WOULD FOREIGN DIRECTORS AND WOMEN DIRECTORS AFFECT THE FINANCIAL PERFORMANCE OF ISLAMIC BANKING?

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ABSTRACT

Our research study aims to investigate and empirically examine the impact of the Board of Directors' characteristics (foreign directors and women directors) on the financial performance of Islamic banking. Regression analyzes are used to evaluate the impact of foreign directors and women directors on the financial performance of banks, employing a panel data consisted of 32 Islamic banks during the period 2015-2018. The findings show that the foreign directors have a negative impact on the financial performance of Islamic banking. However, the women directors do not have any significant effect on the financial performance of banks. Through this study, we are engaged in a very interesting academic debate that discusses the impact of the Board of Directors on the financial performance of Islamic banking

Keywords: Board of Directors, Financial performance, Foreign director, Islamic banking, Woman director.

INTRODUCTION

The Board of Directors has an important role in the Islamic banking corporate governance and must guarantee compliance with shariah laws, according to Hakimi et al. (2018); Khalil & Taktak (2020). In other words, the Board of Directors is responsible for the shariah corporate governance framework, and verifies that this framework is compatible with the size of the Islamic financial institution (IFI) activities (Islamic Financial Services Board (IFSB), 2006; Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), 2010). Hakimi et al. (2018); Khalil & Chihi (2020) indicate that the Board of Directors organization affects the corporate governance of Islamic banks and has a significant impact on its future. It seems necessary, thus, to review the Board of Directors' feature. In this research paper, we purpose to examine the effect of the Board of Directors' characteristics (foreign directors and women directors) on the financial performance of Islamic banking during the period 2015-2018.

LITERATURE REVIEW AND HYPOTHESES

Foreign Directors

Foreign directors diminish agency costs and affect the bank management, according to agency theory (Khalil & Chihi, 2020). Ramly et al. (2018); Khalil & Chihi (2020) add that the international directors increase the financial performance of the banks and attracts investors. Furthermore, foreigners ensure that the Board of Directors has expertise and different skills to

fulfill its duties (Bank Negara Malaysia (BNM), 2015). Khalil & Chihi (2020) investigated 67 Islamic banking during the period of 2015-2018 and found that the foreign directors have a positive effect on the financial soundness of banks. Several studies, in contrast, indicate that accounting laws and management standards are less common to foreigners. This hinders the directors' ability to provide the necessary information and run the bank Masulis et al., (2012); Rafindaa et al., (2018); Boussaada (2012) says that the foreign directors have difficult to handle risks and improve the financial performance of the banks. The sign of this variable is expected to be negative:
H1. The percentage of foreign directors has a negative impact on the financial performance of Islamic banking.

Women Directors

Adams & Ferriera (2009) argue that the presence of the female directors can positively influence governed corporations. This is in line with Yar & Ahmed (2020) study stating that the board's gender diversity has a positive effect on the financial performance of banks. Khalil & Chihi (2020) claim that Muslim nations have fewer women directors, which can hinder the shareholders ability to have female board appointments. Khalil & Chihi (2020) conducted a study on a sample of 32 Islamic banks from 2015 to 2018 and showed that the presence of women directors is positively related to the Islamic banks soundness. However, Faccio et al. (2016) indicate that women directors are more risk averse than men directors. Faccio et al. (2016) add that the presence of women directors encourages managers to adopt too conservative strategies, and thus make Islamic banking less competitive. We propose the following hypothesis:

H2: The percentage of women directors has a positive impact on the financial performance of Islamic banking.

METHODOLOGY

Sample & Data

Our sample is consisted of 32 Islamic banking over the period 2015-2018. Data is manually collected from the annual reports of Islamic banks. In other words, we use the Islamic banking websites to download the annual reports and the World Bank website[1] to obtain the gross domestic product data.

Variables measurement

According to Bourkhis & Nabi (2013) and Khalil & Taktak (2020), we define the financial performance of the banks by two ratios:

Return on Asset (ROA) = Net income / Total asset (1)

Return on Equity (ROE) = Net income / Shareholder's equity (2)

In this research paper, two characteristics of the Board of Directors are employed. The foreign directors (FD) measured by the percentage of foreign directors and the female director (WD) measured by the percentage of women directors. We add 3 control variables to enhance our empirical results. BS is the number of directors, BA is the logarithm of the bank age, and GDP is the gross domestic product rate.

We propose the models below to investigate the influence of the foreign directors and the women directors on the financial performance of Islamic banking:

$$ROA_{it} = C + \beta_1 FD_{it} + \beta_2 WD_{it} + \beta_3 BS_{it} + \beta_4 BA_{it} + \beta_5 GDP_{it} + \varepsilon_{it} \quad (3)$$
$$ROE_{it} = C + \beta_1 FD_{it} + \beta_2 WD_{it} + \beta_3 BS_{it} + \beta_4 BA_{it} + \beta_5 GDP_{it} + \varepsilon_{it} \quad (4)$$

Hence, C: a constant, β1 ... β5: the coefficients to be estimated, εit: the error term, i: the individual which ranges from 1 to 32, t: the period which ranges from 2015 to 2018.

