THE EFFECT OF CORPORATE GOVERNANCE, SHARIA GOVERNANCE, AND RISK MANAGEMENT ON THE PERFORMANCE OF ISLAMIC BANKS IN AFRICA

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by

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AGE	Bank Age
BAZ	Bank Size
BOZ	Board Size
BOI	Board Independence
CE	Common Era
CG	Corporate Governance
EXA	External Auditor
FOD	Foreign Director
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
IBs	Islamic Banks
IBP	Islamic Banking Performance
IFSB	Islamic Financial Standard Board
IFSI	Islamic Finance Stability Index
IFSISR	Islamic Finance Services Industry Stability Report
IIBI	Institute of Islamic Banking and Insurance
LEV	Leverage
MENA	Middle East and North Africa
MESA	Middle East and South Asia
NWC	Networking Capital
OIC	Organization of Islamic Countries
OWS	Ownership Structure
PM	Profit Margin
RA	Radiyallahu Anhu (May Allah be pleased with him)
RIC	Risk Committee
RM	Risk Management
ROA	Return on Assets
ROE	Return on Equity
SAC	Sharia Audit Committee
SAW	Sallallahu alaihi wa sallam (may peace and blessings be upon him)
SBZ	Sharia Board Size

SCE	Sharia Committee Expertise
SCM	Sharia Committee Meeting
SEA	Southeast Asia
SWT	Subhanahu wata‘ala (The most glorified, the most high)
SG	Sharia Governance
SNCR	Sharia Non-Compliant Risk

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KESAN TADBIR URUS KORPORAT, TADBIR URUS SHARIA DAN PENGURUSAN RISIKO TERHADAP PRESTASI PERBANKAN ISLAM DI AFRIKA

ABSTRAK

Perbankan Islam telah menjadi subjek perbincangan semasa dalam kalangan cendekiawan dan pengamal industri. Ini berhubung dengan krisis kewangan global yang sedang berlaku di negara-negara berkembang dan maju. Perbankan Islam telah wujud di Afrika selama beberapa dekad, malah bank Islam pertama juga berasal dari Mesir. Walaupun populasi Muslim mempunyai jumlah kedua terbesar selepas Asia, prestasi perbankan Islam merupakan yang paling rendah di Afrika. Walau bagaimanapun, cabaran ini boleh dikaitkan dengan tadbir urus dan pengurusan risiko kerana kegagalan korporat kebiasaannya dikaitkan dengan tadbir urus korporat dan pengurusan risiko. Sebagai tambahan kepada tadbir urus korporat, bank Islam juga mempunyai tadbir urus syariah; yang bertujuan untuk memandu pematuhan syariah dalam operasi dan dalam pembinaan produk bank yang merupakan perbezaan utama antara sistem perbankan Islam dan sistem konvensional. Tiga objektif telah dikenalpasti untuk kajian ini untuk menangani masalah tersebut. Objektif pertama adalah untuk menganalisis hubungan tadbir urus korporat dengan prestasi bank Islam di Afrika. Kedua, untuk menilai kesan tadbir urus syariah terhadap prestasi bank Islam di Afrika. Akhirnya, untuk menyelidik kesan pengurusan risiko dan prestasi bank Islam di Afrika. Data panel telah digunakan dalam kajian dari tahun 2015 hingga 2020 untuk 28 buah bank Islam di Afrika. Reka bentuk kajian korelasi telah digunakan untuk menentukan hubungan antara pembolehubah. Data dikumpulkan melalui sumber sekunder daripada penyata kewangan bank. Analisis regresi panel

digunakan dalam menganalisis data menggunakan Kaedah Umum Momen (GMM) untuk mencapai objektif yang dinyatakan. Kajian ini mendapati bahawa tadbir urus korporat sebagai komponen penting dalam bank adalah signifikan dalam menentukan prestasi bank Islam di Afrika. Ini menunjukkan bahawa pencapaian objektif dan akauntabiliti perniagaan dengan saiz lembaga dan kebebasan lembaga yang sesuai. Selain itu, dapatan kajian juga menunjukkan bahawa tadbir urus syariah adalah signifikan dalam prestasi bank Islam. Ini menunjukkan fungsi penting tadbir urus syariah dalam menghalang ketidakpatuhan syariah yang merupakan ciri unik yang paling penting bagi bank Islam. Selain itu, pengurusan risiko menunjukkan peranan yang rancak dalam risiko syariah dan risiko kecairan dalam meningkatkan prestasi bank Islam. Penemuan kajian ini memberikan implikasi yang signifikan kepada tadbir urus dan pengurusan risiko bank Islam di Afrika. Keputusan kajian ini mempunyai implikasi praktikal kepada pembuat dasar dan pembuat keputusan dalam mereka bentuk dan melaksanakan strategi tadbir urus dan pengurusan risiko yang berkesan untuk bank Islam. Kebanyakan kajian lepas tertumpu kepada prestasi bank Islam di Asia dan Timur Tengah dengan mengabaikan konteks Afrika. Tambahan lagi, beberapa kajian telah mengkaji kesan gabungan tadbir urus korporat, tadbir urus Syariah dan pengurusan risiko terhadap prestasi perbankan Islam. Oleh itu, kajian ini mengisi lompang tersebut dengan menjalankan analisis menyeluruh terhadap faktor tadbir urus dan pengurusan risiko yang mempengaruhi prestasi bank Islam di Afrika. Keputusan mendapati bahawa bank Islam di Afrika harus mengamalkan amalan terbaik tadbir urus korporat dan tadbir urus Syariah untuk memastikan akauntabiliti dan pematuhan prinsip-prinsip Islam. Kajian ini juga mengesyorkan bahawa bank Islam di Afrika harus mempelbagaikan portfolio dan menguruskan risiko kecairan mereka dengan berkesan untuk menghadapi turun naik pasaran dan ketidakpastian.

