Contribution Of Sharia Supervisory Board (SB) and Sharia Compliance Levels to Performance Indonesian Sharia Banking

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ABSTRACT

Sharia compliance is an absolute requirement that must be fulfilled by financial institutions that conduct business activities based on sharia principles as a manifestation of the characteristics of Islamic financial institutions. Supervisory Board (SB) contribution oversees and is responsible for ensuring all products and procedures of Islamic banks are by sharia principles. This study aims to measure the ratio of participation, effectiveness and efficiency of the sharia supervisory board to Islamic banking in Indonesia. This study used the AHP method with three indicators; the rate of contributions measured through sharia branch office in public Islamic bank and sharia business unit, to the effectiveness ratio measured by the total productive assets variable in public Islamic and sharia businesses unit, while the efficiency ratio is measured by aggregate variables of operating expenses and labour costs for Islamic public bank and sharia businesses unit. Based on this research, here are some critical result such as the ratio of the overall contribution is useful. The effectiveness ratio shows that the Supervisory Board (SB) is ineffective or not valuable for lending activities in Islamic banks based on Islamic public bank branch offices and sharia businesses unit. And the results for efficiency ratios indicate that overall Supervisory Board (SB) is less efficient for Islamic banks when issuing operational costs on Supervisory Board (SB) contributions.
1. INTRODUCTION

Sharia compliance is an absolute requirement that must be met by financial institutions; it carries out business activities based on sharia principles as a manifestation of the characteristics of Islamic Bank institutions. Economic globalization and laissez-faire appear in the attitude of caution among Islamic financial industry players and businesses, include maintaining the aspects of sharia compliance (shariah compliance) as a way to prevent possible risk and financial sector fraud of action. (Sula, Alim, Prasetyono, 2014). Every Islamic bank is required to have a sharia supervisory board as a complement to the supervisory board that suitable to conventional banks such as BI, Bapepam and the board of commissioners. (Fahmi, Daryanto, Siregar, Harianto 2012).

Sharia compliance is a critical player in the implementation of Good Corporate Governance (GCG) in the sharia banking industry. As stated in Bank Indonesia Regulation No. 11/33 / PBI / 2009 concerning Implementation of Good Corporate Governance for Islamic public bank and Sharia Business Units, that the implementation of GCG in the sharia banking industry must fulfill sharia principles. The importance of GCG implementation is one of the ways to protect the interests of stakeholders, increase compliance with the prevailing laws and regulations and ethical values that are generally applicable to the Islamic banking industry (Saramawati, Lubis, 2014).

The uniqueness and peculiarity of sharia compliance ultimately triggered various researchers to test and analyse the role of Supervisory board (SB) that has an essential part in the agreement of Islamic bank and its application by Islamic banks in Indonesia (Saramawati, Lubis 2014). The scholars who are competent in sharia law have a substantial function and role in Islamic banking, namely as a sharia supervisory board and a national sharia board. The central part of the sharia supervisory board is to monitor daily operations of the bank so that they are always by the provisions of sharia and regularly reported in the annual report of the bank concerned. But in reality, Supervisory board (SB) also has its problems, like the control of Islamic bank that very less, especially regarding practices of products in Islamic banks, which should have guidelines to regulate it refers to matters that have been determined by the DSN. While the Sharia Advisory Board (SB) which is in charge of overseeing sharia operations is very limited, and many Supervisory boards (SB) who work in Islamic banks are not focused because of the many positions they hold, even the lack of improvement in the quality of Supervisory
board (SB) in Islamic Financial Institutions (Islamic Banks, insurance, capital markets, pawnshops, insurance, non-bank Islamic financial institutions).

