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ACCOUNTING, CORPORATE GOVERNANCE & BUSINESS ETHICS | RESEARCH ARTICLE

The effect of board of directors and sharia supervisory board on zakat funds at Islamic banks in indonesia

Ataina Hidayati^{1*}, Ihsan Muhamad² and Marfuah Marfuah¹

Abstract: The purpose of this study was to analyze the impact of corporate governance on the distribution of zakat funds by Islamic banks in Indonesia. The study focused on two elements of governance: the characteristics of the board of directors (BOD) and the sharia supervisory board (SSB). Data were extracted from the annual reports of Islamic banks in Indonesia from 2011 to 2020 and analyzed using panel data regression in EViews. The results showed that the size and remuneration of the BOD and the size of the SSB had a significant positive effect on zakat funds, while the reputation of the SSB had no effect. This study contributes to the literature on the role of governance in improving the performance of Islamic banks by providing empirical evidence of the link between governance and increased zakat

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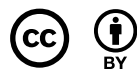
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PUBLIC INTEREST STATEMENT

The global pandemic caused Indonesia's economic performance to decline for two consecutive quarters, from the first quarter of 2020 to the second quarter of 2020. Furthermore, the number of poor people has also increased due to the pandemic. To fulfill their social responsibility, Islamic banks collect zakat funds from the public, which are then handed over to zakat institutions. As a result, the importance of zakat funds in improving people's welfare has been highlighted in several studies, which state that collected zakat funds are one measure of the social performance of Islamic banks. Previous studies examining the role of governance in Islamic banks were mostly focused on improving the economic performance of these banks. This study aims to expand on previous research and examine the influence of governance in Islamic banks in improving their social performance, as measured by zakat funds.



funds. While previous research has primarily focused on the role of governance in financial performance, this study highlights the importance of governance in the context of social responsibility. The practical implication of this study is that Islamic banks wishing to improve social performance, namely zakat funds, should consider designing a large BOD and large SSB structure, while also considering increasing BOD remuneration.

Subjects: Accounting; Corporate Governance; Corporate Social Responsibility & Business Ethics

Keywords: corporate governance; zakat performance

1. Introduction

The presence of Islamic banking in the global era is increasingly widespread. This is because people have started to realize the existence of Islamic banking (Antonio et al., 2012). Banks, including Islamic banks, play an important role in developing the economy, but without efficient and effective corporate governance, banks can turn into institutions that interfere the development and construction of the global economy (Mohamed, 2016). Islamic banks must carry out commercial functions as well as social functions. The dual role of Islamic banks is in accordance with the opinion of experts in the field of Islamic economics who state that the performance of Islamic banks should be measured more broadly including financial performance and social performance (Antonio et al., 2012; Asutay & Harningtyas, 2015; M. O. Mohammed & Taib, 2015). One of the mechanisms to achieve this performance is to implement a corporate governance mechanism. Although it is recognized that governance plays an important role in improving performance, Ulussever (2018) finds that the governance mechanism provides a weak explanation for changes in shareholder value in Islamic banks, indicating that conventional banks have a better and more effective governance system than conventional banks. This finding implies that there is still a need for studies related to the effectiveness of Islamic bank governance in improving performance.

The concept of corporate governance according to Amine (2018) is how companies are managed and protect the interests of their stakeholders. Corporate governance is a framework that protects the rights of stakeholders by establishing an effective board of directors, adequate internal controls, efficient audits, and reliable financial reporting and disclosure (Mohamed, 2016).

Several previous studies have examined and found the benefits of corporate governance in Islamic banking, namely 1) improving financial performance (Abdallah & Bahloul, 2021; Almutairi & Quttainah, 2017; Amine, 2018; Darwanto et al., 2019; Hakimi et al., 2016; Khalil, 2021; Khan & Zahid, 2020; Mollah & Zaman, 2015; Nawaz, 2019; Nomran et al., 2018); 2) reducing opportunistic/ earnings management behavior (Almutairi & Quttainah, 2020, p. 3; Elghuweel et al., 2017; Rahman & Bukair, 2013) increase disclosure (Albassam & Ntim, 2017; Elamer, Ntim, & Abdou, 2020a), 4) improve social performance (Iryani & Wahyudiono, 2020; Nugraheni, 2018). These previous studies imply, the study of the role of governance in Islamic banking is dominated by the role of governance in improving financial performance. However, the role of governance in improving the social performance has not received much attention from researcher, and therefore this study aims to analyze the role of governance in improving the social performance of Islamic banks as measured by the amount of distribution of zakat funds. Zakat shows social performance because by paying zakat, Muslims are able to help the poor. N. Abdullah et al. (2015) and Muhammad and Saad (2016) argue that zakat is effective in alleviating poverty. Nomran and Haron (2022) stated that zakat is one of the performance measurements of Islamic banks.

Previous studies outside Islamic banks that link governance and social performance/non-financial performance, namely: 1) examining the effect of governance and non-financial performance of cooperatives in Uganda (Kyazze et al., 2017); 2) examining the effect of governance and

social performance company (Harjoto et al., 2019; Shu & Chiang, 2020); 3) the effect of governance on social performance and environmental performance (Orazalin, 2019).

Similar to the governance structure of conventional banks, the governance structure of Islamic banking consists of a board of directors and a board of commissioners. To ensure that the bank's operating system complies with Islamic law, Islamic banks have a Sharia Supervisory Board (SSB) where this SSB is not owned by conventional banks (Grassa & Matoussi, 2014; Khalil & Chihi, 2020; Khalil & Taktak, 2020). The governance structure of Islamic banks pursues sharia compliance, which is strictly guided by the SSB (Mollah et al., 2017). Thus, it can be concluded that the main governance structures of Islamic banks are the board of directors (BOD), board of commissioners and SSB. Two (2) out of three (3) main governance structures, namely the Board of Directors (BOD) and SSB, will be the focus of this study.

One of the roles of corporate governance is to improve performance so that many previous empirical studies examined the effect of size of BOD on bank performance. Some previous studies found that size of BOD has a significant positive influence on financial performance (Almutairi & Quttainah, 2017; Amine, 2018; Darwanto et al., 2019; Hakimi et al., 2016; Nawaz, 2019; Sheikh & Kareem, 2015; Ulussever, 2018). Although the previous research described earlier found that the size of BOD had a significant positive effect on performance, other studies found different results, this implies the need for a study on the relationship between BOD size and performance. Mollah and Zaman (2015) and Elgadi and Ghardallou (2021) found that larger BOD will have a negative and significant impact on a bank's financial performance.