THE EFFECT OF CORPORATE GOVERNANCE, SHARIA GOVERNANCE, AND RISK MANAGEMENT ON THE PERFORMANCE OF ISLAMIC BANKS IN AFRICA

ABSTRACT

Islamic banking has become a contemporary topic of discussion amongst academics and practitioners. This relates to the ongoing global financial crises in developing and developed nations. Islamic banking in Africa has been in existence for decades; in fact, the first Islamic bank was from Egypt. Despite having the second-largest Muslim population after Asia, Islamic banking performance is the lowest in Africa. Nonetheless, this challenge can be attributed to governance and risk management, as most corporate failures are attributed to corporate governance and risk management. In addition to corporate governance, Islamic banks have Sharia governance; these guides Sharia compliance in their operations and in building their products, which is the primary distinction between Islamic and conventional systems. Three objectives were formulated for this study to accommodate these problems. The first objective was to analyse the effect of corporate governance on the performance of Islamic banks in Africa. Secondly, to examine the effect of Sharia governance on the performance of Islamic banks in Africa. Lastly, investigate the effect of risk management on the performance of Islamic banks in Africa. Panel data were used in the study from 2015 to 2020 for 28 Islamic banks in Africa. A correlational research design was used to determine the relationship between the variables. Data was collected through secondary sources via the financial statement of the banks. Panel regression analysis was used in analysing the data using a generalized method of moment (GMM) to achieve the stated objectives. The study discovered corporate governance as a vital component in banks is significant in ascertaining the performance of Islamic banks in Africa. This implies achieving the business objective and accountability with the appropriate board size and board independence. More so, the findings also indicated that Sharia governance is significant in the performance of Islamic banks. This implies the vital function of Sharia governance in deterring Sharia non-compliance, which is the most important unique feature of Islamic banks. In addition, risk management indicated the vivacious role of Sharia risk as well as liquidity risk in improving the performance of Islamic banks. This study's results have practical implications for policymakers and decision-makers in designing and implementing effective governance and risk management strategies for Islamic banks. Previous research has mostly centred on the performance of Islamic banks in Asia and the Middle East while neglecting the African context. Moreover, few studies have examined the combined effects of corporate governance, Sharia governance, and risk management on Islamic banking performance. Therefore, this study fills these gaps by conducting a comprehensive analysis of the governance and risk management factors that influence the performance of Islamic banks in Africa. Based on these results, Islamic banks in Africa should adopt best practices of corporate governance and Sharia governance to ensure accountability and compliance with Islamic principles. The study also recommend that Islamic banks in Africa should diversify their portfolios and manage their liquidity risk effectively to cope with market fluctuations and uncertainties.

CHAPTER 1

INTRODCUTION

1.1 Introduction

Islamic banking is gaining global recognition, especially with the unending financial crisis Kayed and Hassan (2011), Rabbani (2022), and Kadi (2023). This is because the banking sector is one of the most important parts of every nation's economy, hence the need to study the sector's management and how it affects performance. Corporate governance is one of the most important components in achieving organizational performance, and in addition, Sharia governance is required for Islamic financial institutions.

Banking is a vital component in the contemporary economy by facilitating the provision of financial resources to individuals and enterprises. The banking industry has a significant role in influencing the national economy by providing investment, loans, and infrastructure. The significance of the banking sector's success lies in its multiple impact on the economy. Banks that exhibit strong performance have the potential to foster economic growth through the provision of loans to both enterprises and individuals. This, in turn, engenders job creation and improves consumer expenditure. On the contrary, underperforming banks may have adverse effects on the economy as they reduce the availability of credit to both firms and individuals, causing a decrease in economic activity. Hence, financial institutions must maintain a good level of performance to ensure the stability and advancement of the economy (Alam et al., 2021).

For Islamic finance to be successful, it must comply with Sharia principles. Therefore, it will only be possible to achieve an organization's objectives with the right people to cater for the risk management challenges. The primary objective of this research is to investigate how corporate governance, Sharia governance, and risk management effect the performance of Islamic banks in Africa. Effective management is essential for achieving high performance in any organization. According to Bourne et al. (2018), the concept of management encompasses the activities of planning, organizing, leading, and controlling resources to attain organizational objectives. Performance, on the other hand, refers to the results achieved by an organization or individual concerning their goals (Andersen et al., 2016). Effective management can help to improve performance because effective management practices play a crucial role in the early detection and management of performance concerns, mitigating the likelihood of their escalation into significant challenges. It can also motivate employees and establish a productive environment, which may result in higher performance. In addition, management can help to allocate resources effectively, which can improve the efficiency of an organization and lead to better performance. Finally, management can help to develop and implement measures and techniques that support the objectives of the organization, which may result in better performance over time.

1.2 Background of the Study

The inception of Islamic finance can be attributed to the principles of the Quran and Sunnah (Uddin, 2015). The Quran and Sunnah serve as authoritative sources that offer individuals guidance in adhering to the ideals outlined in the Holy Quran and the Sunna while making decisions throughout various domains of life. The concepts of Islamic finance, which are generally perceived as a contemporary development, may be traced back to the teachings of the Quran, which were revealed about 1443 years ago (Wan & Ismail, 2015).

Traditional Islamic banking instruments, such as letters of credit and checks, have been incorporated into conventional financial products. Some Islamic financial concepts originate in ancient Abrahamic traditions ((Islamic Finance Foundation, 2015). According to Choudhury and Malik (1992), eradicating interest was a gradual process, culminating in a fully-fledged Islamic system during the reign of Khalifa Umar (r.a). However, with time, Muslim communities gradually returned to dealing with interest, including during the Ottoman Empire (Koran, 2004).

As a complete way of life, Islam did not leave any aspect of existence without proper guideline. The modern Islamic finance generally date back to the second century (SarayCon, 2018). During the silk route, when traders passed through the Arabian Peninsula from China to Europe (Ghazanfar, 2004). The Islamic banking concept emerged after the fall of the Khalifate. In the mid-1930s, Islamic religious scholars (ulamas) recognized the socio-economic problems of the time and attempted to address the issue of interest, which was becoming a pandemic. They developed an Islamic approach that prohibited interest and relied on profit and loss-sharing arrangements (Abasimel, 2023). They approached the issue differently from the modernists and apologists trying to justify staying away from Islamic rulings on interest. Instead of altering the Islamic teachings to suit contemporary practice, they reiterate the Islamic position without compromising and strive to achieve conformity with Islamic standards and principles (Chapra, 2004).

