

# **THE EFFECT OF CEO'S ATTRIBUTES AND ZAKAT ON THE PERFORMANCE OF ISLAMIC BANKS**

**Souhir Neifar**

University of Sfax, Faculty of Economics and Management Of Sfax, Tunisia

**Amal Aissa**

University of Sfax, Faculty of Economics and Management Of Sfax, Tunisia

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## **Abstract**

This paper aims to examine the impact of CEO attributes and Zakat on the performance of Islamic banks in the MENA region and Malaysia. In this paper, we test the effect of CEO tenure, foreign CEO, CEO duality, CEO education level and Zakat on the Islamic bank performance measured by ROA. The sample comprises 126 firm-year observations of 42 Islamic banks from MENA countries and Malaysia that registered over the period of 2017-2019. To overcome the problems of heteroscedasticity and autocorrelation, we apply the generalized least square (GLS) panel regression. The findings of the regression show the great impact of CEO attributes (Tenure, nationality, duality, education level) and Zakat on Islamic banks performance. We control the robustness of our main results by testing the impact of our independent and control variables on bank performance measured by ROE. The results of this test confirm in general our main results.

To our knowledge, this paper is the first to provide empirical evidence regarding the effect of CEO attributes (CEO nationality, CEO tenure, CEO duality and CEO education level) and Zakat all together on the performance of Islamic banks. To our knowledge, the analysis of the effect of CEO nationality on Islamic banks performance is also new.

## **1. INTRODUCTION**

Islamic finance has gained the attention of many researchers (Bukair & Rahman, 2015). This great interest has been explained by the fact that Islamic banks are well capitalized and profitable (Sturm et al., 2008). Thus, analyzing the factors that can improve those banks' performance seem to be of great interest.

Firm performance is the achievement of both financial and market performance. The failure or the success of a firm depends on the CEO. Many scholars have investigated the effect of CEO attributes on firm performance (Wicaksana, 2010; Suryanto et al., 2017; Noor and Fadzil, 2013).

According to the upper echelon theory, the managerial background traits of top managers could directly influence the strategic choices and performance of the firm (Hambrick and Mason, 1984). The top managers (especially CEOs) play a leading role in implementing strategic firm decisions (Dyrenge et al., 2010). CEOs are considered as the chief responsible for the financial statements. As the CEO is the main person responsible for the bank's management, analyzing the effect of CEO attributes on the bank's performance seems to be of great importance. This question is also important for Islamic banks that attract the attention of researchers and different stakeholders. Normally, local CEOs and foreign CEOs are different in terms of risk-taking as well as in terms of management decisions. Therefore, studying the influence of a foreign CEO on bank firm performance seems to be an interesting topic. This study aims to bridge this gap by examining the impact of the new CEO attributes, namely the foreign CEO. It also provides a

link between two literature trends: the behavioral and Islamic finance literatures. Note also that it only a few papers investigate the impact of zakat on firm performance. In this paper, we will test the effect of CEO tenure, foreign CEO, CEO duality CEO education level and Zakat on bank performance.

The sample used in this paper comprises 126 firm-year observations of 42 Islamic bank from MENA countries and Malaysia that registered over the period of 2017-2019.

Overall, our findings give proof of the great importance of CEO attributes on Islamic bank performance. We also report the significant effect of Zakat on Islamic bank performance.

The remainder of this paper is organized as follows. Section II reviews the related literature and develops the research hypotheses. Section III depicts the data and methodology. Section IV shows the main results, and section V presents the robustness test. Finally, section V concludes.

## **2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT**

### **2.1. CEO Attributes**

Based on a review of previous research and through the Upper Echelons Theory (UET) (Hambrick & Mason, 1984; Wang et al. 2016) which has shown that executives characteristics have impact on firm performance, we will investigate the impact of four independent variables related to CEO attributes, which are tenure, nationality, duality and education of the chief executive officer (CEO) on bank performance.