The expertise possessed by the Supervisory board (SB) members cannot be separated from the decrement system that has not been effective. Most Supervisory board (SB) members do not have a background in banking or financial knowledge (Faozan, A. 2014). So that it is difficult for the sharia supervisory board as one of its tasks to be the first filter on products to be issued by Islamic banks. Mardian (2011) explores the application of sharia compliance in Islamic banks by evaluating the performance of the Sharia Supervisory Board (SB) which has an essential role in sharia compliance in Islamic banks.

The results of this study conclude that the implementation of Supervisory board’s (SB) duties and responsibilities are less than optimal and the lack of independence of Supervisory board (SB) is seen from the absence of rules regarding the term of office of Supervisory board (SB). With this phenomenon, researchers want to measure the performance of the Supervisory board (SB) how much contribution, effectiveness and efficiency of Supervisory board (SB) to Indonesian Islamic banking.

2. LITERATURE REVIEW

**DPS Role Theory in Islamic Bank.** The supervisory board (SB) has an essential and strategic role in the application of sharia principles in Islamic banking. The supervisory board (SB) is responsible for ensuring all Sharia bank products and procedures are by sharia principles. Because of the importance of the role of the Supervisory board (SB), two laws in Indonesia include the necessity of Supervisory board (SB) in sharia companies and sharia financial institutions, namely Law No. 40 of 2007 concerning Limited Liability Companies and Law Number 21 of 2008 concerning Sharia Banking. Those juridical, DPS in banking institutions occupies a strong position (Yulianti, 2009). This DPS position is significant for Islamic banking, especially in terms of financial performance. There is no difference between Islamic banks and conventional banks in Indonesia (Ika and Abdullah, 2011).

Supervisory board (SB) ensures that the operational activities, products and services of sharia banks are always in accordance with sharia principles while the DSN is an institution that provides recommendations for Supervisory board (SB) members who have adequate sharia expertise and competencies and issues national Islamic bank products and services that can be used as uniform guidelines for Supervisory board (SB) (Syaiful, 2003).
The existence of SB in the sharia banking legal system is the implementation of the involvement of the Scholars in the implementation of the people's economic policy. The scholars who are competent towards sharia law have an essential function and role in mobilizing and motivating the community in carrying out muamalah activities that are by sharia principles. (Shafi'i 2001).

Related to the process of sharia compliance escort, Accounting has established that, Auditing and Governance Standards for Islamic Financial Institutions (AAOIFI, 2002) and the Islamic Financial Services Board (IFSB, 2006), which confirms the existence of supervision before businesses are run (ex-ante) and after the business is run (ex-post).

The position of Supervisory board (SB) can be seen in the following figure (Moh. Rifai, 2002):

Ex The tasks of the DSN are: to develop the application of sharia values in financial and economic activities, fatwas issue on types of business activities, fatwas issue on sharia financial products and services, supervise the use of the fatwa issued. While the authority of the DSN is: fatwa an issue that binds supervisory board (SB) in each LKS and becomes the basis for legal action of the related parties, issuing fatwas that form the basis for the provisions or regulations issued by the authorized agencies such as the Ministry of Finance, Bank Indonesia (BI) (now-Financial Services Authority), provide recommendations or revoke recommendations for names that will sit as Supervisory board (SB) on LKS, inviting experts to explain the problems needed in the discussion of sharia economics, including monetary authorities or domestic and foreign financial institutions, giving warnings to the LKS above deviations from the DSN fatwa, proposes to authorized agencies to take action if warns are not heeded (Abidin, 2011).

In Indonesia, at least Supervisory board (SB) has 3 important roles in fulfilling sharia principles in the bank, that are; first, as a counselor and advisor to the board of directors and management regarding the fulfillment of sharia principles, second, as a mediator between management and the National Sharia Board regarding fatwas on products and services proposed by Islamic banks, and third, as a representative of the National Sharia Board related to the implementation of DSN fatwas (Arifin, 2005).

