

CHAPTER I

INTRODUCTION

1.1 Background

In fact, Indonesia is the number one country with the highest number population of Muslims. Therefore, the needs of the Muslim community in Indonesia are becoming increasingly taken into account. One of the needs of the Muslim that is about how to stay away from the haram, in every single aspects in their life, including in economic aspect, Muslim have to make sure that everything is in halal context . The concept of halal plays a bigger role in the life of businessmen where they have to satisfy the demands of their Muslim customers for example to get the confidence in buying and selling in this sensitive part of Muslim belief (Toure, 2000). Talking about business or the financial sector, this can't be separated from the banking sector, one of which is still a controversy among Muslims about the bank namely, Riba (interest).

In Islam, usury (interest) is prohibited; .in this case, Riba is counted into Haram that must be avoided. This creates confusion and anxiety for Muslim, because Muslims need to use banking services, while on the other hand also have to stay away from Riba (interest).It is obvious then, that Islamic Banking present to help Muslim in avoiding interest-based transaction which is prohibited in Shariah. As Beck et al (2012) note, Islamic Banking are prohibited from charging interest (riba) payments, are not allowed to engage

in speculation, and are based on a profit and loss and thus risk-sharing model, not only for that, but also to avoid un ethical business practices and reach the effectiveness of achieving the goals and objectives of the Islamic Economy.

Islamic banking will be a trend in which financial institution used the set of Qur'an principles and laws that govern daily life. Islamic Banking is also predicted to grow rapidly in Indonesia along with increasing of institutional expansion and accelerated growth of Sharia banking assets is very high and coupled with the increasing volume of sukuk issuance based on data obtained from the Islamic Finance Country Index (IFCI). In running its function as Islamic institution, Islamic Banking must ensure that in every single of its operation based on Islamic principle, because the significant differences between Islamic Banking and conventional Banking are the latter provide Shariah compliant finance and have Shariah Supervision Board (SSB) as a key feature of their governance. SSBs are a significant feature of Islamic Banking and are considered as the 'Supra Authority' (Choudhury and Hoque, 2006).

Good Corporate is really important and crucial for a company to protect the interests of its stakeholders. If it is Islamic Banks, which offering financial product and services, the stakeholder will expect that whole of its operation be carried out in compliance with the principle of Shariah. Firstly, we show that the assumptions of Agency Theory make it unsuitable for analyzing governance in commercial banks because regulations intended to prevent

systemic risk (e.g. secure the integrity of the banking system) limit the disciplinary power of market forces (Ciancanellidkk, 2000). Secondly, we demonstrate that the agency problem in commercial banks is structurally different from that found in other publicly listed firms (Ciancanellidkk, 2000). A corporate structure that enables such as institution to implement good governance through Shariah- compliant operations is therefore essential (Grais and Pellegrini 2006). GCG Implementation in Shariah Banking is in order to make Shariah banking becoming more syar'i because the practice must really follow Islamic regulation or principle in every aspect including its operational things. The operational things must follow the principle declared by the *National Shariah Council and Indonesian Council of Ulama*.

The primary purpose of this study is to provide the empirical evidence concerning board characteristic and company's performance in Shariah Banking. Board of Commissioner is seen as the most important corporate governance mechanism that monitors and advises the top management in performing their responsibility to protect the shareholders' interest (Johl, 2015). Therefore by investigating board characteristic such as board independence, board meeting, board size and board expertise and experience, this study hopes to bring new approaches for researchers and regulators on the importance of board commissioner's characteristic and company's performance.

This research will be only focusing on characteristic of board toward bank's performance. Some research has lately examined the effect of corporate governance, which is board characteristic element toward company's performance, and most of them are examine the non-financial institution or firm. It can't be denied that for the Board of Commissioner as the top level management of the company can influence the performance of the company itself, some research point out there is positive effect of corporate governance on the value of non-financial firms (Lee et al., 1992), but in contrast, there is also research found that there are negative effect between board characteristic and firm performance. Writer intends to see how the result is going to be if it is in Islamic Banking institution. To support this research, writer will use the secondary data from Islamic Banking in Indonesia that published its annual report on its website. The data will be taken is the annual report of Islamic Banking in Indonesia from 2012-2017. That is why the title of this thesis is **“The Effect of Board of Commissioner's Characteristic to the Performance of Shariah Banking in Indonesia”**

1.2 Problem Identification

1. Does the frequency of board of commissioner meeting have significant impact toward Bank's performance?
2. Does the board of commissioner size have significant impact toward Bank's performance?

3. Does the independent board of commissioner have significant impact toward bank's performance?
4. Does the background of the board of commissioner have significant impact toward bank's performance?

1.3 Research Objectives

The objective of this research that use the board of commissioner size, number meeting of board of commissioner, proportion of independent commissioner and the board of commissioner background as the variable to get the empirical proof about:

1. Impact given by the Board of commissioner size toward Shariah Bank's performance.
2. Impact given by the frequency of meeting held by the board of commissioner toward Shariah Bank's performance
3. Impact given by the independent board of commissioner toward Shariah Bank's performance
4. Impact given by the Board of commissioner background toward Shariah Bank's performance

1.4 Research Benefits

By analyzing the impact of board characteristic toward the performance of the company especially in Shariah Banking in Indonesia, this research is expected can give benefit and contribution to

1. Researcher

This research is expected will be the reference for the next researcher and also can be the information that will advance the researcher knowledge in the future, and can be comparison for the next research that relate with company's performance through some additional revision of the variable that is not included in this thesis yet.

2. Organization

The result of this research will give a good insight for the organization about how the characteristic of board of commissioner give impact to the Shariah bank's performance, so that the organization can put more attention in their board of commissioner characteristic. This research also expected will be a foot-print for the organization to arrange its board of commissioner.

3. Regulator

This thesis also expected can give benefits for the regulator such as OJK (Financial Service Authority) by knowing the impact of board of commissioner characteristic to the performance, it expected will easier the OJK in doing its function to investigate and regulates the financial service sector.

1.5 Writing Systematic

The writing system in this thesis will be divided into five chapters, in order to get a quick review of this thesis. In Chapter one is the Introduction which gives the explanation about the background of the research, problem identification, research objectives and the research benefits. Chapter Two is

Literature Review, the concept and theories about Corporate Governance, board of commissioner characteristic, GCG in Shariah Banking and also the Shariah banking performance measurement will be explained in this chapter. This chapter covers the review of literature from related previous research and hypothesis development. Chapter three is the Research Method; about the methods will be used in this research will explained in detail. What kind of data collection method and data analysis method will explain here. The next is Chapter Four consist of the analysis and finding of the data. The data would be analyzed using the analytical software will show the result and its interpretation. The last part is Chapter Five, discuss about the conclusions and the suggestion based on the analysis and the finding from the chapter four.