The BOD in carrying out its functions receives supervision, advice, and suggestions from SSB. One dimension of SSB quality is SSB size. Research by Nomran et al. (2018); Almutairi and Quttainah (2017); Amine (2018) found empirical evidence that SSB has a positive effect on financial performance. However, Nawaz (2019) found that SSB size has a negative effect on performance. To expand on previous research, this study analyzes the effect of SSB size on social performance measured by zakat funds.

Besides SSB size, another characteristic of SSB that has been widely studied is SSB reputation. Nomran et al. (2018) stated that the reputation of SSB has a positive effect on the performance.

Besides the governance structure, another mechanism to improve performance is remuneration. Previous research has found that executive remuneration affects financial performance (Amine, 2018; Lee & Isa, 2015; Pangestu et al., 2019). Nevertheless, other studies have shown different results. Research conducted by Kutum (2015); Ogbeide and Akanji (2006); Sheikh and Kareem (2015), shows that CEO remuneration has no effect on financial performance.

From the explanation above, it can be concluded that previous research on the influence of corporate governance (size of BOD, SSB size, and SSB reputation) showed inconsistent results which implied the need for a similar study to be carried out again. Likewise, the results of studies related to the effect of executive remuneration on performance. Therefore, the purpose of this study is to investigate the influence of two governance mechanisms, namely the BOD (size and remuneration), and the SSB (size and reputation) toward zakat funds.

This study contributes to previous research in several ways. First, research related to the influence of governance on the performance of Islamic banks is dominated by the influence of corporate governance on financial performance (Abdallah & Bahloul, 2021; Darwanto et al., 2019; Harisa et al., 2019; Khalil, 2021; Khalil & Chihi, 2020; Khalil & Taktak, 2020). This study examines the effect of governance on the social performance of Islamic banks, which in this study is measured by zakat funds. Nomran and Haron (2022) stated that zakat is a measure of bank performance. Previous studies related to the influence of governance examined the effect of governance on social performance. Johnson and Greening (1999) examined the effect of

governance on employee relations and product quality; Harjoto et al. (2019) examines the effect of governance on corporate social performance; Kyazze et al. (2017) examines the effect of governance on social performance of cooperative societies.

Second, previous research related to the effect of executive remuneration on social performance is associated with carbon performance (Haque & Ntim, 2020) and climate performance (Ritz, 2022). Perhaps, it is rare to find works that examine the influence of board remuneration in improving the social performance of Islamic banks, especially zakat funds. Thus, this study is expected to expand on previous studies and be able to show that executive remuneration is not only capable of improving financial performance but also able to improve social performance.

Third, Iryani and Wahyudiono (2020) have empirically tested the effect of governance on the social performance of Islamic banks in Indonesia. The social performance of Islamic banks is measured by qordhul hasan funds, while the current research uses zakat funds. Iryani and Wahyudiono's (2020) used the 2012–2016 observation period, the current study uses a longer observation period, namely 2011–2020. Nugraheni (2018) has also studied the effect of governance on social performance. The governance studied is only the structure of the SSB. In addition to examining the role of the SSB structure, this study also examines the role of the BOD size and BOD remuneration.

The rest of the paper is arranged as follows. First, it will explain the background of the study related to the management of zakat funds in Islamic banks in Indonesia. Next, a review of the theoretically and empirically relevant literature will be carried out for hypothesis development. The research design will be explained in the fifth section. The sixth section will explain the results of the study and discussion. The paper will end with a summary and conclusion section.

2. Background

At the beginning of 2020, a global pandemic known as Coronavirus Disease-19 (hereinafter referred to as Covid-19) was declared a health crisis, which quickly caused an economic crisis. The economic performance in Indonesia decreased for two consecutive quarters since the first quarter of 2020 as reflected in the economic growth rate in the first quarter of 2020, which only reached 2.97%. Worse, there was a significant decline in the second quarter in 2020 in which the growth rate was minus 5.32% (BPS Indonesian Central Bureau of Statistics, 2021). In addition, COVID-19 had an adverse effect, namely an increased poverty rate. The number of poor people in March 2020 reached 26.42 million people (9.78%), showing an increase by 0.37% compared to 25.14 million poor people in March 2019 (BPS/Indonesian Central Bureau of Statistics, 2021).

The government has established collaborations with private institutions to boost economic growth. Islamic financial institutions are expected to focus not only on profit but also on social principles in their daily operational activities, which should prioritize not only financial gains but also the fulfilment of their social obligations (Antonio et al., 2012; Asutay & Harningtyas, 2015; M. O. Mohammed & Taib, 2015). Islamic banks must be socially more responsible than conventional banks (Asutay & Harningtyas, 2015), and can contribute to reducing poverty among society both directly and indirectly (Hamidi & Worthington, 2021).

One of the roles of Islamic banks in fulfilling their social responsibility is the collection and distribution of the zakat fund. The financial reports of Islamic banks include reports on the sources and uses of zakat funds within a certain period of time, as well as the zakat funds that have not been distributed on a certain date. In terms of management, Law No. 23 of 2011 concerning Zakat Fund Management states that each person is prohibited from intentionally acting as an amil zakat, including collecting, distributing, or using zakat funds without the permission of an authorized official. Based on the provisions of this law and as an effort to fulfil their social responsibility, Islamic banks establish Zakat Collecting Units under the coordination of the National Zakat Amil Agency, usually called *Badan Amil Zakat Nasional (BAZNAS)*, a foundation that distributes zakat funds to the society. In addition, Zakat Collecting Units in Islamic banks may collaborate with the National Zakat Amil Institute, usually called *Lembaga Amil Zakat*

Nasional (LAZNAS). The collaboration with *BAZNAS* and *LAZNAS* shall be regulated through a Memorandum of Understanding (MoU), in which the management of the social responsibility programs of Islamic bank shall be aligned with the provisions of the applicable laws concerning zakat funds.