According to Rifat Abdul Karim (Suprayogi, 2007), there are three models of the existence of
Supervisory Board (SB) organizations in Islamic Financial Institutions, namely the first advisor model, Supervisory board (SB) acts as an advisor and works part-time and comes to the bank if needed, both supervisor models. Supervisory board (SB) functions as a supervisor who conducts regular discussions with management regarding the fulfilment of principles in products, services and operations, and the three sharia department models, Supervisory board (SB) organizations in the form of individual departments that work full time and are assisted by staff in supervising under the supervision of an expert.

There is no doubt that the role of Supervisory board (SB) is recognized as very important to oversee the welfare of an Islamic bank by the sharia principles that have been stated by DSN-MUI (Sudi, 2015).

**Sharia Compliance Theory DPS.** According to Ilhami (2009), Islamic compliance is an absolute requirement that must be met by financial institutions that carry out business activities based on sharia principles. Sharia compliance is the fulfilment of all sharia principles in all activities carried out as a manifestation of the characteristics of the institution. The compliance function is a preventive action, to ensure policies, provisions, systems and procedures, as well as business activities carried out by Islamic banks. Sharia compliance is part of the implementation of a risk management framework that has international standards that are prepared and established by the Islamic Financial Service Board (IFSB) where Islamic compliance is part of institutional governance.

Sharia compliance is a manifestation of the fulfilment of sharia principles by Islamic banks which have the characteristics of characteristics, integrity and credibility. This compliance culture is in the form of values, behaviour and actions that support the creation of Islamic bank compliance with all BI provisions (Sukardi, 2012).

In the governance of a company, compliance means a specification, standard or law that has been regulated an authorized institution or organization have issued that in a particular field — compliance functions as an executor and compliance risk manager who coordinates with work units in risk management. The compliance function carries out preventive supervision tasks and becomes an essential element in the management and operation of the institution.

This is to ensure that the policies, provisions, systems and procedures determined are by the regulations and legislation as well as the determination of laws that have been established in the international standards of IFSB and AAOIFI (Waluyo, 2016). To see the legitimacy theory
can measure the level of compliance of an institution. Legitimacy theory is a condition that exists when an institution company value system is in line with the prevailing value system, where the institution has carried out its operational activities by the current norms and rules. "Legitimacy is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some social systems constructed of norms, values, beliefs, and definitions." Based on this definition, legitimacy is considered as an attempt to equate perception or assumption that the actions taken by an entity are actions that are desirable, appropriate, and by the system of norms, values, beliefs and definitions that are socially developed (Slack, et al 2010).

Legitimacy is considered necessary for the institution company because the legitimacy of the community to the company becomes a strategic factor for the future development of the institution or company (Waluyo, 2016).

**AHP Implementation Theory for Sharia Compliance DPS.** Analytical Hierarchy Process (AHP) is a functional hierarchy with input mainly derived from expert perceptions. Wirdianto and Elpira (2008), said that AHP is one method that can be used in the decision-making process of a complex problem such as planning, determining alternatives, arranging priorities, choosing policies, allocating resources, identifying needs, forecasting needs, planning performance, optimization and conflict resolution. AHP’s working principle is a simplification of a complex problem that is not structured, strategic, and dynamic into parts and arranged in a hierarchy.

The level of importance of each variable is given a numerical value, subjectively about the significance of the variable and relative to other variables. After that, from various considerations then synthesized to determine variables that have high priority and play a role to influence the results of the system (Marimin & Maghfiroh 2010).

To make effectiveness in sharia compliance, it takes several efforts. First, it is protective, that is, ensure the creation of compliance with applicable policies, provisions and regulations through analysis in the fields of finance, accounting, operations and other activities in inspection and supervision. Second, constructive, which is to maintain the level of savings in the use of resources and the effectiveness of maximum results through suggestions for improvement and objective information to conduct reviews at all management levels. Third, consultative, which provides recommendations that are beneficial to all management as a refinement of policies to achieve organizational goals through
the identification of all possible risks and irregularities to improve and improve the efficiency of the use of resources and funds, so that anomalies can be detected (Waluyo, 2016).