It is possible to track the origins of Islamic banking and finance in general since the initial phase of history, which follows a gradual progression. According to Choudhury and Malik (1992), Islamic banking culminated with a fully-fledged Islamic economic system under Khalifa Umar between 634 to 644 CE. However, with the rise and fall of Islam from time to time, there was a shift gradually from non-interest banking to interest banking systems found among Muslims and Muslim countries. This is due to colonization, conquest and penetration of the Western and Christian ideologies into the Islamic world. During the 1970s, several initiatives were undertaken to establish the Islamic banking system as a formal institution. These included the International Conference on Islamic Economics in 1976, organized in Mecca, Saudi Arabia; the International Economic Conference in 1977, held in London, United Kingdom; and the Conference of the Finance Secretaries of Islamic Countries in 1970, hosted in Karachi, Pakistan, among other conferences and studies. The primary objective of these events was to implement the theory of the Islamic Financial System into practice.

However, the modern pioneer experiment with Islamic banking started on the African continent. Ahmad Elnaggar founded the bank in Egypt without projecting a picture of Islam out of apprehension of being associated with Islamic fundamentalism, and thus being seen as a denunciation of the political government. In 1963, the Egyptian town of Mit Ghamr served as the location of the institution's humble beginnings as a savings bank operating on a profit-sharing model. This trial continued until 1967; by 1981, nine such banks were in the country. Furthermore, in 1975, the United Arab Emirates (UAE) established its first Islamic bank, which is referred to as Dubai Islamic Bank. Also, the United Bank of Kuwait was the first traditional bank to offer services that are Sharia compliant when it opened for operations in Kuwait in 1997. By 2019 there were already 526 Islamic banks across the globe, and they are still growing (Mordor Intelligence Report, 2022).

Islamic banking is advantageous over conventional banking for two main reasons. The first is the conviction that Islamic financial institutions will always adhere to greater ethical standards. The second is that being an asset-based system, and earnings are derived from identifiable assets. Islamic banks are prohibited from earning money through interest-based transactions and instead rely on profit and loss sharing arrangements. To generate revenue, Islamic banks depend on tangible assets such as real estate and equity and charge rent on these assets. This is an alternative to the use of interest and allows Islamic banks to earn a profit while adhering to Islamic principles.

The Islamic finance sector has experienced significant growth, representing approximately 1% of world financial assets. According to the Islamic Finance Development Report (2021), it is projected that the value will exceed USD 4940 trillion by the year 2025. The present financial crisis has been documented as seeing the most substantial decrease in the stock market since the 2008 financial crisis, all within one week (Peltz, 2020). Islamic banking has grown significantly and is currently recognized as one of the rapidly expanding sectors within the financial industry (Mahomadrizoevna and Sodirovich, 2022; Mukhitdinova, 2023). Based on the findings of the Global Islamic Finance Market Report released in 2019, it is evident that Islamic banking holds the largest share within the industry, constituting 71% or $1.7 trillion. Projections indicate that this subsector is anticipated to grow further and reach $2.175 trillion by 2024. Additional components of the system encompass takaful, Sukuk, and the Sharia capital market.

Over the years, Islamic finance has seen a considerable growth of 10% to 12%, with countries like Malaysia, Iran, Saudi Arabia, and UAE in the lead. The majority of the world's Islamic banking and financial assets are situated in the Middle East and Southeast Asia, accounting for more than 80% of the industry asset (Debashis & Xuan, 2018). Islamic banks performance has been commendable over the years, with Sharia-compliant banking assets growing at 17.6% between 2009 and

2013 and is expected to grow by up to 19.7% in 2018 (Al-Deehani, 2015). This is quite an impressive growth for an industry of about three decades only. Islamic Finance Services Board (IFSB) asserts that that the PSIFIs (Prudential and Structural Islamic Finance Indicators) database shows that eleven of the twenty-two jurisdictions covered by the database experienced double-digit growth in assets, at least nine of the jurisdictions experienced the same achievement in financing growth. Only one region saw deposits increase by double digits compared to 2017, but at least eight regions improved by at least two percentage points. There are 189 fully-fledged Islamic banks as of 2018 compared to 169 in 2013, with branches growing from 28,717 in 2013 to 29,652 by the end of 2018 (African Review, 2019). Even with the Covid pandemic, global Islamic finance maintained its growth momentum of USD 2.70 trillion in 2020 (IFS, 2021).

The Islamic banking industry is prompted by improved asset quality because of expanding financing, among other factors. The industry's stability indicators are pleasing to the bare minimum of international regulatory standards and favourably contrast with traditional banking in the US and the EU (IFSBoard report 2019). The IFSB report also revealed that global Islamic banks have a higher return on assets (ROA) of 1.8% and 16.3% of return on equity (ROE) compared to their conventional counterparts' moving averages of 1.6% and 13.0% over the past five years. The global Islamic banking industry has a higher return on equity than conventional banks in the European Union (7.2%), and United States (11.9%) over the same period. This demonstrates the growth that has occurred over time in the Islamic banking industry, which has exhibited promising performance. Even though it holds just a small portion of the international market, Islamic banking has expanded its presence in many nations.

Examining corporate governance, shariah governance, and risk management practises in Islamic banks operating in Africa is an intricate and diverse subject encompassing a broad spectrum of factors. Kikhia (2014), Soveinia & Haryanto (2022), and Tashkandi (2023) highlight several variables that require consideration, including board size, board independence, foreign directors, external audit, ownership structure, shariah board size, shariah audit committee, risk committee, meetings of the shariah committee, shariah committee expertise, nett working capital, and leverages. These variables are interconnected and play a crucial role in shaping the corporate governance structure of both conventional and Islamic financial institutions. They contribute to the financial stability, operational efficiency, and overall success of these institutions.

