can contribute to negative performance because the majority of meetings are dominated by protocol, especially in the case of independent members who will spend most of their time trying to understand company issues (Vafeas, 1999). SSB educational background is very important in overseeing the Islamic banking industry where knowledge is needed such as Islamic law, economics, and financial and accounting practices (Rahman & Bukair, 2013).

LITERATURE REVIEW

Agency Theory

Corporate governance research is often based on agency theory. According to Eisenhardt (1989), reveals agency theory in corporate governance companies are used to reduce agency risk. Constitutionally, agency theory examines the relationship that exists between individuals (managers) and the way they are contracted to work for the interests of owners (principals) and also about the conflicts of interest that arise.

SSB has a significant role in corporate governance in Islamic banks. Several researchers have shown this, including research by Garas and Pierce, (2010), stating that the Sharia Council is a group of Islamic scholars, appointed by shareholders and similar to the council. The Sharia Supervisory Board (SSB) has the advantage of being close to the market, competent, independent, and empowered to approve new Shariah-compliant instruments, and SSB can enable innovations that may emerge within Islamic banks.

According to Grais and Pellegrini, (2006) and Ahmed, (2014) in issuing their instruction, SSB can be guided by standard contracts and practices that can be aligned with professional association arrangements. Such a framework can ensure adequate consistency of interpretation

and increase the enforceability of contracts before the courts (H. Ahmed, 2014). The review of transactions will be entrusted mainly to the internal review unit, which will collaborate with the external auditor responsible for issuing an annual opinion on whether the activities of the institution comply with its sharia requirements.

The literature documents several characteristics of the SSB, such as size of the SSB, multiple positions, number of SSB meetings, qualifications of SSB members, which can impact the performance of Islamic banks (Farook & Lanis, 2011; Rahman & Bukair, 2013). SSB governance which may affect the company's performance. One of the main functions of the SSB is to decide whether to introduce a new financial instrument based on its compliance with Sharia requirements (Warde, 1998).

SSB Size and Sharia Bank Performance

SSB with a large size contains scholars with various experiences and skills, and *fiqh* schools which lead to better interpretation of products and operations, and subsequently, better performance (Hamza, 2015). Several empirical studies have examined the impact of SSB size on Islamic bank performance such as research by Aisyah *et al.*, (2022) and Mollah and Zaman, (2015) where they found that SSB size has a significant impact on Islamic bank profitability..

H1. SSB size has a positive effect on the performance of Islamic banks

SSB Meetings and Sharia Bank Performance

The intensity of board activity is measured by the frequency of board meetings, and the quality or effectiveness of their monitoring (Vafeas, 1999). Higher frequency of board meetings leads to higher quality of managerial monitoring, and therefore positively affects financial performance. Frequent meetings with informal side line interactions can create and strengthen cohesive bonds among directors, and will have a positive effect on company performance. Farida *et al.*, (2019) find a positive correlation between the frequency of SSB meetings and company performance. Thus, it is assumed that there is a positive correlation between the frequency of sharia supervisory board meetings and company performance. So that the hypothesis can be taken as follows.

H2. SSB meetings have a positive effect on the performance of Sharia banks

Concurrent Positions and Performance of Sharia Banks

One of the most prevalent issues in Sharia banking in corporate governance studies is 'cross-directorships' which implies that directors sit on more than one board (Sulistyawati *et al.*, 2020). Companies can be connected to the external environment through director interlocks because cross-membership allows interlocked directors to monitor external companies and disseminate information about these companies. Directors provide an important resource for the company (Nugroho, 2020), so that interrelated board members can be considered as a source of information

about other company activities and policies (Nugroho, 2020). Likewise, cross-membership is an important feature of SSB in Islamic banks (Rahman and Bukair, 2013) because most SSB scholars sit on several boards of different Islamic banks at the same time (Sulistiyawati et al., 2020). Membership across SSB affects their efficiency positively by increasing their knowledge and experience, and then improving the performance of Islamic banks (Sulistiyawati et al., 2020). Repetition of several SSB names helps in attracting new customers, thereby increasing the productivity and efficiency of Islamic banks. So that the hypothesis is as follows.

H3. SSB Concurrent Positions have a positive effect on the performance of Sharia banks

SSB's Educational Background and the Performance of Sharia Banks

Most SSB have a lack of experience in banking which affects their ability to make sound decisions about financial products and activities. Therefore, many have replaced their entire SSB because the moslem scholars have limited knowledge and exposure to both Sharia principles and product knowledge, and therefore, they are unable to function properly (Bakar, 2013). Corporate governance assumes that the company board provides important resources for the company (Nugroho, 2020), such as experience (H. Abdullah & Valentine, 2009), which in turn can improve company performance. In relation to SSB members, scholars who have financial knowledge and experience are more effective in their performance compared to scholars who do not have this ability (Rahman & Bukair, 2013). Indeed, the majority of SSB members are Islamic scholars, and only a few of them have expertise in accounting, banking, economics and finance (W. A. W. Abdullah et al., 2015). SSB who have knowledge in finance can have a positive and significant impact on performance because knowledge in Sharia law in addition to knowledge in business, accounting and finance helps them in improving the performance of Sharia banks. So that the hypothesis is as follows.