Islamic banking is one of the strategic institutions for collecting zakat because it has numerous offices spread throughout Indonesia. As of the end of December 2021, there were a total of 2,643 Islamic banking offices, consisting of 12 Islamic Commercial Banks with 2,035 branch offices, 21 Conventional Banks with Islamic Business Units (UUS) with 444 branch offices, and 164 Islamic Rural Banks (OJK Indonesian Financial Services Authority, 2021). According to Article 4, Paragraph 2 of Law Number 21 of 2018, Islamic banks are mandated to play social functions as well as commercial functions. These social functions are intended to improve social performance.

3. Theoretical literature review

3.1. Governance

Corporate governance is generally defined as a framework that protects the rights of stakeholders by depicting an effective BOD, internal controls, efficient audits, as well as accountable financial reporting and disclosure (Mohamed, 2016). In Islamic banking, the main external stakeholders consist of the Financial Services Authority usually called *Otoritas Jasa Keuangan, Bank Indonesia*, Indonesia Deposit Insurance Corporation, tax authorities, shareholders, bondholders, creditors, suppliers, customers, and community members who are affected by the company's activities. Meanwhile, the internal stakeholders consist of the BOD, and other employees. Regulations related to Good Corporate Governance (GCG) for banking in Indonesia are regulated in POJK No. 55/POJK.03/2016 concerning "Implementation of Governance for Commercial Banks" by implementing bank management procedures that apply 5 (five) principles, namely: transparency, accountability, responsibility, independence, and fairness.

The governance of Islamic banks is different from that of conventional banks. The governance structure of Islamic banks is designed in a way that it is sharia-compliant and it is monitored directly by SSB (Mollah et al., 2017) as well as compliant with a dual governance system monitored by SSB and Directors (Khalil, 2021).

BOD of an Islamic Bank is responsible for the continuity of business by maintaining the bank health by applying the principles of prudence, Islamic principles, and risk management. BOD of an Islamic bank has the same legal responsibilities as that of a conventional bank. In fact, the responsibility and expectations to BOD are greater by applying the Islamic finance principles (Grassa & Matoussi, 2014). BOD consists of the compliance director that seeks to ensure that Islamic banks are compliant with the applicable laws and regulations, including fatwas from the Indonesian Ulama Council. Non-compliance with Islamic principles is likely to reduce the bank health, thus bringing an effect on the performance of Islamic banks.

As mandated by Law Number 21 of 2018, Islamic Banks are obliged to have SSB whose job is to provide advice and recommendations to BOD and oversee bank activities to ensure that the bank activities comply with the Islamic principles. This is what distinguishes Islamic banks from conventional banks, i.e., the governance structure of Islamic banks is oriented to sharia-compliant characteristics and is strictly guided by SSB (Mollah et al., 2017).

3.2. Performance of Islamic banks

The performance of Islamic banks comprises financial performance and social performance. There have been many studies on the financial performance Islamic banks with commonly used proxies including ROA, ROE, Z-score, Net Performing Financing (NPF), CAMEL, etc. The analytical tools or ratios used in conventional banks can be adapted to Islamic banks and the results are quite successful (Badreldin, 2009).

Nomran and Haron (2022) and S. A. S. Mohammed and Muhammed (2017a) in their studies used zakat as an indicator to measure the performance of Islamic banks because it is quite dynamic to reflect the profitability of a bank. The more the profits generated by Islamic banks, the more the zakat paid. Therefore, zakat is a measure of both financial performance and social performance; it is also a good indicator to reflect the health of Islamic banks.

Zakat plays an important role in the development of society and the nation, as it is an economic catalyst that promotes justice (N. Abdullah et al., 2015). Hamidi and Worthington (2021) state that Islamic banking services, including zakat and qardhul hasan, aim to alleviate poverty and achieve other social objectives, although Islamic banking is still accused of failing to fulfil its commitment to social responsibility.

The zakat funds in Islamic banking source from zakat paid by the Islamic bank itself, its employees, and its customers over the profit-sharing or bonuses they receive from their deposits. In general, Islamic banks calculate the amount of zakat to be paid using a formula, i.e., 2.5% of profits before deducting zakat and income tax for one reporting year. The zakat funds from its employees are generally 2.5% of their gross monthly income. Meanwhile, the zakat funds from its customers are 2.5% of the profit sharing or bonuses received every month and or payments at any time.

Islamic banks serve as Zakat Collecting Units under the coordination of the National Zakat Amil Agency, even though some Islamic commercial banks establish foundations that manage the distribution of zakat funds. Islamic banks transfer or delegate zakat funds to particular foundations to help them distribute the zakat funds for social activities. However, in practice, these foundations may work together with other zakat amil institutions.

3.3. Agency theory

H. Abdullah and Valentine (2009) argue that Agency Theory underlies other theories that explain the role and need for corporate governance. Agency theory is a theory that explains that agency relationships emerge when one or more people employ other people to provide services, then delegate decision-making authority to agents (Jensen & Meckling, 1976). Agency theory views the company as the center of the contract between agents and principals (Jensen & Meckling, 1976). More specifically, this theory posits that agents are opportunistic, self-interest, risk averse, and work averse (Eisenhardt, 1989; Jensen & Meckling, 1976; Ross, 1973). Suppose the agent's behavior, coupled with the information inequality between the agent and the principal results in the formation of agency problems. The definition of an agency problem is a problem caused by the behavior of an agent who is self-interest and causes the agent to act contrary to the interests of the principal. Agency problems emerge because decision-making and risk functions are separated (Fama & Jensen, 1983).

Agency Theory is a branch of game theory that analyzes the design of contracts to motivate agents to act on behalf of the principal when the agents have conflicting interests with the principal (Scott, 2015). The Agency Theory developed by Jensen and Meckling (1976), shows that principals (shareholders) can convince themselves that agents (management) will make optimal decisions only if they are given the right incentives and monitored. Incentives include stock options, bonuses, and particular prerequisites that are directly related to the extent to which the results of the management decisions can satisfy the interests of the shareholders. Meanwhile, monitoring includes agent engagement, systematic review of management prerequisites, financial audits, and implementation of specific limitations on management decisions. This involves unavoidable agency costs incurred due to separating ownership and control over the company. However, such costs are not always bad for shareholders, but they must have efficient monitoring activities.