Numerous existing research papers have investigated the correlation between these variables and the performance of Islamic banks. The research conducted by Mousavi et al. (2022) revealed that the board size of a company is vital in determining the effectiveness of its corporate governance practises and has a notable impact on the probability of occurrences of fraudulent financial statements. A larger board size with extensive networks and connections within the external environment might facilitate a company's access to various resources and subsequent enhancement of firm performance, according to a recent study by Almashhadani & Almashhadani (2022).

According to the findings of a study conducted by Hapsari & Rokhim (2017), it was determined that foreign ownership has a positive effect on the performance of banks in Indonesia. Moreover, research by Arsyianti (2019), indicated that the presence of Sharia audit committees holds significant significance in upholding adherence to Shariah law and ethical norms in Islamic banking institutions. Board independence refers to a situation where the majority of board members are independent directors who have no affiliation with the firm or its managers. According to Orozco et al. (2018), it is regarded as an indication of effective management and a method to avoid or decrease unethical behavior within corporations. More so, foreign directors, as stated by Masulis et al. (2018), can offer essential international expertise and guidance to companies, particularly those with substantial foreign activities or intentions to expand abroad. In addition, external auditors play a crucial role in promoting corporate governance by verifying the accuracy of a company's financial reporting and evaluating the company's overall risk tolerance. According to research conducted by El Rakyby in 2024, it has been found that efficient external audit procedures have a favorable impact on corporate performance by increasing transparency, credibility, and investor trust. Furthermore, the ownership structure of a corporation has a direct impact on governance procedures and the behavior of the organization (Camisón-Zornoza et al., 2020). It establishes a balance of power within the organization. The consolidation of ownership can have a profound effect on business decision-making, governance processes, and long-term strategic direction (Bajagai et al., 2018).

According to Saleh, et al. (2023), the size of the Shariah Supervisory Board (SSB) plays a crucial role in reviewing and guiding the operations of Islamic banks, as well as maintaining their integrity, credibility, and transparency. According to their research, having larger Shariah boards can provide a wider range of viewpoints and more profound understanding of intricate ethical and religious matters. This, in turn, enhances the effectiveness of governance in Islamic financial institutions. In addition, Saleh, et al (2023) argues that the Shariah Audit Committee has a vital function in guaranteeing the adherence to Islamic principles in all activities and operations of an Islamic bank. However, risk committee provides support to the board in managing strategic risks at the organizational level. The implementation of appropriate procedures and regulations is essential for effectively handling significant risks and promptly informing top-level management about major risk matters (Tao & Hutchinson, 2013). Convening regular meetings of the Shariah Committee is crucial for the purpose of addressing and resolving matters pertaining to Shariah compliance in Islamic banks (Saleh, et al (2023). While the Shariah Committee's knowledge or expertise is crucial in guaranteeing the adherence to Shariah principles in all activities and operations of an Islamic bank (Nguyen, 2021).

Net working capital on the other hand, is a measure of a company's liquidity and its financial health in the short term. Shariah-compliant companies encounter distinct difficulties when it comes to handling working cash since they are limited by the prohibition of interest-based financing and the requirement to adhere to ethical business principles. Examining the correlation between net working capital management and business performance can provide useful insights into the financial robustness and competitiveness of Shariah-compliant companies (Hassanein & Mostafa, 2023). Leverage is the utilization of borrowed monies to finance the acquisition of a company's assets. Utilizing high leverage has the ability to enhance the return on investment, but it also escalates the danger of default. In Shariah-compliant enterprises, the utilization of leverage is regulated by Islamic principles that forbid interest-based loans and speculative endeavours. Examining the influence of leverage on the performance of firms in Shariah-compliant settings can provide insights into the balance between financial leverage and adherence to Shariah principles, as well as the consequences for risk management and decisions about capital structure (Mennawi, 2020).

By examining these diverse aspects and their influence on Islamic banks' performance in Africa, scholars can gain valuable knowledge on the functioning and efficacy of these institutions. This assessment can facilitate the identification of areas for enhancement and provide valuable insights for policy-making attempts to foster the expansion and advancement of Islamic banking in the African region.

Furthermore, the discussion in the background will be divided into four parts: African Islamic banking, Islamic banking performance, corporate governance, and risk management of Islamic banking.

1.2.1 Islamic Banking

Over the course of the past two decades, the Islamic finance industry has undergone extraordinary expansion, with most concentrated in the Arab world (Saudi Arabia, Oman, UAE, Egypt, Qatar etc.) and other Islamic countries (Indonesia, Pakistan, Malaysia etc.). According to IFSB, The GCC area holds the biggest portion of the world's Islamic banking assets, followed by Asia, then which had a smaller portion. Despite the area's low share of global Islamic banking assets, numerous efforts and initiatives are being made to establish the IFSI in sub-Saharan Africa firmly. According to Sayyed and Tahir (2007), Islamic banking is just coming up in Africa.

Table 1.1 Breakdown of Islamic Banking Share by Region

Region	**Banking Assets (USD)**
GCC	979.7
South-East Asia (SEA)	258.2
Middle East and South Asia (MESA)	499.0
Africa	43.1
Others	61.8

Source: Islamic Financial Service Stability Report (2021)

Islamic banking asset has seen tremendous growth over the period, with USD 1.68 trillion, USD 1.58 trillion, USD 1.77 trillion, and USD 1.84 trillion in 2017, 2018, 2019 and 2022 projection, respectively (Islamic Finance Services Industry Stability Report, 2021). Figure 1 indicates that the GCC (Gulf Cooperation Council) region has the highest share of Islamic banking, then the MESA (the Middle East and South Asia) region, then South-East Asia, and at the bottom is Africa.