H4. SSB educational background has a positive effect on the performance of Islamic banks

The Size of Sharia Banks and the Performance of Sharia Banks

Bank size can be assumed to affect its market share. Large banks that have a large proportion of total assets have a large market share resulting in high profitability (Umiyati & Baiquni, 2018). Herawati, (2021) shows that bank size has a statistically significant impact on the profitability and stability of Pakistan's commercial banks. This finding is supported by the findings of Herawati, (2021) stating that bank size has a significant positive effect on profitability. Wasiuzzaman and Nair (2013) in their comparative study between the performance of Islamic and conventional banks in Malaysia determined that bank size is the main determinant of financial performance in Islamic and conventional banks. This finding is also confirmed by Awo *et al.*, (2019) in Ghana who observed a statistically significant effect of bank size on financial performance. So that the hypothesis is as follows.

H5. The size of Sharia banks has a positive effect on the performance of Sharia banks

METHOD

The selection of this research method was a quantitative method. The quantitative method can be interpreted as a research method based on the philosophy of positivism, used to examine certain objects by collecting data using research instruments, analysing statistical data, aiming to describe the influence and test the relationship between variables (Sugiyono, 2014). The type of data in this study used secondary data. The data collected was Sharia Supervisory Board data proxied by (size of SSB, SSB meetings, SSB concurrent positions, SSB’s educational background) and financial performance proxied by Return On Assets (ROA) obtained from annual financial reports for the period 2015 to 2020 in each bank's website. The following is the measurement formulation for each variable:

Table 1. Variable and Variable Measurement

Variable	Measurement	Scale
Performance of Sharia Banks	ROA (Return On Asset)= Total profit after tax divided by total assets	Ratio
Size of SSB	The number of SSB in Islamic banks	Nominal
SSB Meeting	The number of meetings held by SSB in one year	Nominal
Concurrent positions of SSB	Number of other positions held other than SSB	Nominal
SSB Educational Background	Number of SSB members who have economic/financial education	Nominal
Size of Sharia Bank	Natural logarithm of total Sharia bank assets	Nominal

RESULTS & DISCUSSION

RESULT

The research was conducted at Sharia Commercial Banks in Indonesia in 2015-2020. The results of the descriptive analysis can be seen from the following table:

Table 2. Result of Descriptive Analysis

	ROA	UDPS	RDPS	JDPS	PDPS	LN_ASET
Mean	1.042024	2.261905	13.13095	4.142857	1.000000	30.05452
Median	0.885000	2.000000	12.00000	4.000000	1.000000	29.80000
Maximum	13.60000	3.000000	27.00000	6.000000	2.000000	32.47000
Minimum	-20.13000	2.000000	7.000000	3.000000	0.000000	27.22000
Std. Dev.	4.430840	0.442312	3.999337	0.837996	0.537733	1.235219
Skewness	-1.019508	1.083061	1.428904	0.469099	0.000000	-0.148097
Kurtosis	9.983505	2.173021	5.515920	2.764706	3.500000	2.621668
Jarque-Bera	185.2442	18.81592	50.73923	3.274527	0.875000	0.808030
Probability	0.000000	0.000082	0.000000	0.194512	0.645649	0.667634

Sum	87.53000	190.0000	1103.000	348.0000	84.00000	2524.580
Sum Sq. Dev.	1629.484	16.23810	1327.560	58.28571	24.00000	126.6385
Observations	84	84	84	84	84	84

Source: Data Processed (2023)

Test of Best Model Determination

Panel data regression test is used to select the best model. Panel data is observational data that combines time series data and cross section data. Time series means that the data consists of several periods and cross section means that the data consists of several objects. The following is the most appropriate model, namely using the common effect model (CEM) after using the test:

1. Test of LM

Table 3. Test of LM Breusch-Pagan

	Test Hypothesis		
	Cross-section	Time	Both
Breusch-Pagan	1.198419 (0.2736)	0.075681 (0.7832)	1.274100 (0.2590)

Source: Data Processed (2023)