3.4. Stakeholder theory

Stakeholder Theory mentions that the success of a company is determined not only by principals (shareholders) and agents (management) but also other relevant parties, namely suppliers,

customers, and even competitors. The involvement of other parties is due to their ability to influence the company or vice versa, i.e., the fact that they can be influenced by the activities of the company.

Stakeholder Theory emphasizes the role of the company in always maintaining good relations with any parties related to it. It is important for the company to identify stakeholders they have relations with. The stakeholders for Islamic commercial banks include depositors, shareholders, government, employees, management, suppliers, and the community (Rahman & Bukair, 2013). Since the Stakeholder Theory was introduced by Edward Freeman in 1984, the theory has become the theoretical foundation in many studies on Islamic governance (Mohammed & Muhammed, 2017b).

In addition to improving financial performance, good governance may also increase social performance. For example, a company will be more motivated to pay zakat (Muhammad & Saad, 2016); the disclosure of Islamic Social Reporting (ISR) in the financial statements of Islamic banks is increasingly accountable and transparent (Hussain et al., 2021), and the disclosure of ISR can bring a significant effect on financial performance, leading to increased profitability in Islamic banks (Sarea & Salami, 2021).

4. Empirical literature review and hypotheses development

4.1. Effect of the size of BOD on zakat funds

The effect of BOD size on zakat funds can be explained by Agency Theory (Ross, 1973); Jensen and Meckling (1976); and Eisenhardt (1989). Agency Theory views the company as the center of the contract between agents and principals (Jensen & Meckling, 1976). More specifically, this theory argues that agents are opportunistic, self-interested, risk averse, and work averse (Eisenhardt, 1989; Jensen & Meckling, 1976; Ross, 1973). Agency Theory views monitoring systems and contract design to motivate agents to act on behalf of principals. In the relationship between size of BOD and zakat funds, BOD size is a monitoring system of agent behavior. Because the goal of Islamic banks is not only to achieve financial performance, but also social performance, so the BOD size will be able to encourage Islamic banks to achieve social performance (increasing zakat funds). The larger the size of the BOD, it allows BOD to have board members with varied educational and experience backgrounds including the understanding that zakat funds are one of the performance measures that must be achieved. Almutairi and Quttainah (2017) stated that larger boards are more likely to offer better recommendations to the chief executive officer (CEO), and thus are more beneficial to company performance.

In general, Agency Theory view that principals are shareholders. Unlike conventional banks which view shareholders as principals, Islamic banks are assumed to be established for the benefit of a wider stakeholders. Thus, the relationship between BOD size and zakat funds is not only explained by Agency Theory but also by Stakeholders Theory. In addition, Stakeholder Theory asserts that boards should serve the needs of a wider group of stakeholders and ensure that companies do not violate ethical standards or the rights and interests of stakeholders when making decisions (Almutairi & Quttainah, 2017). Stakeholder Theory states that the success of a company is determined not only by shareholders but also by other parties, including potential recipients of zakat funds. Stakeholder theory emphasizes the company's role in always maintaining good relations with any party, including the recipient of zakat funds.

Empirically, there have been many studies which showed that the size of BOD has a positive effect on the financial performance (Almutairi & Quttainah, 2017; Amine, 2018; Darwanto et al., 2019; Hakimi et al., 2016; Nawaz, 2019; Sheikh & Kareem, 2015; Ulussever, 2018). Based on Agency Theory, Stakeholder Theory and empirical studies that BOD size has a positive effect on financial performance, this study predicts that BOD size also has a positive effect on improving social performance, zakat funds. Therefore, the first hypothesis was proposed as follows:

H1: The size of BOD has a positive effect on zakat funds.

4.2. Effect of the remuneration of BOD on zakat funds

Agency theory analyses contract designs to motivate agents to act on behalf of the principal, when the agent has conflicting interests with the principal (Scott, 2015). Agency theory suggests that the principal can convince himself that the agent will make optimal decisions only if the agent is given an incentive. Incentives can be in the form of stock options or bonuses or other forms of financial incentives. Lee and Isa (2015) supported the opinion of Scott (2015) and state that the Agency Theory encourages executives to be paid based on performance, which is known as the executive remuneration mechanism. This executive remuneration is an effort to encourage agents to achieve company goals.

Remuneration has been regulated in Regulation of OJK (Indonesian Financial Services Authority) No. 59 of 2017 concerning Implementation of Governance in Providing Remuneration for Islamic Commercial Banks and Islamic Business Units. Remuneration is a reward given to BOD, which can be either fixed or variable. Fixed remuneration is not related to performance and risks, such as basic salary, health benefits, pensions, etc. On the other hand, variable remuneration is related to performance and risk, including bonuses or other equivalent forms, in the form of cash, shares, or share-based instruments issued by the Bank. Remuneration can motivate executives to achieve good financial performance (Scott, 2015). Sheikh and Kareem (2015); Lee and Isa (2015); Pangestu et al. (2019) stated that the remuneration of BOD had a positive effect on company performance. Several empirical studies have found that executive compensation has an effect on social performance. Haque and Ntim (2020) found that executive compensation has a positive effect on carbon performance. Kartadjudena and Rodgers (2019) suggest that higher executive compensation may motivate management to do more for climate and environmental concerns. Based on Agency Theory, empirical studies which state that executive remuneration can improve financial performance and social performance, this study predicts that BOD remuneration will be able to increase zakat funds. Therefore, the second hypothesis was proposed as follows:

H2: The remuneration of BOD has a positive effect on zakat funds.

4.3. Effect of size of SSB on zakat funds

Similar to the effect of BOD on zakat funds, the effect of SSB size on zakat funds is also based on Agency Theory. Agency theory views that corporate governance mechanisms are a good tool for minimizing conflict between parties and for preventing managerial opportunism. SSB is an independent body consisting of selected scholars in Fiqh Muamalat and is considered one of the most important elements of Shariah governance (Khalil & Taktak, 2020). Khan and Zahid (2020) state that SSB is involved in issuing fatwas on financial products that will be developed, conducting sharia audits, calculating zakat, disbursing, and distributing income that is not in accordance with sharia, guiding banks in their broader social roles, and acting as the backbone Islamic banking.

