

Maqasid Shariah Performance Index Conceptualisation: Examples from Malaysia and Indonesia

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Abstract

Maqasid Shariah (MS) is a tool for analyzing the acceptability of Islamic structural reforms and their alignment with Islamic law's principles, aims, and objectives. Measurement of Islamic banks' performance can use MS index to find out to what extent where is the level of achievement of sharia values carried out in shariah banking. The purpose of this article is to investigate the legislative framework and the use of the MS index as performance index for Islamic financial institutions in Malaysia and Indonesia. Indonesia and Malaysia are two Muslim countries in Southeast Asia and have many similarities. Indonesian Islamic banking, carrying out its operational activities following the objectives of shariah, seems to be more prevalent in *Iqamah Al Adl*. In Malaysia, based on the MS concept shows the lack of application of shariah principles, especially in the case of *Tahdzib AlFard*, so that the existence of shariah banking in Malaysia still cannot be felt optimally to provide benefits in terms of education for employees and the surrounding community. Malaysia follows an instructional model in which the Shariah board serves as an advising body, but Indonesia follows a monitoring model in which the Shariah board serves as the supervisory body.

Keywords: Maqasid Shariah Index, Performance, Islamic Banks, Sharia Board, Corporate Governance.

Introduction

During the past several decades, Islamic finance has been witnessing a phenomenal development not only in countries where Islam is practiced, but also in countries where Islam is not practiced. The current expansion of Islamic finance has been encouraged by the construction of various Islamic monetary support and institutions, which have contributed to the industry (Dusuki, 2010). Islamic financial products must be designed and developed with a conservative mindset in conformity with *fiqh muamalah*. Furthermore, these products must be following the principles of sharia law. According to Islamic finance literature, the Islamic banks differs greatly from the conventional banks in several ways. The values that direct the

overall functioning and outlook of each financial system reveal a startling contrast between the two financial systems, these values are the source of the gap (Dusuki, 2010). In Islamic finance, these ideals are derived from the *Maqasid* Shariah, which may be translated as the purposes of sharia and have as their overarching goal the enhancement of human wellbeing (Asutay & Harningtyas, 2015). Therefore, the issue of convergence in Islamic finance towards the present neo-classical system may be gradually solved if certain general norms in *Maqasid* Shariah are carefully applied.

Malaysia and Indonesia are two Muslim countries in Southeast Asia, and if we look closely, there are many similarities. The Malay population dominates both countries, and the Syafii madhhab is also the most widely adopted madhhab, and there is a substantial customary influence in the legal system. Historical examination of the evolution of Islamic financial institutions reveals that the political climate in both nations has had a considerable impact on the expansion of the banking industry in general, and Islamic banks in particular.

Both countries have similarities regarding the background for the rise and fall of Islamic banking (sharia). In both countries, the 'up and down' of Islamic banking (sharia) is gaining momentum due to the banking business crisis. The banking crisis in Malaysia in the 1980s forced banks to diversify their products and services. In comparison, the banking crisis in Indonesia in the 1990s led to the need for sound banking (prudent) and more directed towards the real sector, which would be more profitable. Able to drive economic development. Fortunately, Islamic banks (sharia) are proven to have diversified products and have a healthy performance during the crisis. Thus, it can be said that the emergence of Islamic banking in both countries answers these two needs.

Literature Review

Legal Framework-Malaysia

Malaysia's Sharia compliance system is very similar to that of Indonesia. Both nations demonstrate that existing regulatory tools, in general, promote conformance of the banking industry to Islamic teachings in at least three (3) aspects: definition, licensing criteria, and operational principles. The Bank and Financial Institutions Act (BAFIA) 1989 and the Islamic Banking Act (IBA) 1983 are two regulations governing Malaysia's Islamic banking industry. The Central Bank also established several rules to support the performance of this company, the most notable of which are the Guidelines on Shariah Committee Governance for Islamic Financial Institutions and Tanpa Faedah Banking Scheme (SPTF) 1993.