Sharia compliance is among the aspects that distinguish Islamic economics from conventional economics or between Islamic banking and traditional banking. (Rahman, 2008; Abduh, 2012; Ahmed H., 2014).

Sharia compliance in Islamic banks proxies by Islamic Maqasid is the main objective that must be realized from the realization of the Islamic economic system, include Islamic banks. The implications of this goal are more than just the purpose of fulfilling the needs of the community but also aim to realize growth and justice in 5 (five) aspects of the sharia objectives of religion (in), reason, descent, wealth and honor (Ahmed H., 2014).

Theory of Effectiveness Ratio. Mahmudi (2005) said that the relationship between input and purpose, which can be described by the enormous input contribution to the achievement goals, the more effective the organization, program or activity. So it can be concluded that effectiveness is closely related to the comparison between realization or output with targets or goals that have been set so that to measure the efficacy can be by comparing the achievement with the objective.

According to (Kurniawan, 2005) Effectiveness is the ability to carry out tasks, functions (operations of activities, programs or missions) rather than an organization without any pressure or tension between its implementation.

Theory of Contribution Ratio. Contribution is something that is given to other parties who have a goal together. In this journal to get the results used in Islamic banks by using variable sizes proxies from the number of a branch office in Public Islamic Bank (PIB) and Sharia Business Unit (SBU), the results of the size of the number of office services can illustrate the extent of contributions from DPS in serving sharia compliance in all regions of Indonesia where BUS and UUS are located (Adhayani, et al. 2015)

Theory of Efficiency Ratio. Komaryatin (2006) said that banking efficiency could be analyzed by scale efficiency, effectiveness in scope, technical capability, and location efficiency. Banks are supposed to achieve profitability on a scale when the concerned banking can operate on constant returns to scale, while coverage efficiency is achieved when banks can perform on location diversification. The allocation efficiency is achieved when the bank can determine various outputs that can maximize profits.

In this journal to get the results used in Islamic banks by using variable sizes proxies from
the total operating expenses in Public Islamic Bank (PIB) and Sharia Business Unit (SBU), the results of this measure of labor costs illustrate the extent to which Islamic banks incur DPS contributions in serving sharia compliance in all regions of Indonesia where BUS and UUS are located.

3. RESEARCH METHODS

This study used purposive sampling to process Analytical Hierarchy Process (AHP). The research design used descriptive analysis without a hypothesis. By setting a random sample of respondents who can represent and understand the contribution of the sharia supervisory board to Islamic banks. There are three analytical methods used; the first method of analysis is contribution analysis. How is the input of the Supervisory board (SB) measured through working visits to Public Islamic Bank (PIB) and Sharia Business Unit (SBU) each year? In measuring the value of the contribution in detail, the criteria for participation into six levels are used. The contribution analysis is classified as follows:

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-50</td>
<td>Very less</td>
</tr>
<tr>
<td>51-100</td>
<td>Less</td>
</tr>
<tr>
<td>101-150</td>
<td>Average</td>
</tr>
<tr>
<td>151-200</td>
<td>Pretty good</td>
</tr>
<tr>
<td>201-250</td>
<td>Good</td>
</tr>
<tr>
<td>Above 250</td>
<td>Very good</td>
</tr>
</tbody>
</table>

Table 1. Contribution Ratio

For contribution ratios, the interpretation refers to Mahmudi’s study (2005) which can be formulated through the combined sharia office service data of PIB and SBU divided by PIB and SBU office networks as follows:

\[
\text{Contribution Ratio} = \frac{\text{Branch Office}}{\text{PIB and SBU}} \times 100
\]

The contribution is the giving of a role activity, input of ideas and so on (Badudu, 1994). According to Soerjono and Djoenaesih, (1997) Contributions are participating or giving both ideas, energy and others in activities. The meaning of contribution is giving or contributing to an event in the form of information, ideas, energy, to achieve something planned (Gunadi and Djony, 2013). From the explanation of the theory, it can be concluded that the contribution is the energy provided by Supervisory board (SB) to provide input, ideas for an activity to all levels of human resources available in all Public Islamic Bank (PIB and SBU) in Indonesia. This study measures and observes the contribution of the sharia supervisory board of PIB and SBU from 2014 to 2018.

