CHAPTER 1

INTRODUCTION

1.1 Background of the Study

South-East Asia was a heavily hit region for global corporate crises in the last decades that led to the weakening of Corporate Governance (CG), significant failures, and assets losses of investors running into hundreds of billions of dollars. As a result, the quality of CG became an essential matter after the world financial scandals due to the failure of CG systems at several large companies in the United States, Canada, and the European Union, including Enron, WorldCom, Adelphia, Tyco, HealthSouth, Fannie Mae, AIG Nortel, Crocus Parmalat, and Royal Ahold, (Bremer & Elias, 2007).

Islamic Financial Institutions (IFIs) like Islamic Banking, Takaful: Islamic Insurance, Sukuk: Islamic Bonds, and Shariah Capital Market, are not immune to financial crises as attested by the failures of several IFIs in the 1990s and 2000s (Sadek et al., 2020). For instance, the closures of Ihlas Finance in Turkey and the Islamic investment banks of Egypt were due to weak CG and failure of internal controls. Dubai Al Nakheel Sukuk, this debt standstill caused much disturbance in capital markets and became known as the "Dubai Debt Crisis".

Furthermore, the Islamic Bank of South Africa and Bank Islam Malaysia were face defecite and difficulties to a lack of supervision from the regulatory authorities, bad management and weak risk management. All these cases indicate that IFIs are just as vulnerable to failures and crises as non-Islamic companies. Thus, the need for a good and efficient governance system is considered as a crucial part of CG for IFIs (Grais & Pellegrini, 2006; Abdullah et al., 2015; Mnif & Tahir, 2020).

One of the biggest shocks was the bankruptcy case of world largest insurance company, American International Group (AIG) for which the US Federal government injected a bailout package of $85 billion (Schich, 2009; Harrington, 2009). AIG's failure was devastating for market players as it was interconnected with 71 US insurance companies and 176 other financial services companies. The effects of the financial crisis rippled across the European insurance market, particularly the Romanian insurance industry, whose insurance penetration was dropped by 25% in just two years (Firtescu, 2014). Insurance companies were affected by banking crisis because of the inter-connectedness of the insurance industry with the banking sector through non-traditional business activities such as raising premiums through "bancassurance" and investment of insurance funds in equity and bond market (Baluch et al., 2011).

One of the most significant events in the history of the Malaysian economy was the Asian Financial Crisis of 1997-1998, which caused Malaysia's Gross Domestic Product (GDP) to shrink from US$100.8 billion in 1996 to US$72.2 billion in 1998. The Malaysian economy's GDP did not recover to 1996 levels until 2003 (World Bank, 2016). This Asian Financial Crisis that affected the Malaysian economy was also compromised the Takaful industry as the same tsunami of global crises cut across all financial sectors (Jianing et al., 2018). According to Akhter et al., (2016) investigate the effect of financial crises on Takaful industry reveals that negatively affected Takaful demand in ASEAN region showing lack of awareness about Takaful. Overall results recognize the significant role of education that has positive impact of Takaful demand.

Malaysia was considered a country with weak CG regulations compared to other USA, UK and Asia countries before 1997 (Mitton, 2000; Zain et al., 2006; Alnasser & Muhammed, 2012; Orazalin & Mahmood, 2018). These weak CG regulations in Malaysia resulted from harsh global market conditions, in which Takaful decreased in its recorded profit in 2009 from RM170.1 million to RM145.8 million in 2010. As a result of this weakness of CG regulations, the total profit dropped drastically. Due to relatively high operating costs, the overall profit declined (Abdou et al., 2014), which made Malaysia lack the capacity to effectively withstand the Takaful industry crisis. Besides the global crisis, empirical proof has also indicated that agency costs were among the factors that weakened CG practices (Singham, 2003; Ngee, 2005).