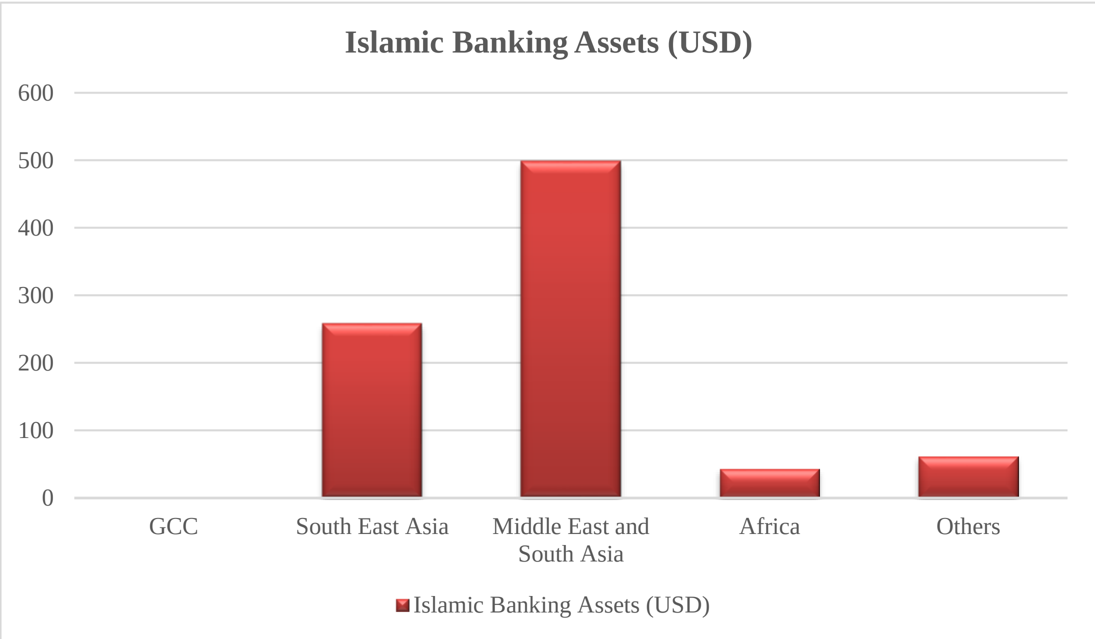

Figure 1.1 Islamic Banking Share by Region
Source: Islamic Financial Service Stability Report 2021

A clear picture of the share is provided in figure 1.1, which shows clearly that Africa has the least share despite the number of Muslims on the continents. Africa is a potential region in which Islamic finance can undeniably thrive. Islamic Financial Services Industry Stability Report (2021) claims that Africa has seen numerous growths stressing its expressive viable market for Islamic banking. In the second quarter of 2018, Nigeria's non-interest banking retained its 0.3% percentage of all domestic banking assets. However, this increased to 0.7% in 2021 with the establishment of another fully-fledged bank in 2019.

In Morocco, several banks opened their doors for participatory banking in 2017. Furthermore, Tunisia is about to enhance its regulatory environment to support the growth of its 5.1% market position in the Islamic banking industry. Algeria is also getting ready to establish the necessary regulatory framework and allow a few banks to introduce banking products that adhere to Sharia. Although there are currently only three Islamic banks and a handful of Islamic windows in Kenya, the country is contemplating a proposed Islamic banking regulatory framework that aims to promote the development of the sector and attract foreign capital inflows to the country. Conversely, Uganda has not yet put its early 2018 Islamic banking regulation into operation.

The Central Bank of Nigeria (CBN) has been actively engaged in fostering the expansion of Islamic banking inside the country of Nigeria. The Central Bank of Nigeria (CBN) has recently released regulatory rules for the oversight and management of Islamic banking within the country. Consequently, a number of banks have been authorized to establish Islamic banking windows, while two institutions have been granted full-fledged licenses to operate as Islamic banks. Egypt possesses a robust and firmly developed Islamic banking sector, characterized by the presence of multiple Islamic financial institutions operating inside its borders. Sudan harbors a flourishing Islamic banking sector, encompassing the operation of multiple Islamic banks inside its borders. The Islamic banking business in South Africa is characterized by its modest size, however it is seeing a notable expansion. Multiple institutions inside the country provide a range of Islamic banking products and services. Islamic banking businesses are also present in Libya and Mauritania, where a number of Islamic banks are actively working.

Islamic banking institutions have also been set up in several African nations with the help of multilateral organizations; these countries include Senegal, Benin, Mali, and Côte d'Ivoire (IFSISR, 2019). Based on the report of the United States Commission on International Religious Freedom, the Muslim population in Africa is more than 45% of the continent's population (Vellturo & Omer, 2021). Additionally, there are at least 500 million Muslims currently living in Africa, which is one-fourth of the world's Muslim population (STATISTA, 2023). The IFSI Stability report of 2021 disclosed that even though Africa recorded the highest improvement in terms of asset worth with a 27.1% increase, however, the region still recorded the lowest percentage of Islamic bank assets worldwide with only 2.3%.

Additionally, with the huge number of people still unbanked and only 42% of the populace holding a deposit or checking account at a recognised financial institution (world bank, 2020). This shows the capability of Islamic banking to strive with more efforts required from stakeholders of the industry.