Second is the analysis of effectiveness. Effectiveness analysis is used to measure the benefits and effectiveness of Supervisory board (SB) on lending in Islamic banks. For the effectiveness ratio, the interpretation refers to the
study of Mahmudi (2005). Interpretation of the effectiveness ratio as follows:

### Table 2. Effectiveness Ratio

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt; 100 %</td>
<td>Very Effective</td>
</tr>
<tr>
<td>90-100%</td>
<td>Effective</td>
</tr>
<tr>
<td>80-90%</td>
<td>Average</td>
</tr>
<tr>
<td>60-80%</td>
<td>Effective less</td>
</tr>
<tr>
<td>&lt; 60%</td>
<td>Not effective</td>
</tr>
</tbody>
</table>

Source: processed by researchers, 2018

The effectiveness ratio can be formulated through the total productive asset data divided by the PIB and SBU office networks as follows:

\[
\text{Effectiveness Ratio} = \frac{\text{Total Productive Assets}}{\text{PIB and SBU}} \times 100
\]

Public Islamic Bank (PIB) and Sharia Business Unit (SBU). The third is the method of efficiency analysis; this efficiency analysis is to measure the comparison of whether the compensation costs obtained by Supervisory board (SB) are by their contribution. For efficiency ratios, the presentation is made bigger and bigger, meaning more inefficient, because the measurement is based on the burden borne by the bank. The interpretation refers to Mahmudi’s (2005) study. Interpretation for efficiency ratios as follows:

### Table 3. Efficiency Ratio

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; 100 %</td>
<td>Very Efficient</td>
</tr>
<tr>
<td>100-200%</td>
<td>Efficient</td>
</tr>
<tr>
<td>201-300%</td>
<td>Average</td>
</tr>
<tr>
<td>301-400%</td>
<td>Less Efficient</td>
</tr>
<tr>
<td>&gt; 400%</td>
<td>Not Efficient</td>
</tr>
</tbody>
</table>

Source: processed by researchers, 2018

For the efficiency ratio can be formulated through the complete data operating expenses divided by the labour costs as follows:

\[
\text{Efficiency Ratio :} \quad \frac{\text{Total Operating Expense}}{\text{Labor Load}} \times 100
\]

### 4. RESULTS

The results of the contribution ratio are as follows:

### Table 4. Result Contribution Ratio

<table>
<thead>
<tr>
<th>Year</th>
<th>Branch Office</th>
<th>PIB and SBU</th>
<th>Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>1.761</td>
<td>556</td>
<td>316.72</td>
</tr>
<tr>
<td>2015</td>
<td>1.469</td>
<td>589</td>
<td>249.40</td>
</tr>
<tr>
<td>2016</td>
<td>1.342</td>
<td>622</td>
<td>215.75</td>
</tr>
<tr>
<td>2017</td>
<td>1.315</td>
<td>612</td>
<td>214.86</td>
</tr>
<tr>
<td>2018</td>
<td>1.320</td>
<td>617</td>
<td>213.93</td>
</tr>
</tbody>
</table>

Source: processed by researchers, 2018

From the data obtained that the contribution of the Supervisory board (SB) in 2014 show excellent results through Islamic services provided with the number 316.72. Seen in 2015 indicates the number 249.40 means that the contribution given is useful but has decreased
slightly. While in 2016 with the increase in the offices of Public Islamic Bank (PIB) and Sharia Business Unit (SBU), it was not accompanied by an increase in its service offices so that the contribution value showed 215.75 meaning that it was good but decreased. In 2017 there was a decline in offices and service offices until 2018. The reduction in sharia services had an impact in that year the total contribution in 2017 showed 214.86, and in 2018 it showed 213.93 which means good even though it still decreased. This means that the gift of dps from 2014 to 2018 is decreasing, due to the decline in the number of offices and service offices each year from 2016 to 2018. So this result can be an input for sharia bank policymakers to develop their service office network further.