**2.1.1. CEO Duality.** The responsibility of a CEO is to manage and operate the firm; meanwhile the chairman is responsible for leading the board of directors.

CEO duality is defined as a person who serves both as a firm's CEO and board chair. There are some studies that have found a positive impact of CEO duality in firm performance like Mobbs (2015) who argued that CEOs who double as board chairmen are important to have higher firm value and to strengthen human capital.

In contrast, other studies, like Aktas et al., (2019), argued that the CEO duality has a negative effect on board member independence and leads to conflict of interest as well as reducing firm value. Therefore, the first hypothesis is formulated as follows:

H 1. CEO duality positively affects Islamic banking performance.

**2.1.2. CEO education.** A study by Kokeno and Muturi (2016) indicated that CEO education had a positive and significant effect on firm performance using data of firms listed on the Nairobi Securities Exchange (NSE). In terms of the CEO's level of education, Kyenze (2014) found a significant relationship between educational level of a CEO and firm performance using data of listed firms in the NSE. Also, Ramezani et al., (2007) stated that the level of education has a great effect on improving performance.

Thus, the second hypothesis is:

H2. CEO education level affects positively Islamic banking performance.

**2.1.3. Foreign CEO.** Multiple previous studies have examined the impact of CEO nationality on financial performance of the company.

The distinction between foreign and local CEO and the effect on different decision making can be related to the place attachment theories that proposes that people improve places to which they feel more attached (Vaske and Kobrin, 2001), like their birthplaces (Lai et al., 2020). For Hu (2018), foreign CEOs have less place attachment than local CEOs.

According to Zheng and Zhu (2022), companies prefer to hire local CEOs as they may benefit from this social capital and produce better firm performance. In addition, social capital can allow businesspeople to identify their investment opportunities (Bhagavatula et al., 2010).

Lai et al. (2020) also reported that firms with local CEO's have better financial performance than those with foreign CEOs.

Arioglu and Borak (2015) argued that CEOs from developed countries have no significant effect on the stock market or on firm market value. The authors justified this result by the fact that foreign

executives normally have low attendance and, thus, play a weak monitoring role due to their residence abroad. Moreover, language barriers and unfamiliarity with or superficial knowledge of the local culture, market and economy may reduce a foreign CEO's efficiency.

Thus, the third hypothesis as follows:

H3: A foreign CEO negatively affects Islamic banking performance.

**2.1.4. CEO Tenure.** The association between CEO tenure and firm performance remains a matter of considerable debate both theoretically and empirically. According to Simsek (2007), CEO tenure has a direct impact on firm performance.

Theoretically, there exists two different points of view attached to the impact of CEO tenure on firm performance. First, Agency theory considers that CEO tenure negatively affects firm performance since a longer CEO tenure leads to an increase in the CEO's power, which can be used, and which negatively affects firm performance (Hill & Phan, 1991). Second, and contrary to agency theory, stewardship theory and resource dependency theory suggest a positive impact of CEO tenure on firm performance. Stewardship theory argues that CEO tenure is a great indicator for good experience and superior ability that improves firm performance (Dikolli et al., 2014). Similarly, Wulf et al., (2010) found that a long-tenured CEO leads to higher firm performance.

Empirically, previous studies that have been made in Arab countries reveal a mixture of positive, negative and no effects of CEO tenure on firm performance. The study of Al-Matari et al. (2012) found a negative relationship between CEO tenure and firm performance in Kuwait. While Al-Matari et al., (2014) reported a positive but insignificant relationship. Arosa et al., (2013) found that CEO tenure has no effect on firm performance.

Based on the discussion above, we formulate our fourth hypothesis as follows:

H4: CEO tenure positively affects Islamic bank performance.