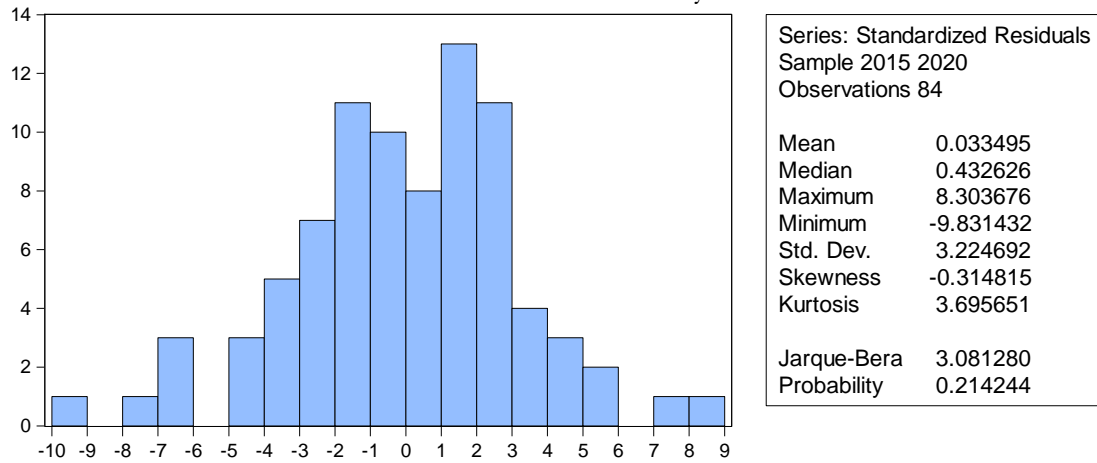
From the results of the LM test on a random cross-section, a probability value of 0.2736 > 0.005 is obtained, so H₀ is rejected. So the results show that the common effect model is the chosen model. Next, to conduct a classic assumption test on the results of the common effect model.

Test of Classic Assumption

Normality Test

Normality test is conducted to see the regression model between the dependent and independent variables with normal distribution. This study applied the Jarque-Bera test to test normality. The basis for decision making in the normality test is the significance value of > 0.05. It can be concluded that the data is normally distributed. Meanwhile, if the significance value is <0.05, it can be concluded that the data is not normally distributed. The results of the normality test in this study are described in the table

Table 4. Result of Normality Test



Source: Data Processed (2023)

From the table of normality test results, it shows that the probability value is 0.214244 which is greater than 0.05. So that it can be said that the data is normally distributed. After knowing the data is normally distributed, then proceed with the next test

Result of Multicollinearity Test

Table 5. Multicollinearity Test

	ROA	UDPS	RDPS	JDPS	PDPS	LN_ASET
ROA	1.0000	-0.0579	-0.1864	0.1881	-0.2703	0.1195
UDPS	-0.0579	1.0000	-0.0809	0.2229	0.5066	0.3143
RDPS	-0.1864	-0.0809	1.0000	0.3574	-0.0560	0.0248
JDPS	0.1881	0.2229	0.3574	1.0000	0.3208	0.5342
PDPS	-0.2703	0.5066	-0.0560	0.3208	1.0000	0.5614
LN_ASET	0.1195	0.3143	0.0248	0.5342	0.5614	1

Source: Data Processed (2023)

In the table above, it shows that the correlation value for each independent variable has a value less than 0.8, so it can be seen that all independent variables; SSB Size, SSB Concurrent Positions, SSS Meetings, SSB’s Educational Background, and the size of Sharia banks can be concluded not to have occurred multicollinearity in this model.

Heteroscedasticity Test

Table 6. Heteroscedasticity Test

Variable	Coefficient	Std. Error	t-Statistic	Prob.
UDPS	0.139976	0.561081	0.249476	0.8036
RDPS	0.024660	0.058284	0.423103	0.6734

JDPS	-0.053379	0.312052	-0.171058	0.8646
PDPS	-0.341783	0.473288	-0.722145	0.4723
LN_ASET	0.054167	0.055338	0.978831	0.3307

Source: Data Processed (2023)

From the results of the table heteroscedasticity test, it reveals that the probability value for each independent variables; SSB size, SSB concurrent positions, SSB meetings, and SSB's educational background is greater than 0.05. So, it can be concluded that in this regression model there are no symptoms of heteroscedasticity.

The results of the panel data regression test can be seen in the table below:

Table. 7. Regression Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-23.87533	12.75774	-1.871439	0.0650
UDPS	0.434695	1.102212	0.394384	0.6944
RDPS	-0.384131	0.115447	-3.327351	0.0013*
**JDPS	1.871238	0.649422	2.881391	0.0051*
PDPS	-4.612993	1.034646	-4.458525	0.0000*
LN_ASET	0.859732	0.461708	1.862069	0.0664***
R-squared				0.308660
Adjusted R-squared				0.264343
F-statistic				6.964859
Prob(F-statistic)				0.000020

Significant Level: *1%, **5%, ***10%

Source: Data Processed (2023)

DISCUSSION

The Effect of SSB Size on Financial Performance

The results show that the SSB size variable has no effect on financial performance. In the t statistical test, a significance value of 0.694 is obtained, which is greater than $\alpha = 0.05$ with a positive coefficient value. It can be concluded that SSB size has no effect on the financial performance of Sharia banks.