Based on the above formula, the effectiveness measures of Supervisory board (SB) in all PIB and SBU in Indonesia from 2014 to 2018 are as follows:

### Table 4. Result Effectiveness Ratio

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Productive Assets</th>
<th>PIB and SBU</th>
<th>Effectivity</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>249,560</td>
<td>536</td>
<td>44,884</td>
</tr>
<tr>
<td>2015</td>
<td>270,735</td>
<td>589</td>
<td>45,965</td>
</tr>
<tr>
<td>2016</td>
<td>324,034</td>
<td>622</td>
<td>52,095</td>
</tr>
<tr>
<td>2017</td>
<td>382,697</td>
<td>612</td>
<td>62,532</td>
</tr>
<tr>
<td>2018</td>
<td>380,819</td>
<td>617</td>
<td>61,721</td>
</tr>
</tbody>
</table>

*Source: processed by researchers, 2018*

Table 4 results of the calculation of effectiveness show successively from 2014 to 2016 of 44,884, then 45,965, and 52,095 interpretations produced are ineffective. This means that the Supervisory board (SB) benefits and effectiveness of lending activities in Islamic banks is not effective. Next, in 2017 and 2018, the calculation results show a value of 62,532 and 61,721 whose interpretation is less effective. This means that the role of DPS is less effective and less effective in lending activities for PIB and SBU throughout Indonesia.

### Table 6. Result Efficiency Ratio

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Operating Expenses</th>
<th>Labor Load</th>
<th>Efficiency</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>17,942</td>
<td>5,339</td>
<td>336.05</td>
</tr>
<tr>
<td>2015</td>
<td>22,011</td>
<td>6,087</td>
<td>361.60</td>
</tr>
<tr>
<td>2016</td>
<td>29,708</td>
<td>6,653</td>
<td>440.52</td>
</tr>
<tr>
<td>2017</td>
<td>23,842</td>
<td>7,200</td>
<td>331.13</td>
</tr>
<tr>
<td>2018</td>
<td>10,432</td>
<td>3,122</td>
<td>334.14</td>
</tr>
</tbody>
</table>

*Source: processed by researchers, 2018*

Table 6 results of the calculation of the Supervisory board (SB) efficiency from 2014 to 2015 amounted to 336.05, and 361.60. Likewise, the results for 2017 and 2018 are 331.13 and 334.14 respectively. These four results show the results of interpretations are less efficient. This means that the costs incurred by Islamic banks for DPS contributions are less active. While in 2016 the results of a dynamic calculation amounted to 440.52 whose interpretation was inefficient, meaning that the costs incurred by Islamic banks for DPS contributions were careless.
5. CONCLUSION

Based on the AHP method used to measure the contribution of Supervisory board (SB) by using three indicators, the contribution ratio, effectiveness ratio and efficiency ratio show the results that for the overall contribution ratio is excellent. The results for effectiveness ratios show that Supervisory board (SB) is ineffective mainly or not useful in lending activities in Islamic banks based on Public Islamic Bank (PIB) and Sharia Business Unit (SBU). The results for efficiency ratios indicate that overall Supervisory Board (SB) is less efficient for Islamic banks when issuing operational costs on Supervisory board (SB) contributions.

For further research, it is expected that researchers focus on the role of Supervisory Board (SB) in the operations of Islamic banks such as lending products, funding products and other services. Further research is about policies in compensation for the Supervisory Board (SB).

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