## 2.2. Zakat

Few studies have analyzed the effect of zakat on firm performance. Hassan al-Tally (2014) examined the effect of zakat on financial performance among 57 firms in Saudi Arabia. This study concluded that zakat has a positive impact on financial performance of IFIs. Saeed and Al Ali (2020) have investigated the effect of zakat, as a CSR proxy, on financial performance using data of high street banks of Saudi over the period 2014 to 2019. The main result of this study is that the amount of zakat paid had a statistically significant direct impact with banks' financial performance. This research indicates that banks engaging in CSR activities (zakat) have better financial performance than those that do not. Sri Hermuningsih (2017) examined the impact of zakat on the performance of Islamic banks in Indonesia. This study demonstrated that the allocation of zakat has a positive and significant effect on the performance of banks.

By examining a sample of 15 Islamic banks for the period between 2011 and 2018 in Malaysia, Rosman et al. (2019) underlined the importance of zakat's contribution and its effect as a basic element of CSR on financial performance. Al-Malkawi and Javaid (2018) tested the impact of zakat as a proxy of CSR on financial performance. The study investigated a sample of 107 non-financial firms listed on the Saudi Arabia stock market from 2004 to 2013. The results indicated that there is a strong positive relationship between Zakat (as a measure of CSR) on financial performance. The authors claim that the contribution of zakat by the companies has positive effects on both firm profitability and value to the society as a whole and that Zakat can be a win-win strategy. These findings encourage Islamic banks to focus on CSR, especially on zakat contributions to ameliorate the Islamic bank's financial performance. This idea has been underlined by Abbas (2020) who highlighted the relationship between zakat and firm value and profitability. In addition, the author indicates that zakat contributions can be considered as a "reputation strategy" since it plays an important role in building a good business image with

stakeholders that can help a firm to possess a highly positive trust in the market. So, according to Abbas (2020), the sign of a firm's value or profitability or marketability is earned by zakat payment.

Thus, based on the previous results, we formulate our hypothesis as follows:

H5: Zakat positively affects the financial performance of Islamic banks

### 3. RESEARCH METHODOLOGY

#### 3.1. Sample And Data

The sample used in this paper is selected from the annual reports of 42 listed Islamic financial banks in MENA Countries and Malaysia. We select Data related to CEO attributes and zakat over a three-year period from 2017 to 2019.

We gathered financial data from Data-Stream. We hand collect data about CEO attributes of each bank from annual reports. The foreign CEO variable was collected via extracting the CEO's name from annual reports and searching origin through Google and Wikipedia. Thus, our final sample comprised 126 firm-year observations. Table 1 shows the details of sample-selection.

**Table 1: Sample**

Active Islamic banks listed on MENA Region and Malaysia	60
- Banks whose Data on zakat is not available for none of the 3-year studies	18
= Total banks	42
X years	3
- Missed observations	0

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= Total observations	126
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### 3.2. Dependent Variable

A variety of measures have been used to evaluate firm performance in previous studies. Most of the research is based on accounting performance measurements such as ROA and ROE and market performance measurements like the Tobin Q ratio, earnings per share ... In our study we will use ROA as measure of Islamic banks' performance. As Mangena et al. (2012) states about the robustness of ROA to study firm performance "ROA dominates the accounting-based measures and is the most powerful operating financial measure because it possesses distributional properties"

ROA is widely adopted to evaluate the efficiency of management in using firm assets to generate earnings (Nor et al., 2014). ROA is calculated by dividing net income by total assets (Tran et al., 2020):

$$\text{ROA} = \text{Total net income} / \text{Total assets}$$

### 3.2. Independent Variable

In our paper, our independent variables are CEO attributes (tenure, duality, education level, foreign CEO) and zakat. The measures of the independent variables and the expected signs are described in table 2.

