

UNIVERSITI TEKNOLOGI MARA

**THE SOCIAL PERFORMANCE OF
ISLAMIC BANKS IN INDONESIA
AND MALAYSIA: THE ROLE OF
INTELLECTUAL CAPITAL AND
SHARIAH SUPERVISORY BOARDS**

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ABSTRACT

This study aims to explain the relationship between Intellectual Capital (IC) and governance mechanism of the Sharia Supervisory Board (SSB) with 4 (four) components, namely educational background, reputation, cross-membership, and gender diversity towards Social Performance (SP) of Islamic Banks in Indonesia and Malaysia. This study also, examines the moderating role of SSB characteristics in strengthening the use of IC in improving SP. The objective of Islamic economics is not only to concentrate on commercial goals stated in achieving maximum profit but also on its role in providing welfare to the community, which is the social performance. This social performance is achieved through maqasid sharia performance with 3 (three) objectives, namely education (Tahdhib al-Fard), justice (Al-'Adl), and public interest (Al-Maslahah) to improve the welfare of the community. Islamic banks will help to achieve the SDGs by building social performance and assisting in achieving the Sustainable Development Goals (SDGs). This research is important to improve Islamic banks' social performance. This study was carried out using panel data regression models analysis. Overall, the empirical findings reveal a significant and positive association between intellectual capital efficiency and Islamic banks' social performance in Indonesia and Malaysia. The findings imply that Islamic bank stakeholders in Indonesia and Malaysia should consider intellectual capital resources as one of the factors that leads to better social performance for Islamic banks. On the other hand, each of the SSB characteristics appears to have a different relationship with the social performance of Islamic banks in both countries. While in Indonesia, the SSB educational background has a positive relationship on SP and SSB reputation and cross-membership have negative relationship on SP, those SSB characteristics has no relationship on SP in Malaysia. For gender diversity, the results from both countries found that it has no relationship on SP. Meanwhile, the results regarding the moderating effect of each SSB characteristic in the relation between intellectual capital and social performance of Islamic banks in both countries are varied and mixed with mostly non-significant. For the practical implications, the study results provide useful insights to practitioners of Islamic banks in reallocating intellectual resources properly and SSB governance since it is a way to enhance superior performance and build sustainable advantages in emerging economies. Meanwhile, for the academics' perspectives, the results provide useful insights in supporting the Resource-based Theory (RBT) which explained that IC is a resource that serves as the core of value creation and a company's competitive advantage and can be utilized to produce better social performance for the banks.

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CHAPTER ONE

INTRODUCTION

1.1. Research Background

In Islamic Economics, there is a concept of comprehensive social performance measurement, called as *maqasid sharia*, that is intended to assist (good) people in the world and hereafter. This idea includes financial and social performance to maximize benefits and minimize harm (*mudharat*) to public wellbeing (Al-Zuhaily, 1997). This is assumed to be suitable for managing and accessing the performance of Islamic financial institutions, especially Islamic banks. *Maqasid sharia* is a global concept.

In Islamic banking industry context, Mohammed and Razak (2008) and Mohammed and Taib (2015) have tried to develop Islamic banking performance measures based on *maqasid sharia* framework based on Abu Zahrah's theory. The framework focuses on the implementation of Islamic bank social performance that can be realized in accordance with sharia objectives which are divided into three aspects, namely the aspect of *Tahdhib al-Fard* (educating individuals), *Iqamat al-'Adl* (establishing justice), *Jalb al-Maslahah* (creating the public interest) (Mohammed & Razak, 2008). Those objectives are important as the main goal for Islamic banks in doing their business because that is how the banks is expected to become according to the *fiqh*.

Considering the urgency of *maqasid sharia* as the measurement for social performance of Islamic Banks in directing business players and drive them to promote public welfare, in general, the purpose of this research is to thoroughly explore the factors that may positively related to *maqasid sharia*. As the need for knowledge-based resources increases its urgency for wealth determination and organizations' sustainability, the emergence of the knowledge-based economy has brought about an integral change in the current market. The economy is shifting once again to the fourth industrial revolution (industry 4.0), with goods, supply chains and business models becoming more digitalized and interconnected. The digital revolution is expected to transform the sector significantly, requiring substantial