Furthermore, agency theory argues that SSB monitors many other aspects of management behavior (e.g., religion, morals, and ethics) (Almutairi & Quttainah, 2020). SSB also oversees and approves banking products, services, and transactions. SSB ensures that all bank activities comply with sharia principles. SSB also provides advice to managers in allocating resources. Thus, it can be predicted that a large SSB size can be seen as more powerful so that it will be able to encourage Islamic banks to achieve social as well as financial performance and allocate more funds to increase zakat funds.

SSB continuously guides and trains management to apply Islamic rules in daily transactions to avoid religious conflicts in business transactions with others. SSB also provides religious guidelines to the BOD to ensure compliance with sharia. Therefore, a large SSB size will be able to encourage

Islamic banks to carry out various programs and services so that the zakat funds collected are higher. SSB explains to managers how to distribute losses and profits between shareholders and investment account holders, implement new fatwas and distribute illegal profits to charities. The SSB is responsible for ensuring that zakat, which is a religious tax, is calculated and distributed according to Islamic law (Khalil & Taktak, 2020).

Regulation of Bank Indonesia Number 11 of 2009 concerning Islamic Commercial Banks states that the number of SSB members shall be a minimum of 2 (two) people or a maximum of 50% (fifty percent) of the total members of BOD. The regulation implies that SSB size is something that needs to be considered. A larger number of SSB members could more effectively monitor bank transactions and activities to ensure that they comply with Islamic principles and achieve the social functions of Islamic banks, thus reducing sharia risks and improving the performance of Islamic banks. Elamer et al. (2020b) found that SSB increased operational risk disclosure. Elghuweel et al. (2017) argues that companies that are highly committed to Islamic values tend to be less involved in earnings management. Elamer, Ntim, and Abdou (2020a) stated that Islamic corporate governance may have positive effect on risk manajemen disclosure. Based on the argument of empirical findings that Islamic governance is able to improve financial reporting performance, this study predicts that Islamic governance (SSB size) is able to increase zakat funds.

Specifically, previous studies found that the size of SSB has a positive effect on the financial performance of Islamic banks (Amine 2018; Darwanto et al., 2019; Nomran et al., 2018). Nugraheni (2018) found that SSB size affect positively social performance. Following theretical basis and empirical finding of the previous research, therefore, the third hypothesis was developed as follows:

H3 : The size of SSB has a positive effect on zakat funds.

4.4. Effect of reputation of SSB on zakat funds

The effect of SSB's reputation on zakat funds can be explained using the Resource Dependence Theory. Resource Dependence Theory assumes that company boards provide important resources for companies and then these resources will improve company performance (Hillman & Dalziel, 2003). Because human resources are one of the important resources and play an important role in improving company performance, reputation is technically attached to human resources that can be brought by board members to the company. Thus, there is a relationship between SSB members who have a good reputation and the performance of Islamic banks.

Resource dependency theory concentrates on the role of board directors in providing access to resources needed by the firm (H. Abdullah & Valentine, 2009). Resources can be in the form of expertise and experience. A reputable SSB reflects expertise and experience in Islamic banking. SSB's reputation causes SSB members to truly understand that Islamic banks are not only required to achieve financial performance but also social performance.

Based on article 32 of Law Number 21 of 2018, SSB shall be appointed by the General Meeting of Shareholders based on the recommendation of the Indonesian Ulama Council. A good reputation of SSB is used as a measure of business knowledge, which helps them have a better understanding of the modern application of the banking industry (Rahman & Bukair, 2013). Nugraheni (2018) states that selecting the SSB members among prospective candidates who have a good reputation expectedly improves the performance of Islamic banks, especially in terms of compliance with Islamic principles, including achieving better social performance. Nomran et al. (2018) found that the reputation of SSB had a positive effect on the financial performance of Islamic

banks. Nugraheni (2018) found that reputation of SSB affect positively social performance. Based on the argument of Resource Dependence Theory, an empirical study of the effect of SSB's reputation on financial performance, this study predicts that SSS's reputation can improve social performance in the form of zakat funds. Accordingly, the fourth hypothesis was developed as follows:

The reputation of SSB has a positive effect on zakat funds.

H4 :

5. Research design

The population of this study consisted of 14 Islamic banks in Indonesia. The study used purposive sampling based on the following criteria: 1) bank must be registered with the Financial Services Authority (OJK); 2) bank must publish annual reports from 2011 to 2020, including a Good Corporate Governance report; 3) bank must collect zakat funds consecutively from 2011 to 2020. Finally, a total of 7 banks met the requirements and were selected as the sample, providing a total of 70 observations. Banks that did not distribute zakat funds consecutively from 2011 to 2020, including Bank BJB Syariah, Bank Panin Dubai Syariah, Bank Syariah Bukopin, Bank BTPN Syariah, and Bank Aladin Syariah, were excluded. Bank Aceh Syariah and Bank NTB Syariah were also excluded because they started conducting Sharia activities after the study's time frame. The study period is only until 2020, because since 2021 Bank Syariah Mandiri, Bank BNI Syariah and Bank BRI Syariah have been merged to become Bank Syariah Indonesia.

The data were secondary and were in the form of annual reports for ten consecutive years (2011 to 2020), which were downloaded from the official website of each bank.

The dependent variable in this study was zakat funds, while the independent variables were governance, as indicated by the Board of Directors (BOD) and the Sharia Supervisory Board (SSB). The size and remuneration of BOD and the size and reputation of SSB were the characteristics considered. Bank profitability and size were the control variables. The measurement of the variables is described in Table 1.

The data were processed using Eviews 9 software. The panel data regression started by selecting the estimation method, namely the Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM). Then, to determine the best method of this approach, several tests including Chow test, Lagrange Multiplier test, and Hausman test were performed. After the model

Table 1. Variable measurement

Variables	Size
Dependent Variable:	
Zakat Funds	Distribution/Collection of zakat funds
Independent Variables:	
Size of BOD	Number of BOD members
Remuneration of BOD	Amount of remuneration received by BOD
Size of SSB	Number of SSB members
Reputation of SSB	Proportion of each SSB member as National Sharia Council - Indonesian Ulema Council
Control Variables:	
Profitability	Amount of net profits
Size of Bank	Amount of assets

Sources: Size of BOD based on Almutairi and Quttainah (2017); Hakimi et al. (2016; Nawaz (2019) ; Sheikh and Kareem (2015); Amine (2018) ; Ulussever (2018). Remuneration of BOD based on Sheikh and Kareem (2015); Lee and Isa (2015); Pangestu et al. (2019). Size of SSB based on Darwanto & Chariri (2019); Nomran et al. (2018); Amine (2018). Reputation of SSB based on Nugraheni (2018).

had been selected, the Classical Assumption test, model estimation, and hypothesis testing were performed. The final stage was to draw conclusions and propose recommendations.