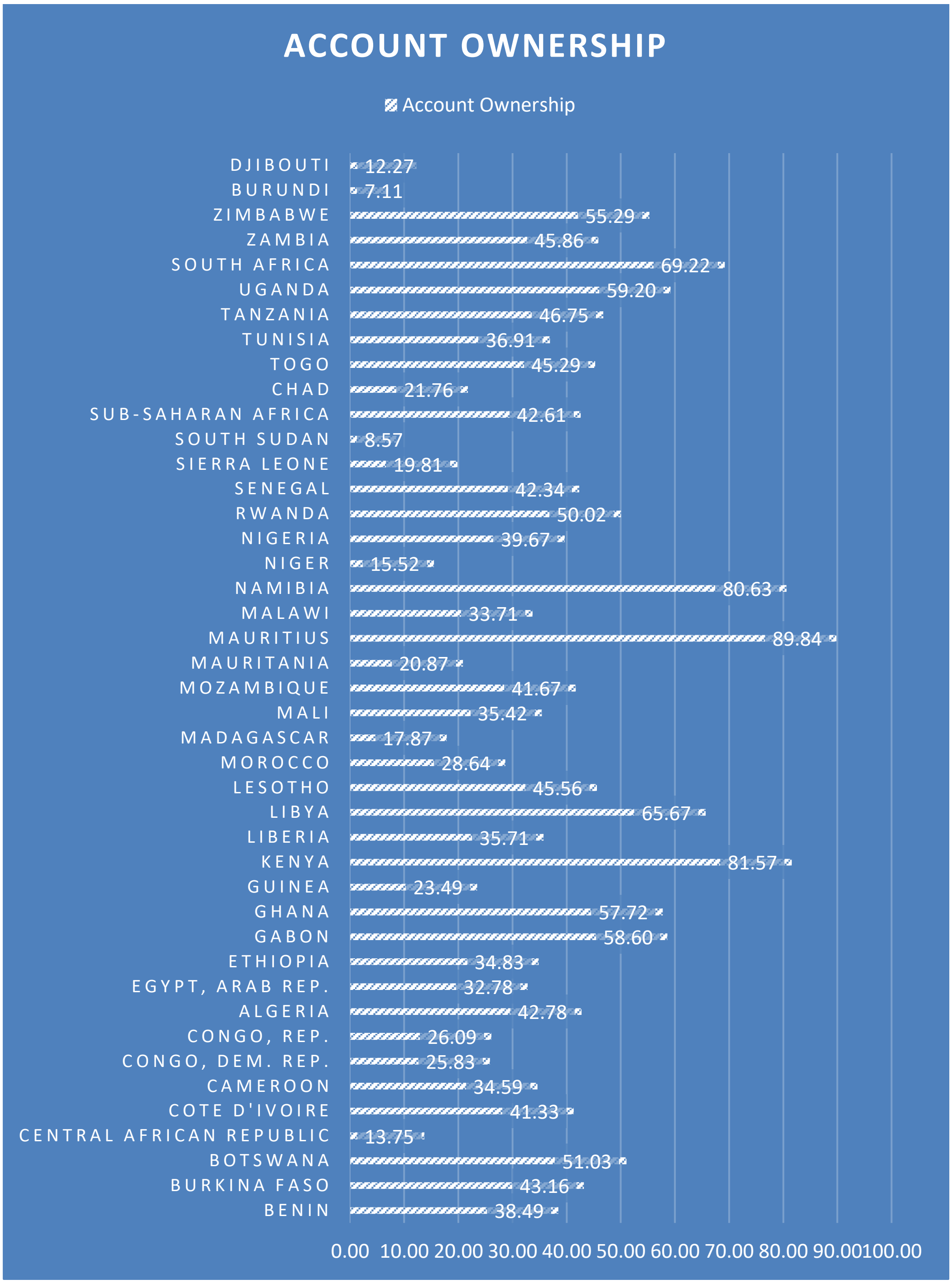

Figure 1.2 Account Ownership in African Countries
Source: World Bank Database (2022) And Author's Graph

Figure 1.2 shows account ownership by country, with Mauritius having the highest number of banked at 89.84 followed by Kenya with 80.63 and Namibia with 80.63. While at the bottom list is Djibouti with 12.27%, South Sudan with 8.57%, and Burundi with 7.11%. However, for the entire sub-Saharan Africa, only 42.62% possess an account with a financial institution or other providers of mobile money services. Meaning that there are still 57.38% unbanked across the continent. The unbanked have neither bank accounts nor access to any financial services. Although more African countries now have access to financial services with mobile money, other emerging technologies are expanding people's access to banking and other financial services. However, despite numerous changes across the continent, when compared to other developing countries, the financial structures of several African nations still need to be enhanced. Less than one-fourth of people in Africa had access to formal financial services in 2012 (Demirguc-Kunt & Klapper, 2012). However, this has improved to about half of the population of about 42%, according to World Bank Database (2022). Despite the improvement, there is still a huge market of about 58% of the unbanked population.

The banking sector plays a crucial role in the economy by providing financial services to individuals, businesses, and governments. Banks are responsible for mobilizing savings and channelling them into productive investments, which can lead to increased production, employment, sales, and prices, and thereby, faster economic development. According to a report by the World Bank, banking sector openness may directly affect growth by improving the access to financial services and indirectly by improving the efficiency of financial intermediaries (Bayraktar & Wang, 2008). In addition, a study by the IMF found that higher credit growth, arising from better capitalized banks with lower non-performing loans, is associated with higher GDP growth.

1.2.2 Islamic Banking in Africa

According to Moody's, the adoption of Islamic banking in Africa has been limited despite the presence of sizable Muslim populations on the continent. According to Gelbard (2014), Sub-Saharan Africa (SSA) is home to around 18% of the global Muslim population. However, the Islamic finance assets in this region account for merely 1% of the total global assets in this sector. There are several factors contributing to this issue, including inadequate levels of banking inclusion, insufficient public knowledge, limited domestic savings, and historically minimal government focus (Shinkafi, 2020). Nevertheless, there is an anticipated significant growth in Islamic banking assets across Africa.

Africa possesses significant potential for expansion in the realm of Islamic banking, primarily attributable to its substantial Muslim populace, a modest initial foundation, and an increasing level of governmental attention towards this sector (Hassan, 2022). The countries at the forefront of this growth trajectory in Africa are Egypt, Morocco, Sudan, South Africa, Nigeria, and Senegal. Except for South Africa, the nations, as mentioned earlier, possess substantial Muslim populations and are currently witnessing the implementation of dynamic legal and supervisory frameworks to facilitate swift expansion.

The previous year has witnessed a period of swift recuperation for the largest banks in Africa. The Covid-19 pandemic and its related limitations had a negative impact on revenue and profitability. However, the resilience of banks and proactive support from certain central banks played a crucial role in enabling them to manage the issue effectively.

The penetration of Islamic finance is progressively expanding in certain regions of the continent. For instance, Banque Nationale d'Algérie is currently in the process of establishing twelve branches that will only offer Islamic financing products. Similarly, Omdurman National Bank in Sudan strategically expands its Islamic banking activities by focusing on digital channels. Egypt, being the birthplace of the first bank according to Islamic banking principles in 1967, currently has 14 out of the total 38 licensed banks in the country that provide Islamic banking products. According to Ahmad (2015) and Zubair (2023), proponents contend that Islamic banking facilitates increased investment in economically productive sectors, such as agriculture, compared to conventional banking. This is attributed to the presence of certain constraints that limit the sectors eligible for financial support.