As a result of these issues, the Malaysian government created a high-level Finance Committee on Corporate Governance (FCCG) in 1997 that involved almost all sectors across government bodies, the Central Bank of Malaysia, private sectors, Malaysia Accounting Standard Board, and association of banks. In 1999, this was expanded to include Capital Markets Strategic Committee. In 2000, the FCCG issued the Malaysian Code on Corporate Governance (MCCG) with the requirement for the listed companies to disclose their level of compliance with its recommendations with a view to providing a robust and facilitative regulatory regime including corporate accountability and high-quality CG mechanisms that would strengthen investor confidence (Securities Commission, 2001). Later, the MCCG was amended in 2012 and 2017 to generate an optimum relationship between stakeholders and the firm and ensure companies disclose relevant and necessary data for their annual reports (Ismail & Aziz, 2017; Razak, 2018).

Most Takaful companies in the world are concentrated in the Southeast Asia (SEA), Gulf Cooperation Council (GCC), Middle East and North African (MENA) regions (Sallemi et al., 2021). The sustainable growth in Islamic financial industry led the augmented demand of Takaful in many Muslim countries. According to Islamic Finance Development Indicator (2019), 47 countries with 335 Takaful operators were involved in Takaful business in 2018 (ICD-IFDI, 2019). Size of global Takaful business was also $46bn in 2018 which is expected to reach to $65bn by the end of 2024. Particularly, Saudi Arabia, Malaysia and Iran are among the top contributors in terms of size of Takaful industry, whereas Maldives, Pakistan and Brunei are among the fastest-growing markets (ICD-IFDI, 2019).

Yet, being the biggest does not necessarily denote achieving the highest performance. For instance, at the end of 2014, Saudi Arabia's return on asset (ROA) averaged -2% and a return on equity (ROE) averaged -5%. Touching Malaysia and Indonesia, their ROA averages are 0% and 7%, and ROE averages are 3% and 5%, respectively (ICD – Thomson Reuters, 2015). Amongst them, Malaysia and Saudi Arabia are the most important markets and are characterized by a remarkable predominance and credibility of Islamic finance (Sallemi et al., 2021).

The Takaful industry was reinforced in Malaysia in line with South East Asia reform efforts (Ngee, 2005; Vithiatharan & Gomez, 2014). Although Malaysia identified the importance of CG reforms far before the East Asian crises (Narayanan, 1996), Malaysia's CG reforms were enacted in 2001. The reforms were introduced by the Securities Commission to regulate the Malaysian capital market for one decade (Ngee, 2005). However, until when all stakeholders are united in their conviction and understanding that the current situation in the Takaful industry in Malaysia demands all-inclusive outlooks on the CG mechanisms to realize desirable outcome, the reform did not happen (Singh, 2000; Ritchie, 2005; Felker, 2017; Karbhari et al., 2018).

The motivation for reform may emanate from external factors (e.g., from the IMF, the US, or the UK) or internal factors (South East Asian countries re-evaluating the costs and benefits of the reform). However, dynamically, in some instances, both are somehow the same (Blanton & Kegley, 2016; Jackson, 2018). Nonetheless, agreement on the necessity for change or reform must be commonly reached at the time of critical economic adversity.

It is a well-known fact that Takaful is an emergent and rapid-developing industry offering an insurance policy that complies with Shariah regulations (Mahmood, 1991; Arifin et al., 2018) with unique CG practices different from conventional ones. Muslim scholars vastly advocate Shariah regulations as they represent the real meaning of brotherhood through safeguarding individuals against losses (Sadeghi, 2010; Alnemer, 2013; Nordin, 2018). These regulations demand strong principles, transparency, fairness, and dissemination of wealth, resulting in economic stability, social integrity, and environmentally friendly (Mahmood, 1991; Bhatty, 2010). They oppose generating money from money and thus forbid interest. They conjoin deposits and investments to actual primary assets. With these values, the Takaful industry has succeeded in sustaining more steady returns, even during economic recessions or crises (Nordin, 2018). Takaful is still growing and requires more innovation and modernization, particularly in the regions of asset management and risk evasion (Mroueh & Waal, 2018).

Takaful has experienced unparalleled development, particularly in the most recent decade. The Malaysian Takaful Association (MTA) statistics showed that in 2019 new Takaful protection grew 17.3% to MYR 380.2 billion (US$ 93.62 billion), in 2018 sums assured for all policies compared with MYR324.2 billion (US$79.83 billion) in 2018 (MTA, 2019). Given that Malaysia and the GCC countries are among the pioneers in Islamic finance, the Islamic insurance industry's achievements in these countries are quite significant.