6. Empirical results and discussion

Below is the result of the descriptive analysis in this study (as seen in Table 2):

The results of the descriptive statistical analysis are as follows. The average amount of zakat funds distributed per year by banks is IDR 9,989,699,366 with the largest amount at Bank Syariah Mandiri (IDR 66,056,000,000) and the smallest is BCA Syariah (IDR 2.000.000). The average BOD size in Islamic banks is 4 people, the largest were Bank Muamalat Indonesia and Bank Syariah Mandiri (7 people), and the smallest were Bank Victoria Syariah, BNI Syariah, Bank Mega Syariah and BCA Syariah (3 people).

The average BOD remuneration per year is IDR 12,494,367,579, - with the largest at Bank Syariah Mandiri (IDR 43,104,000,000) and the smallest at Bank Victoria Syariah (IDR 1,261,000,000). While the average SSB size is 2 people, with the largest number being at Bank Muamalat Indonesia, Bank Syariah Mandiri, and Bank Mega Syariah (3 people), and the smallest are Bank Vistoria Syariah, BRI Syariah, BNI Syariah, and BCA Syariah (2 people).

The average SSB reputation is 0.71, with the largest number being Bank Muamalat Indonesia, Victoria Syariah and BNI Syariah (average score is 1), and the smallest is BSM (average score is 0.33). In addition, the average value of net profit is IDR 178,997,004,183 with the largest at Bank Syariah Mandiri (IDR 1,434,488,000,000) and the smallest is Victoria Syariah. Finally, the average value of bank assets is IDR 29,300,291,900,466 with the largest amount at Bank Syariah Mandiri (IDR 126,907,940,000,000) and the smallest at Victoria Syariah (IDR 642,026,000,000).

Based on the data above, the largest zakat funds distributed by banks namely Bank Syariah Mandiri which has the highest BOD size and remuneration, also has the largest SSB size, although the SSB reputation value is the smallest. The value of net profit and assets of Bank Syariah Mandiri is also the largest. Meanwhile, the smallest zakat funds distributed by banks are BCA Syariah, which has the smallest BOD and SSB sizes.

Other data found is the increase in the amount of zakat funds distributed by Islamic banks in Indonesia in the 2 years during the pandemic compared to the 2 years before the COVID-19 pandemic. At the end of 2018, the amount of Islamic bank zakat funds in Indonesia is IDR 78,231,000,000, -, at the end of 2019 was IDR 82,857,000,000. The World Health Organization (WHO) declared COVID-19 a pandemic on March 11 2020. During the pandemic, at the end of 2021 zakat funds increased to IDR 118,707,000,000, while at the end of 2021 it became IDR 142,481,000,000. From the end of 2019 to the end of 2021, there was an increase in zakat funds by 72%. This data shows that banks in Indonesia had relatively high social performance during the Covid pandemic.

The results of the Chow test showed Cross-section Chi-square of 70.840512 with a probability of 0.0000 (<0.05). All the test models had an F-statistic probability smaller than alpha 0.05, so the right model was the Fixed Effect model. Then, whether to use the FE or RE model was determined by calculating the RE model to be compared with the FE model using the Hausman test. The Chi-squared distribution was 99.813717 with a Chi-squared probability of 0.0000 which was smaller than alpha 0.05 (0.0000 <0.05), so the right model was the Fixed Effect model. Based on the results of the Chow Test and Hausman Test, the right model was the Fixed Effect model, so the Langrange Multiplier Test was no longer needed. Therefore, the panel data regression model to be analysed further was the Fixed Effect model.

Jarque Bera is 3.518727 with $p = 0.172154$ (> 0.05), thus it can be stated that the assumption of normality is fulfilled. Because the Centralized VIF of all variables is less than 10, indicating that

Table 2. Descriptive analysis

	Zakat Fund	Size of BOD	Remuneration of BOD	Size of SSB	Reputation of SSB	Bank Profit	Bank Size
Mean	9.99E + 09	4.442857	1.25E + 10	2.357143	0.706429	1.79E + 11	2.93E + 13
Median	5.09E + 09	4.000000	7.83E + 09	2.000000	0.670000	7.36E + 10	1.68E + 13
Maximum	6.61E + 10	7.000000	4.31E + 10	3.000000	1.000000	1.43E + 12	1.27E + 14
Std. Dev.	1.28E + 10	1.137448	9.82E + 09	0.482617	0.237975	2.73E + 11	2.98E + 13
Observations	70	70	70	70	70	70	70

Source: Processed data.

there are no symptoms of Multicollinearity. The Glejser test is used to determine heteroscedasticity. In this test there is no heteroscedasticity problem if the significance is ≥ 0.05 , and there is a heteroscedasticity problem if the significance is < 0.05 . The results of the heteroscedasticity test show that the probability for all independent variables is greater than 0.05. Therefore, it can be concluded that there is no heteroscedasticity problem in the regression model.

Based on the results of Chow and Hausman tests, the Fixed Effect model was selected as the best model.

Based on Table 3, the adjusted R-square or coefficient of determination was 0.843246, meaning that the independent variables, namely BOD Size, BOD Remuneration, SSB Size, and SSB Reputation, as well as the control variable were able to explain the dependent variable, namely Y by 84.32%. The remaining 15.68% was explained by other variables outside the model.

The F-statistic is used to test the Goodness of Fit model. Based on the above results, the F-statistic is 31.93168 with an F-statistic probability of $0.000000 < \alpha 5\%$, meaning that the model is fit and the results of the regression analysis can be used as the right basis for testing the hypothesis.