According to Parker (2021), there are a wide range of barriers that prevent entry into the field, along with the advancements mentioned above. Islamic finance in Africa can be broadly categorized into three distinct groups. The first group consists of countries like Sudan, Senegal, and Djibouti, where there is a proactive policy and regulatory support for Islamic finance. The second group includes countries like Kenya and South Africa, which may not actively promote Islamic finance but are open to developing it as a niche industry. Lastly, there are countries like Nigeria, which have the potential to be significant players in Islamic finance but face constraints due to political sensitivities. The impediments to the adoption of Islamic finance encompass both structural and behavioral factors rather than being solely driven by religious views. African nations have the potential to gain valuable insights from the experiences of Malaysia, Indonesia, and Turkey (Parker, 2021).

Islamic banks exhibit superior capitalization, lower risk, and greater liquidity when compared to conventional banks (Majeed & Zainab, 2021). Additionally, Islamic banks demonstrate higher levels of operational efficiency, asset quality, capital adequacy, and board independence (Wasiuzzaman & Gunasegavan, 2013). Nevertheless, it has been shown that conventional banks exhibit greater profitability and operational efficiency (Majeed & Zainab, 2021; Bitar et al., 2018), as well as larger size and board size (Wasiuzzaman & Gunasegavan, 2013). Islamic banks have the potential to enhance their scale, expand their product range, and decrease expenses (Majeed & Zainab, 2021). However, during the COVID-19 market downturn, both types of banks encountered adverse returns, with no significant distinction observed between them (Ashraf et al., 2022).

A significant proportion of Africa's population, regardless of religious affiliation, needs access to banking services or has limited financial inclusion. Consequently, this demographic represents a promising market with substantial growth potential for expanding Islamic banking and finance. Islamic banks have the potential to significantly contribute to the advancement of financial inclusion and economic progress in the African region.

1.2.3 Performance of Islamic Banks

Every country's economic growth is inextricably linked to the health of its financial system because that is where the power to regulate the amount of money that is circulating lies, which is the primary factor that encourages economic development (Xiang et al,. 2021; Gebremichael, 2022). Economic development is extremely dependent on resource mobilization and effective and efficient investment of resources. Therefore, A healthy banking industry is necessary for a flourishing economy, which helps with factors like GDP growth, employment creation, wealth creation, poverty reduction, and the encouragement of entrepreneurship (Dhanuskodi, 2012). The banking sector also greatly impacts a nation's monetary policies; it enables the creative and effective utilization of funds, therefore assisting society in producing more wealth. Banks will undoubtedly continue to receive increased public monitoring as well as due diligence from financial regulators as the requirement to assess banks more efficiently and effectively increases. Shareholders, supervising institutions, regulators, and bank management entities are not the only ones worried about banks' stability and long-term success. Customers of banks are also getting more worried about the stability and long-term success of these financial institutions.

The performance of Islamic banks has been inspiring with improvement each year, even though most growth is in the Gulf Region. Nevertheless, with more efforts and dedication, the unbanked of the African continents can be adequately carried along.

Table 1.2 Top Islamic Finance Assets Market

Ranking	Country	Percentage Share of Global Asset (%)
1	Saudi Arabia	28.5
2	Iran	22.1
3	Malaysia	11.4
4	UAE	9.2
5	Qatar	6.5
6	Kuwait	6.0
7	Bahrain	3.5
8	Turkey	3.0
9	Bangladesh	2.3
10	Indonesia	2.1

Source: Global Islamic Economy Report (2021)

Table 1.2 shows the ranking of the top ten countries with a percentage share of the global Islamic finance markets as of 2021, which is led by Saudi Arabia with 28.5%, followed by Iran with 22.1%, then Malaysia with 11.4%, United Arab

Emirate 9.2%, Qatar 6.5%, Kuwait 6.0%, Bahrain 3.5%, Turkey 3.0, Bangladesh 2.3%, and Indonesia 2.1%.

According to Islamic Finance Indicators data (2021), Islamic finance assets are at USD2.52 trillion, with a 3.5% annual growth. Out of the USD2.52 trillion, 70% forms the Islamic banking sector, which is expected to grow to USD3.47 trillion by the year 2024.

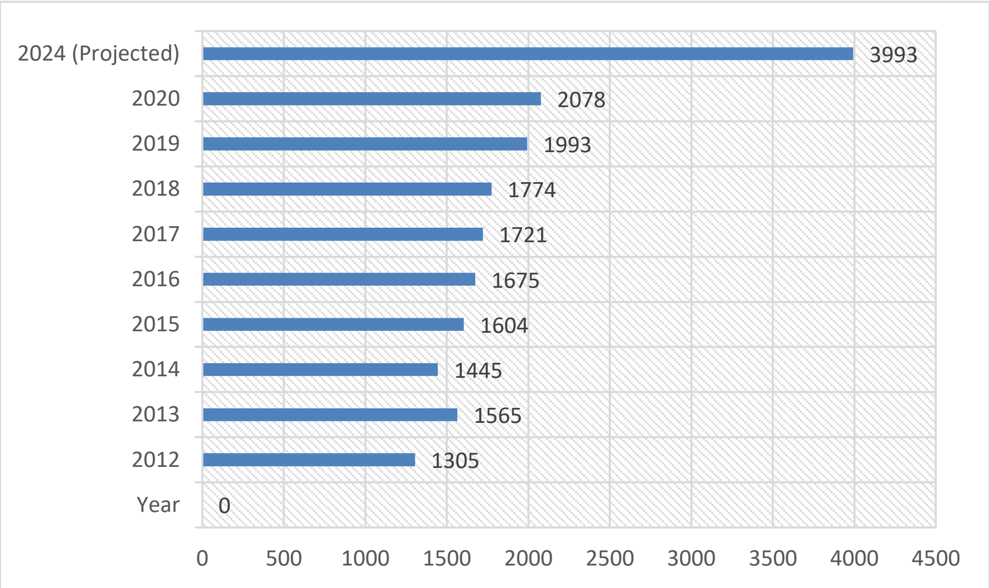

Figure 1.3 Islamic Banking Asset Growth
Source: Global Islamic Economy Report (2021)

Figure 1.3 displays the progression of Islamic Banking assets over the years, which indicates the good performance in the sector. Growing from USD 1305 billion in 2012, USD 1565 billion in 2013, USD 1445 billion in 2014, USD 1604 billion in 2015, USD 1675 billion in 2016 to USD 1721 billion in 2017, USD 1774 in 2018, USD 1993 in 2019 to USD 2078 in 2020. More so, it is projected to reach USD 3693 billion by 2024.