Table 1

Shariah Banking Legal Framework in Malaysia

Law and Regulation	Islamic Bank	Conventional Banks (Islamic Business Unit)
Companies Act 1965	Structure	Structure
Central Bank Act (CBA) 1958	Formation, Shariah Advisory Council (SAC)	Formation, Shariah Advisory Council (SAC)
Islamic Banking Act (IBA) 1983	Authorization, Supervision, Management, Sharia Establishment advisory board.	
Banking and Financial Institutions Act (BAFIA) 1989		Authorization, Supervision, Management
Guidelines on Skim Perbankan Tanpa Faedah (SPTF) 1993		Instruments of Islamic Banking, Rules and Methods of Formation (Islamic Banking Unit)
Shari'ah Council Governance Standards for Islamic Financial Institutions (BNM/GPS1) 2004	Duties and Responsibilities Shariah Member Committee	Duties and Responsibilities Shariah Member Committee

Legal Framework-Indonesia

To lay the groundwork for Islamic (sharia) financial institutions in Indonesia, modifications to Law No. 7 of 1992 and Law No. 10 of 1998 on banking were made. Due to the shortness of the provisions in the Act, Bank Indonesia produced several regulations and circulars. In this case, Bank Indonesia Regulatory oversight on Amendments to Bank Indonesia Regulation (Number: 7/35/PBI/2005) and the regulations on Commercial Banks Conducting Business Activities Based on Sharia Principles (Number 6/24/PBI/2004) are examples of the legal framework in Indonesia. Furthermore, PBI no. 8/3/PBI/2006, Changes in Commercial Bank Business Activities Conventional Becoming a Commercial Bank Sharia-compliant business and bank branch opening

Table 2

Shariah Banking Legal Framework in Indonesia

Law and Regulation	Islamic Bank	Conventional Banks (Islamic Business Unit)
Law No. 21-2008 About Islamic Banking	Authorization, health-related supervision banking, bank administration, conversion sanctions, and other factors not covered by earlier legislation.	Authorization, health-related supervision banking, bank administration, conversion sanctions, and other factors not covered by earlier legislation.
Law no. 23- 1999 concerning Bank Indonesia	The monetary authority must offer the essential assistance to the Islamic banking industry.	The monetary authority must offer the essential assistance to the Islamic banking industry.
Law Number 10-1998 About Change Based on Law no. 7 of 1992 About Banking	Licensing, Supervision related to banking health, Bank management.	Licensing, Supervision related to banking health, Bank management.
Bank Indonesia Regulation No. 6/24/PBI/2004	Establishment requirements & procedures, Banking products, Establishment of Sharia Supervisory Board	Permissions, Supervision, Management
Bank Indonesia Regulation No. 8/3/PBI/2006		Standards and procedure for establishment/conversion, Banking services, Sharia Supervisory Board Formation

Islamic banking has grown at a rate that far exceeds that of the conventional banking system. Some research indicates that Islamic banks' performance appears to be trailing behind conventional banks, and Islamic banking's objectives had not been adequately addressed in line with the initial aim of Islamic banks to uphold the shariah's value. Prior studies posit that Islamic banks are now diverted from the sacred initial aim to worship Allah into secular goals. Many prior studies are found to use Return on Equity (ROE) and Return on Assets (ROA) as proxies for financial performance in the investigation of the relationship between corporate governance, mainly focusing on the role of the board and Islamic bank performance (e.g., Jazil & Syahrudin, 2013; Mollah & Zaman, 2015; Syafii et al., 2012). Shariah's component in corporate governance mechanism is not investigated in *Maqasid* Shariah performance studies (Antonio et al., 2020; Ascarya et al., 2016; Asutay & Harningtyas, 2015; Mohammed & Taib, 2015). Prior literature of Setiawan et al (2020); Syafii et al (2012), argue that in Indonesia the Islamic banks has not fully implemented all of *shariah's* standards. Hence, Islamic banking still looks the same as conventional banking despite the considerations from regulators to adopt *shariah* criteria fully

Conclusion

Apart from the similarities and differences mentioned above, some general conclusions can be drawn from the hypotheses in this study. The discussion on Islamic banking (sharia) growth

suggests that the development of this institution in both nations is highly promising. Developments indicate that along with the rapid development of the product and operational aspects of this banking business in both countries, the issue of sharia compliance is emerging. Some of the products are questionable from the sharia aspect. Moreover, analysis of the sharia compliance framework reveals that the more robust and detailed the existing regulatory framework, the smaller the gaps in legal weaknesses. Therefore, sharia compliance can be easier to maintain.

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