The results of this study are not in accordance with research of (Farook & Lanis, 2011; Rahman & Bukair, 2013) where they find that SSB size has a significant impact on the profitability of Sharia banks. This finding is different because the highest number of SSB is three people and on average only has two SSB. The small number of SSB and the small number of economic backgrounds means that the size of the SSB has no effect on the performance of Sharia banks.

The Effect of Concurrent Positions of SSB on Financial Performance

The results show that the concurrent position of SSB variable has an effect on financial performance in the t statistical test, a significance value of 0.0000 is obtained, less than $\alpha = 0.05$ with a positive coefficient value. It can be concluded that the concurrent position of SSB has a positive effect on the financial performance of Sharia banks.

The results of this study are in accordance with the research of Sulistyawati *et al.*, (2020) who find a positive correlation between the frequency of SSB meetings and company performance. So it can be assumed that there is a positive correlation between the frequency of sharia supervisory board meetings and company performance. Cross-membership exposes SSB members to more debate about the practice of Sharia law in the Islamic banking industry, which can thereby support their knowledge of the application of sharia rules to governance (Farook & Lanis, 2011). Membership across SSB affects their efficiency positively by increasing their knowledge and experience, and then improving the performance of Islamic banks..

The Effect of Sharia Supervisory Board Meeting on Financial Performance

The results indicate that the SSB meeting variable has an effect on financial performance. In the t statistical test, a significance value of 0,000 is obtained, less than $\alpha = 0.1$ with a negative coefficient value. Thus, it can be concluded that SSB meetings have a negative effect on financial performance

The results of this study are in accordance with research of (Farida et al., 2019; Vafeas, 1999) find that the frequency of SSB meetings has an effect on company performance. However, the effect is reversed, where the number of meetings has a negative effect on the performance of Islamic banks. This shows that the meetings are not very effective and reduce bank performance because meetings are held more frequently (Alsartawi, 2019). The data shows that meetings are held at least once a month. A research by Alsartawi, (2019) suggests that SSB meetings should be held every three months to discuss the most important quarterly financial reports and reports, which will reduce the cost of holding these meetings and increase the performance level of Islamic banks.

The Effect of SSB's Educational Background on Financial Performance

The results show that the SSB Education variable has an effect on financial performance in the t statistical test obtained a significance value of 0.000 less than $\alpha = 0.05$ with a negative coefficient value. It can be concluded that SSb education has a negative effect on financial performance.

The results of this study are in accordance with research by (Nugroho, 2020), finding SSB education has an effect on company performance. However, the effect is reversed, where education has a negative effect on the performance of Islamic banks. This is due to the fact that

most members of the SSB are religious scholars who do not have economic education. So, SSB education has a negative effect on the performance of Islamic banks. Most SSB members in banks are Islamic scholars, and only a few of them have accounting, banking, economics and finance expertise (W. A. W. Abdullah et al., 2015). Most SSB have a lack of experience in banking which affects their ability to execute well informed decisions about financial products and activities. Therefore, SSB with a scholarly educational background has a negative effect on bank performance.

The Effect of Sharia Bank Size on Sharia Bank Financial Performance

The results show that the variable size of Sharia banks has no effect on financial performance. In the t statistical test, a significance value of 0.0664 was obtained, which was greater than $\alpha = 0.05$ with a positive coefficient value. It can be concluded that the size of Sharia banks influences the financial performance of Islamic banks using a significance of 10%.

These results are consistent with the research of Awo *et al.*, (2019) revealing that the size of Sharia banks has a significant influence on the performance of Sharia banks. The results become significant using a significance of 10%. The size of Sharia banks has an influence on the performance of Sharia banks.

CONCLUSION

This study aims to examine the effect of the characteristics of the SSB which include the size of the SSB, the SSB meeting, the SSB 's concurrent positions, the educational background of the SSB and the size of Sharia banks on financial performance. From the test results, this shows that the variables of SSB concurrent positions, SSB meetings and SSB's educational background have a significant effect on the performance of Sharia commercial banks. Meanwhile, SSB size and bank size do not affect the performance of Islamic commercial banks. Concurrent positions affect the direction of a positive relationship, while SSB meetings and educational background of SSB have a negative effect on the performance of sharia commercial banks. The implication of this research is that Sharia banks can choose the criteria for SSB members in order to be able to improve the performance of Sharia banks. The limitation of this research is only using ROA as a performance measurement tool for Sharia banks. Suggestions for further research on measuring the performance of Sharia banks can use other indicators, such as *tobinq*, ROE and NPF.

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