**Table 2: Measures of independent variables**

Variables	Abbreviation	Measures	Expected Sign	Authors
<b>Duality</b>	DUALITY	Dummy variable Equal to 1, if the same person occupies the position of chairman and CEO, and 0 otherwise	-	Aktas et al., 2019)



<b>Education Level</b>	EDUC_L	Equals to 3 if the CEO holds the PhD degree, 2 if she/he holds a master's degree and 1 otherwise	+	Ng & Feldman, 2009)
<b>Foreign CEO</b>	F_CEO	Dummy variable with 1 if CEO is a foreigner and 0 otherwise		Jbir et al. (2021)
<b>Tenure</b>	TENURE	Total number of years that the CEO has served in that position	+	Jbir et al. (2021)
<b>Zakat</b>	ZAKAT	Ratio of zakat expense to pretax income	+	Ajili, & Khlif (2020).

### 3.4. Control Variables

In this paper we use two control variables: firm size and leverage.

In line with the studies of Nor et al. (2014) and Tang and Chang (2015), we expect a positive relationship between Firm size, leverage and ROA.

The measures of the control variables are described in table 3.

**Table 3: Measures of control variables**

Variables	Abbreviation	Measures	Expected Sign	Authors
<b>Firm Size</b>	FIRM_SIZE	The natural logarithm of total assets	+	Nor et al. (2014)
<b>Leverage</b>	LEVERAGE	Total debt /total assets	+	Lanis et al. (2017)

### 3.5. Model

To analyze the influence of CEO attributes and Zakat on the performance of financial Islamic banks, we adopt the following econometric model:

$$\begin{aligned}
 Performance_{it} &= \beta_0 + \beta_1 DUALITY_{i,t} \\
 &+ \beta_2 EDUC_{L,i,t} + \beta_3 F_{CEO,i,t} + \beta_4 TENURE_{i,t} \\
 &+ \beta_5 ZAKAT_{i,t} + \beta_6 SIZE_{i,t} + \beta_7 LEVERAGE_{i,t} \\
 &+ \varepsilon_{i,t}
 \end{aligned}$$

With:

**Performance**= bank performance measured by ROA (total income to total assets)

**DUALITY**= A dichotomous Variable equal to 1 in case CEO is also chairman, 0 otherwise.

**EDUC\_L**= Education level of CEO equals to 3 if the CEO holds a PhD degree, 2 if she/he holds a Master's degree and 0 otherwise.

**F\_CEO**= Foreign CEO equal to 1 if CEO is a foreigner and 0 otherwise.

**TENURE**: Tenure of CEO in years

**ZAKAT** = Zakat ratio measured by zakat expense to pretax income

**SIZE**= log total assets

**LEVERAGE**= Total debt to total assets

$\beta_i$ = Coefficients

$\varepsilon_{i,t}$  =error term

The indices i and t are corresponding to the company and the period of the study.

## 4. EMPIRICAL RESULTS

### 4.1. Descriptive Analysis

The objective of this paper is to determine the factors that can lead to higher banking performance in MENA countries and Malaysian. Table 4 shows the descriptive analysis of our dependent variable (ROA) for the entire sample period from 2017 to 2019.

**Table 4: Descriptive analysis of dependent variable**

Year	Mean	Variance	Standard variation	Median	Min	Max
All	0.1203372	0.0060813	0.0779825	0.1050063	0.01	0.4284613
2017	0.1134114	0.0044472	0.066687	0.1083692	0.01	0.2901762
2018	0.1290266	0.0075588	0.0869415	0.103	0.01	0.4284613
2019	0.1185735	0.0064048	0.0800302	0.1094371	0.01	0.4017348

As table 4 shows, the average of ROA was 0.2046201. The total variability of ROA was 0.00779825 ranging from 0.066687 to 0.0869415, which means that the highest value of return on assets was in 2018 while the lowest was in 2017.

**Table 5: Descriptive statistics of independent and control variables**

Variables	Mean	Variance	Standard deviation	Median	Min	Max
<b>ZAKAT</b>	0.1200	0.0059	0.07704	0.1004	0.01093	0.3495
<b>TENURE</b>	4.7444	38.896	6.2366	3	1	37
<b>EDUC_L</b>	1.5	0.396	0.62928	1	1	3
<b>SIZE</b>	11.152	37.037	6.0858	12.908	1.0380	23.415
<b>LEVERAGE</b>	0.4296	0.1156	0.3400	0.3393	0.0403	0.8987

**Table 6: Descriptive statistics of dichotomous variables**

Variables	Unit	Yes	No
<b>F_CEO</b>	%	21.43	78.57
<b>DUALITY</b>	%	32.54	67.46

Tables 5 and 6 contain descriptive statistics of the independent and control variables for the entire observation period.