There are several reasons for the need to assess the performance of banks. One of which is to regulate their operational results and overall financial conditions.

Likewise, to monitor and examine the managerial quality and efficiency, measure the quality of their assets, and follow up if their achievement aligns with their objectives. Similarly, to assess the companies' earning quality, cash sufficiency, liquidity, and innovative capacity as well. The work of banks must be carefully assessed, scrutinized, and analysed in order to ensure a robust financial system and effective economy. Several variables, including but not limited to Sharia governance, Sharia risk management, and liquidity risk management, have an impact on how well Islamic banks function. Some of these other factors include non-performing financing, capital strength, GDP, and Inflation (Setyawati et al., 2017), credit risk (Benamraoui, 2008), and high capital (Hassan & Bashir, 2003).

Furthermore, several empirical studies have conducted comparative analyses between conventional and Islamic banks, revealing little noteworthy disparity in terms of business direction, efficiency, asset quality, or stability between these two banking models. Nevertheless, it has been seen that Islamic banks exhibit a lower tendency to engage in disintermediation during a financial crisis, as highlighted by Beck et al. (2013). According to the study by Majeed & Zainab (2021), it is indicated that Islamic banks have a higher level of cost-effectiveness compared to regular banks in a comprehensive cross-country analysis. However, this observation is found to be reversed when examining a broad cross-country sample of countries that possess both Islamic and conventional banking systems. Nevertheless, in countries where Islamic banks hold a larger market share, conventional banks tend to exhibit greater profitability but need more stability and efficiency (Majeed & Zainab, 2021; Bitar et al., 2018). Furthermore, Islamic banks have higher capitalization and liquidity reserves, which explains why they did better during the recent crisis (Wasiuzzaman & Gunasegavan, 2013). Although there are certain distinctions between the two categories of banks, these disparities are comparatively less significant than initially anticipated.

1.2.4 Corporate Governance in Islamic Banks

The unending financial crisis has made individuals and corporations align their activities based on an ethical stand. The 2008 Global Financial Crisis, which caused major companies like Enron to fail, has rapidly transformed how people view banking and corporate activities in general. Most of the problems realized during the crisis were corporate governance challenges and risk exposure. Corporate governance's primary goal is to raise publicly traded businesses' market capitalisation through more effective management and supervisory processes, which is achieved through disseminating accurate and timely information to investors (German Industry Association & Price water house Coopers, 2002).

Management components of banks are generally monitored through corporate governance, while the Sharia aspect of the banks is monitored through Sharia governance. It is paramount therefore, for Islamic financial institutions to establish Sharia board with excellent knowledge of finance and Islamic jurisprudence. According to Armani (2020), there is no standard template for effective corporate governance. Nevertheless, there are some essential factors that determine the worth of governance. These crucial elements serve as the foundation for the principles, which are detailed to apply to existing models. They are not enforceable and do not set forth specific requirements that must be incorporated into national legislation. Instead, they establish objectives and offer various strategies for achieving them (Mohammed & Hassan, 2020). Different corporate governance reports from different countries have emerged over the years. Examples are the Cadbury Report of 1992, the Green Report of 1995, the Combined Code of 1998, the 2003 and 2006 Corporate Governance Combined Code and the 2003 Higgs Report. Nevertheless, the need to have a standardized corporate governance code is essential for a growing industry like Islamic banking.

Table 1.3 Governance and Sharia Governance Ranking

Governance	
Ranking	Country
1	Malaysia
2	Bahrain
3	Kuwait
4	UAE
5	Oman
Sharia Governance	
1	Kuwait
2	Malaysia
3	Bahrain

Source: Islamic Finance Development Report (2021)

The governance ranking in table 1.3 shows that Malaysia is leading, followed by Bahrain, Kuwait, United Arab Emirates and Oman. However, according to Sharia governance, Islamic banking rankings indicate Kuwait leading, followed by Malaysia and Bahrain. Malaysia is leading in the governance ranking while second in the Sharia governance ranking. Bahrain is second in the governance ranking while third in the Sharia governance ranking. However, Kuwait is third in the governance ranking but first in the Sharia governance ranking.

Nevertheless, no single African country is listed on the governance and Sharia governance rankings. This indicates the inadequacy and inefficiency of corporate governance and Sharia governance in African Islamic banks. However, using the same name, "governance", governance and Sharia governance may differ (Mizushima, 2014). Typically, Sharia administration is defined as:

> “a collection of administrative and organizational arrangements that are put in place by Islamic Financial Institutions in order to guarantee that there is an efficient and independent monitoring of Sharia compliance over the issuance of relevant Sharia pronouncements, dissemination of information and an internal Sharia compliance review (IFSB, 2009)."

On the other hand, governance, which also refers to corporate governance, was defined by OECD Report (2004) as:

> "Involving a set of relationships between a company's management, its board, its shareholders, and other stakeholders, corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined."

1.2.5 Risk Management in Islamic Banking

Globalization has opened many doors regarding opportunities, risks, and prospective losses. Risk in the banking sector can be from uncertainties, natural causes, and deliberate attacks from competitors. Risk management is an essential component of every cooperation, most especially in the banking sector. Islamic banks are unique in terms of operations compared to their conventional counterparts because it entails operations according to Sharia principles. In this regard, using financial instruments with predetermined or fixed interest rates is prohibited, and banks are required to follow specific procedures when conducting business (Errico & Farahbaksh, 1998). Islamic banks, therefore, need to be more open and transparent