6.1. Results of testing hypothesis 1 (H1)

The results of the t-test (Table 3) for the variable of the size of BOD showed a coefficient of 4.904639 and a probability of 0.0000 (< 0.05). This means that the size of BOD had a significant positive effect on zakat funds. Therefore, **H1 was supported**. To the best of the author's knowledge, no previous studies have found empirical evidence of the effect of Size BOD in increasing zakat funds. Thus, this study enriches the findings of previous studies regarding the effectiveness of Size BOD in increasing performance. These results are in line with the research by Albassam and Ntim (2017); Hakimi et al. (2016); Nawaz (2019); Sheikh and Kareem (2015); Amine (2018); Ulussever (2018); and Darwanto et al. (2019) which found that the size of BOD had a significant positive effect on the financial performance. Another previous study found that the size of the BOD positively affected voluntary corporate governance disclosure (Albassam & Ntim, 2017).

In Agency Theory, a larger size of BOD could provide better protection for the interests of shareholders and help managers achieve the financial and social performance. Zakat funds do not cause the financial performance of a company to decline, but they will mutually support other financial performance.

A large number of BOD allows for various collaborations with the National Zakat Amil Institution. They has social programs, and banks could select programs to distribute zakat funds among these

Table 3. Results of the fixed effect testing

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-5.90E + 10	1.41E + 10	-4.178051	0.0001
Size BOD	8.18E + 09	1.67E + 09	4.904639	0.0000
Remuneration BOD	0.544483	0.261664	2.080850	0.0420
Size of SSB	8.88E + 09	2.83E + 09	3.135999	0.0027
Reputation of SSB	-7.42E + 08	9.40E + 09	-0.078962	0.9373
Profits of Bank	-0.004298	0.004394	-0.978186	0.3321
Size of Bank	0.000210	0.000108	1.940963	0.0572
Adjusted R-squared	0.843246			
F-statistic	31.93168			
Prob(F-statistic)	0.000000			

Source: Processed data.

social programs. The greater the number of National Zakat Amil Institution that have collaboration, the greater the amount of Third-Party Funds and the better the financial performance of a bank.

In Stakeholder Theory, the greater the involvement of BOD, the greater the potential for zakat funds to be managed, leading to better social and financial performance. BOD has the authority to conduct social responsibility programs, including managing the amount of zakat funds and allocating them.

Zakat institutions that collaborate with Islamic banks can become strategic partners in achieving the mission of the social programs of Islamic banks. Banks, represented by BOD, can synergize with zakat institutions in building community empowerment, especially for disadvantaged groups, in the fields of economy, health, environment, education, da'wah, as well as disaster and humanity programs. For example, zakat funds can be distributed to educational institutions, especially for outstanding/smart students from poor families. Such synergy can be established to strengthen customer relationships with the bank, to achieve social and financial performance.

Even though this study was able to prove the effectiveness of the BOD Size on social performance (zakat funds), in fact there are still findings from previous studies which show different findings on the effectiveness of a large BOD Size. Mollah and Zaman (2015) and Elgadi and Ghardallou (2021) found that larger BOD will have a negative and significant impact on a bank's financial performance. Elghuweel et al. (2017) found no evidence that Size BOD is able to reduce negative management behavior as measured by earnings management. Therefore, studies are still needed regarding the effectiveness of the large SSB size against various types of Islamic bank performance measures.

6.2. Results of testing hypothesis 2 (H2)

The results of the t-test (Table 3) for the variable of the remuneration for BOD showed a coefficient of 2.080850 and a probability of 0.0420 (<0.05). This means that the remuneration of BOD had a significant positive effect on zakat funds, and **H2 was supported**. Similar to the findings of the study of the effect of SSB Size on zakat funds, to the author's knowledge, there has been no previous research that has found empirical evidence of the effect of BOD Remuneration on increasing zakat funds. Thus, this study enriches the findings of previous studies regarding the effectiveness of BOD Remuneration in improving performance. This result is consistent with the findings of Sheikh and Kareem (2015); Lee and Isa (2015); Pangestu et al. (2019); Amine (2018) who found that the remuneration of BOD had a significant positive effect on the financial performance of a company. BOD Remuneration is much less studied when compared to Size BOD. If previous studies have examined the effect of Size BOD on various performance measures, the findings of previous studies on the effect of Remuneration BOD mostly focus on improving the company's financial performance.

According to Agency Theory, remuneration motivates BOD to apply the prudence principle and effective risk management. In addition to arranging the financial budget, BOD also manages the zakat budget that comes from companies, employees, and customers, along with the costs needed for the implementation of social programs. BOD will strive to achieve the specified targets while considering potential risks to ensure that it does not harm the business continuity of bank.

In Stakeholder Theory, by transparently disclosing information on remuneration, BOD can fulfil their social responsibility by realizing optimal distribution of zakat funds to meet the expectations of stakeholders, particularly those directly related to zakat funds. With the presence of zakat institution whose focus is on zakat management, the social programs of bank will be more effective. In bank annual reports, it is possible to report on social activities held in collaboration with zakat institution. The higher the number of social activities reported in the annual report, the greater the level of trust that stakeholders will have in Islamic bank.

As explained above, previous studies regarding the effectiveness of BOD Remuneration are related to the company's financial performance. This shows that empirical studies are still needed regarding the effectiveness of BOD Remuneration in increasing other performance measures such as disclosure, decreasing earnings management or social performance. Studies are still needed regarding the effect of BOD Remuneration on performance because there are still several empirical studies which show that BOD Remuneration has no effect on performance (Kutum, 2015; Ogbeide & Akanji, 2006; Sheikh & Kareem, 2015).

6.3. Results of testing hypothesis 3 (H3)

The results of the t-test (Table 3) for the variable of the size of Sharia Supervisory Board (SSB) showed a coefficient of 3.135999 and a probability of 0.0027 (<0.05). This means that the size of the SSB had a significant positive effect on zakat funds. Thus, **H3 was supported**. The results of this study support previous studies which found evidence of the positive effect of SSB Size on financial performance (Almutairi & Quttainah, 2017; Amine, 2018; Nomran et al., 2018), and social performance Nugraheni (2018). Larger SSBs are more efficient in dealing with monitoring and advisory roles than smaller SSBs. Consequently, this shows that an increase in SSB size must improve the monitoring function as well as the advisory function of the SSB.