As table 5 showed, the average of zakat was 0.1200606. It ranged between 0.0109394 and 0.34951. CEO tenure ranged between 1 and 37 with an average of 4.7444 years serving in the same bank.

Concerning the control variables, the average bank Size was 11.15244 ranging from 1.038024 to 23.41528, while the mean

Leverage was equal to 0.4296845 and lies between 0.0403 and 0.8987912.

Table 6 shows that CEO Duality exists only in 32.54% of the Islamic banks in our sample, while 67.46% of them have a separation of roles. Moreover, the table indicates that 21.43% of CEOs who hold a position in the bank selected are not local CEO's.

#### 4.2. Multivariate Analysis

Before running the regression of our Model, it is essential to determine the type of our panel model and to verify the correctness of our estimation approach. Therefore, we check the normality of residuals, heteroscedasticity, and autocorrelation problems prior to the application of panel data in our regression. To determine the type of our panel model, we use the test of Hausman.

We then use the generalised least square in order to avoid heteroscedasticity and autocorrelation problems in every regression used in this section.

In the Table 7, we present our findings of the different estimations; OLS, panel regression, General Last Square (GLS).

**Table 7: Model of ROA**

Variables	OLS			Random effect Model			GLS		
	Coef	T	P> t	Coef	T	P> t	Coef	Z	p> Z
ZAKAT	0.3050	3.62***	0.000	0.2527	3.17**	0.002	0.0897	1.84*	0.066
TENURE	-0.0009	1.00	0.319	-0.0009	0.70	0.482	-0.0006	0.97	0.331
F_CEO	-0.0962	5.71***	0.000	-0.0905	3.84v***	0.000	-0.0878	7.45***	0.000
DUALITY	0.0104	0.74	0.462	0.0059	0.33	0.740	0.0167	2.01*	0.045
EDUC_L	0.0083	0.85	0.396	0.0086	0.64	0.525	0.0174	2.83**	0.005

<b>FIRM_SIZE</b>	-0.0023	2.07**	0.040	-0.0011	0.85	0.397	-0.0012	1.63	0.104
<b>LEVERAGE</b>	-0.0382	2.13**	0.035	0.0273	1.20	0.230	0.0233	1.98*	0.048
<b>CONSTANT</b>	0.1027	4.42***	0.000	0.0997	3.37***	0.001	0.1041	6.91***	0.000
<b>R<sup>2</sup></b>	R <sup>2</sup> =30.27 %			Between =38.79%					
<b>Chi 2</b>								98.33	

The Chi 2 statistic is equal to 98.33 and the probability associated is less than 5% ( $p\text{-Chi}2=0.0000$ ); therefore, the null hypothesis of insignificance is rejected, and the model is globally significant. This result is consistent with the R2 value= 0.3027, which mean that our independent variables are explained at the level of 38.79 % the dependent variable (ROA in our model). So, the proposed model explains well the determinants of an Islamic bank's performance related to CEO attributes as one of the important mechanisms of corporate governance and zakat as a basic indicator of CSR.

The results indicate that Zakat affects positively and significantly at the 10% level the performance of Islamic banks ( $p\text{-value}=0.066$ ,  $|Z|=1.84$ ), which implies that the more the payment of zakat is important, the higher the performance of Islamic banks. Our result is similar to the prediction of previous empirical studies (such as Al Malkawi and Javaid, 2018; Abbas, 2020), which demonstrated that zakat has a positive effect on firm value and profitability. Moreover, we find that foreign CEOs have a negative and significant impact on performance of Islamic banks at the level of 1% ( $p\text{-value}=0.000$ ,  $|Z|=7.45$ ), which means that having local CEOs ensure better banking performance than foreign CEOs. This result is in line with the study of Lai et al. (2020), who found that firms with local CEOs are more socially responsible than foreign ones and confirm the place attachment theory that states that foreign CEOs have less place attachment and/or identity compared to local CEOs.