The models of our study are estimated by using the Panel Corrected Standard Errors (PCSE) method, in order to avoid the autocorrelation and heteroscedasticity problems and have more robust findings Beck & Katz, (1995); Khalil & Chihi, (2020); Khalil & Taktak, 2020).

RESULTS AND DISCUSSION

Descriptive statistics

Descriptive statistics indicate that the mean of the (FD) variable is 21.486%. The average for (WD) variable is 2.465%, which varies from 0% to 100%. The Board of Directors is consisted about 9 members. Moreover, Table 1 shows that the Islamic banks' size (BA) has an average of 1.445, with a minimum of 0.568 and a maximum of 3.304. The mean of the (GDP) variable is 3.155. The (ROA) variable has an average of -1.021. The values of the (ROE) variable vary from a minimum of -17.5 to a maximum of 219.7.

Table1
DESCRIPTIVE STATISTICS

Variables	Mean	SD	Median	Min	Max
FD%	21.486	24.047	11.805	0	100
WD%	2.465	6.714	0	0	100
BS	8.710	2.465	9	4	16
BA	1.445	0.581	1.278	0.568	3.304
GDP	3.155	2.552	3.1	-4.7	13.4
ROA	-1.021	27.997	1.205	-314	11
ROE	11.962	26.010	8.055	-17.5	219.7

Cross-Correlation Matrix

The Cross-Correlation matrix shows the absence of multi-collinearity issues in Table 2. Indeed, all correlation coefficients do not exceed the limit (0.7), according to Kennedy (2008).

Table 2
CROSS-CORRELATION MATRIX

Variables	FD	WD	BS	BA	GDP
FD	1.000				
WD	-0.161	1.000			
BS	0.111	-0.071	1.000		
BA	-0.250	0.041	0.054	1.000	
GDP	0.006	0.200	-0.044	-0.003	1.000

DISCUSSION

Table 3 indicates that the coefficient associated with (FD) variable has a negative effect on the financial performance measured by (ROE) variable. H1, thus, is supported. This result is consistent with the study conducted by Masulis et al. (2012), and implies that the foreigners have a negative impact on the financial performance of Islamic banks. It seems that the foreign directors have difficult to handle risks and run effectively the bank, according to Rafindaa *et al*. (2018). The coefficient associated with (WD) variable does not have any significant influence on the financial performance of Islamic banks. H2, therefore, is not supported. This finding contradicts the studies conducted by Khalil & Chihi (2020); Yar & Ahmed (2020). We note that the corporate governance standards (AAOIFI & IFSB) do not suggest any rules on the presence of women directors. These justify the results. In addition, Table 3 shows that control variables (BS, BA, GDP) do not have any significant effect on the financial performance of Islamic banks.

Table 3
REGRESSION RESULTS

Variables	ROA			ROE		
	Coef.	Z	P>|z|	Coef.	Z	P>|z|
BS	1.135	0.89	0.374	-0.472	-1.71	0.088*
BA	-2.366	-0.83	0.405	-0.552	-0.60	0.549
GDP	-0.884	-1.28	0.200	0.079	1.17	0.244
FD	0.156	0.81	0.416	-0.296	-1.95	0.052*
WD	-0.016	-0.12	0.904	0.033	0.55	0.582
Cons	-0.452	-0.06	0.948	12.880	3.37	0.001
R^2	23.15%			18.21%		
N	128					

Notes : *significant at 10 per cent; **significant at 5 per cent and ***significant at 1 per cent

CONCLUSION

The purpose of this study is to examine the impact of the Board of Directors' characteristics (foreign directors and women directors) on the financial performance of Islamic banks. To answer this question, we apply a panel data consisted of 32 Islamic banking during the period 2015 – 2018. The results show that the foreign directors have a negative impact on the financial performance of banks. However, the women directors do not have any significant effect on the financial performance of Islamic banks. Theoretical, practical and managerial contributions are therefore offered in this research study. This paper furnishes new suggestions and empirical evidence to enhance our understanding of the relationship between the Board of Directors and the financial performance of Islamic banks. This research paper, thus, has a major implication for a large audience (policymakers, academics, etc.).

In the future research studies, it is recommended that other corporate governance structures be investigated (e.g. CEO duality, interlocked chairman, etc.), in order to ameliorate our knowledge of the relationship between the Board of Directors and the financial performance of Islamic banks.

ENDNOTES

[1]www.worldbank.org

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