The results of this study contradict with the findings of the study conducted by Nawaz (2019) and Quttainah et al. (2013) which states that SSB size has a negative effect on performance. The findings of Nawaz (2019) study may be caused by the SSB only plays an advisory role, not a supervisory role. Because according to Mollah and Zaman (2015), SSB can have a positive effect on performance when they perform supervisory roles as well as advisors. Accordingly, the finding of this study support bigger size of SSB because zakat fund may increase.

In Agency Theory, a larger size of SSB can minimize the transactions and activities that potentially violate Islamic principles, thereby properly maintaining the health of the bank. Meanwhile, in stakeholder theory, bank still pays attention to its sharia compliance in the collection and distribution of zakat funds. This is manifested in the form of asking for the opinion of SSB members who have a deep understanding of zakat fiqh, particularly on any topics of which Islamic laws are still considered unclear, to help bank fully implement sharia compliance. By complying with Islamic principles, the credibility and trustworthiness of bank among stakeholders will increase, thus lowering sharia risks and improving the performance of Islamic banks, as shown in the research findings of Almutairi and Quttainah (2020).

6.4. Results of testing hypothesis 4 (H4)

The results of the t-test (Table 3) for the variable of the reputation of SSB showed a coefficient of -0.078962 and a probability of 0.9373 (>0.05). This means that the reputation of SSB did not have any significant effect on zakat funds, and thus, **H4 was not supported**. SSB members who had a reputation as a member of the National Sharia Council—Indonesian Ulema Council did not have any effect on zakat funds. This finding does not support the research findings of Nugraheni (2018) and Nomran et al. (2018). Nomran et al. (2018) found that the reputation of SSB had a positive effect on the financial performance of Islamic banks. Nugraheni (2018) found that the reputation of SSB positively affects social performance.

In Agency Theory, SSB members with a good reputation have the ability to improve the financial performance of bank but not the social performance. The selection and formation of SSB members are expected to support the Board of Directors (BOD) in meeting the interests of shareholders to achieve financial performance. Therefore, SSB members may not have independence in giving recommendations to comply with Islamic principles, particularly in terms of zakat management.

According to the Stakeholder Theory, SSB members who have a good reputation still do not have the authority in the fulfilment of Islamic principles; their authority is still limited to providing recommendations to the BOD that bank should manage zakat funds. For example, Bank Syariah

Bukopin and Bank Aladin Syariah have SSB members who were also member of the National Sharia Council—Indonesian Ulema Council but the bank had not had zakat management activities since they were established. It is important for SSB members to improve their relations with stakeholders, including BOD, employees, and the public in general. SSB can make an effort to increase the awareness of the BOD that paying zakat is one of the mandatory Islamic principles and a way to fulfil the social responsibility of Islamic banks, thereby maintaining and increasing trust and good relations with employees and the public in general.

7. Summary and conclusion

The corporate governance of Islamic banking differs from that of conventional banking, as Islamic banking has a Sharia Supervisory Board (SSB) responsible for ensuring Sharia compliance. Meanwhile, the Board of Directors (BOD) is responsible for overall corporate governance. Within an Islamic bank, governance should be used to achieve broader goals including economic (financial) as well as social goals. Studies conducted by academics focus more on the role of governance in improving financial performance. This gap implies the need for a paradigm shift in assessing governance in Islamic banks to focus more on social performance. It is hoped that the paradigm shift carried out by these academics will change the behavior of Islamic bank practitioners to focus more on improving social performance. One measure of social performance in Islamic banks that has been studied by previous research is the availability of zakat funds.

The objective of this study is to investigate the impact of the characteristics of BOD and SSB on zakat funds in Islamic bank in Indonesia from 2011 to 2020. Based on the results of panel data regression, the size of BOD, the remuneration of BOD, and the size of SSB had a significant positive effect on zakat funds, while the reputation of SSB did not have any significant effect on zakat funds. Previous studies related to the role of governance found empirical evidence of the role of governance in various aspects, namely: 1) improving financial performance; 2) reducing the opportunistic behavior of managers (reducing earnings management); 3) increase disclosure 4) improve social performance. This study provides additional empirical support for the role of governance, especially the size of BOD, BOD remuneration and SSB size in improving social performance.

The findings of this study, which show that BOD and SSB sizes are able to increase zakat funds practically imply that larger BOD and SSB sizes encourage social performance improvements, therefore BOD and SSB sizes in the governance structure are things that need to be considered. Likewise the study findings that BOD remuneration has proven to have a positive effect on zakat funds indicating the effectiveness of remuneration. Even though remuneration causes additional costs for the bank, the increase in costs is not in vain because it can improve social performance.

Nonetheless, this study did not find evidence of the effectiveness of SSB's reputation in increasing zakat funds. In this study, SSB's reputation was measured based on the proportion of SSB members who were also members of the National Sharia Council—Indonesian Ulema Council, which had no significant effect on zakat funds. This finding should be of concern to all parties, particularly bank management teams and regulators. The management team can empower SSB to carry out its social functions, such as calculating zakat, collecting zakat funds from customers, and distributing zakat funds. Meanwhile, regulators can encourage Islamic banks to fulfil their social responsibilities as mandated by Law of Islamic Banking No. 21 of 2008. In the absence of regulation that obliges Islamic banks to distribute zakat, the public in general expects Islamic banks to have different functions from conventional banks.

The findings of this study which show that BOD and SSB sizes are able to increase zakat funds practically imply that larger BOD and SSB sizes encourage social performance improvements, therefore BOD and SSB sizes in the governance structure are things that need to be considered. Likewise the study findings that BOD remuneration has proven to have a positive effect on zakat

funds indicating the effectiveness of remuneration. Even though remuneration causes additional costs for the bank, the increase in costs is not in vain because it can improve social performance.

This research has limitations. First, the Islamic banks under study are only Islamic Commercial Banks excluding Islamic Business Units and Islamic Rural Banks (BPRS). Second, the measurement of social performance is limited to distributed zakat funds. In fact, the measurements can also involve other elements, including Qardhul Hasan funds, Zakat on Assets, and Zakat on Equity. Third, the characteristics of governance used in this study are only BOD and SSB. Other characteristics of governance can also be included, such as boards of commissioners and committees. It is recommended for future research to address the limitations of this study by involving more samples and measurement items.

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