Furthermore, our results reveal that CEO duality influences positively and significantly Islamic bank performance (p value=0.045,|Z|=2.01), which means that when the CEO is also the chairman of the bank this can increase bank performance.

We find also that education level is positively and significantly related to Islamic banking performance (p-value=0.005 and |Z|=2.83). Our result is consistent with previous studies (such as Ng & Feldman, 2009), which argued that the education level of the CEO is positively related to performance.

The results of the effect of our control variables on ROA as a measure of firm performance indicate that firm size has a negative and insignificant impact on Islamic banking performance. In contrast, leverage affects ROA positively and significantly.

## 5. ROBUSTNESS TEST

In order to test the sensitivity of our main results, we use the return on equity (ROE) as another proxy of bank performance. The results depict, in general, a similar coefficient sign with the main results, which confirm the robustness of our main analysis. In addition, the results of this test show that Zakat, CEO tenure, CEO education level and leverage have a significant positive impact on ROE.

Variables	OLS			Random Effect Model			GLS		
	Coef	T	P> t	Coef	T	P> t	Coef	Z	p> Z
ZAKAT	0.0646	1.12	0.267	0.0426	0.85	0.393	0.0314	1.74*	0.081
TENURE	-0.0007	1.10	0.272	-0.0004	0.46	0.647	-0.0010	2.29*	0.022
F_CEO	0.0094	0.81	0.419	0.0043	0.25	0.806	0.0010	0.21	0.831
DUALITY	0.0055	0.57	0.568	-0.0080	0.64	0.525	-0.0035	0.48	0.631
EDUC_L	0.0255	3.79***	0.000	0.0174	1.75*	0.079	0.0246	6.17***	0.000
FIRM_SIZE	0.0002	0.27	0.785	0.00001	0.02	0.984	-0.0003	0.82	0.411
LEVERAGE	0.0176	1.43	0.155	0.0229	1.44	0.149	0.0142	1.83*	0.067
CONSTANT	0.0431	2.70**	0.008	0.0619	2.93**	0.003	0.0623	5.78***	0.000

R <sup>2</sup>	R <sup>2</sup> =15.30 %	between =16.34%
Chi 2		76.91

**Table 8 : Results of the robustness test**

## 6. CONCLUSION

The aim of this study is to analyze the influence of CEO attributes and Zakat on bank performance for a sample of 126 firm-year observations of 42 Islamic banks from MENA countries and Malaysia over the 2017- 2019 period. The GLS model is used to test such relationship. The findings show that Islamic banks' performance is influenced by CEO attributes (CEO duality, foreign CEO and CEO education level) and Zakat. In addition, the results have proven that the CEO is responsible for improving the bank's performance and that we must allocate interest to the characteristics of the CEO in the bank. The findings of this paper are a valuable source of knowledge for policymakers and regulators in several ways. First, it may help Islamic banking regulators in creating a guide to minimum requirements of education and CEO personal characteristics. Furthermore, Islamic banking policymakers should assess the importance of paying Zakat by the bank (and not by the shareholders) and to disclose the zakat amount in the annual report as Zakat is an indicator of CSR and has a positive effect on bank performance.

However, this study has its own limitations that can provide opportunities for future research. First, although the model has explored the effect of CEO attributes and Zakat on bank performance, other variables also need to be tested as corporate governance (CG) mechanisms. Future research may use in addition to our dependent variables, other variables related to CG mechanisms. Finally, another limitation consists of the sample that is limited to the unviability of some variables. Thus, future research



may extend the sample or conduct a comparative study between Islamic banks and conventional banks.

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