Effective boards and committees are essential aspects for Takaful, where virtuous asset-liability partnering is vital with safe and competitive returns (Cadbury, 1992). Takaful penetration and its growth rates in Malaysia are somewhat small when compared to conventional insurance. Therefore, the Takaful industry requires a considerable focus on CG practices regarding its values that could influence its demand growth and penetration rates and become a dependable alternative to its notable competitors (Michael et al., 2006; Bhatty, 2010; Fauzi et al., 2016).

Takaful in Malaysia and elsewhere is relatively young when compared to other sectors of the financial industry but it has enjoyed robust growth. However, despite the robust growth, the penetration rate for takaful in Malaysia and elsewhere remained small and this indicates that there is significant opportunity for future growth. The challenges range from competitive elements, business model and processes, changing customers' needs and demands for better product choices, more efficient delivery channels and more customer friendly practices from takaful operators, and having to cope with serious threat on profitability arising from the recent global financial crisis. In the context of Malaysia, the government is committed to promote takaful and to make Malaysia a takaful and re-takaful hub in South-east Asia (Fauzi et al., 2016; Nomran et al., 2018).

To ensure effective CG practices in the Takaful industry by the governing boards, committees, and management, the Malaysia government, enacted a law to encompass all Takaful industries. The law regulating the Takaful industry and conventional insurance is Malaysia Law Act 312 (Takaful Act, 1984; Billah, 2001). The law does not govern some aspects of Takaful roles; among the unregulated matters are the jurisdiction and responsibility of the Shariah Supervisory Board (SSB) (Heradhyaksa & Markom, 2018). SSB is a body or team responsible for overseeing the implementation of shariah codes in the Takaful industry. The Laws of Malaysia Act necessitates that all Takaful companies have an SSB (Takaful Act, 1984). The SSB and boards of directors are constituted on selection standards, which, though, a performance index assessment is implemented as a significant matter (IFSB, 2017). The Shariah Committee is under SSB supervision for an effective CG implementation and quality of Takaful corporate reporting.

During the recent economic recession and financial crises, the Islamic equity indices (specifically Takaful) outperformed conventional insurance companies because of their different configuration and structure mechanisms (IFSB, 2016; Hassan et al., 2018). Despite competitive challenges, Malaysian Takaful operators have achieved healthy financial performances. For example, the Takaful industry recorded a compounded annual growth rate (CAGR) of 6% from 2012 until 2017. The substantial growth in recent years was due to the increasing demand from those who are religion-sensitive and more inclined to engage with financial institutions that comply with Shariah rules (Nomran et al., 2018).

These differences in performances have triggered several related questions about the structural mechanisms and the decisions that Shariah committees and boards of directors made, which resulted in this outperformance (Zyadat, 2011; Razak, 2018). The factors that produced this have yet to be identified and reported. Hence, this knowledge gap calls for examining the Shariah committee and boards of directors functioning and control in the Takaful industry (Ismail & Aziz, 2017; Heradhyaksa & Markom, 2018).

Despite the reported outperformance, the Takaful is not completely immunized from corporate problems such as risks and conflicts. In recent times, the Takaful industry confronted distinctive types of risks, including displaced commercial risk and equity investment risk. The most crucial risk facing this sector now is the Shariah non-compliance risk resulting from ineffective Shariah committees and boards of directors associated with the Takaful industry (Haron & Taylor, 2009; Hassan & Mollah, 2018). This set of risks directly affect all CG structures and performance of the Takaful industry. Shariah non-compliance risk emphasizes potential failure to meet requirements or fulfil Shariah principles as stipulated in the relevant standard laws and generally accepted by the international SC (Bindabel, 2017; Miskam & Nasrul, 2018).

Managing this risk is imperative because failure to comply with Takaful Shariah requirements greatly affects their sustainability and reputations (Rosman et al., 2017). This risk and others and the associated increase in regulatory requirements to improve financial transparency and accountability have made Takaful companies in Malaysia enhance their disclosure quality (Said et al., 2018). Higher disclosures in these capacities are vital to financial information users such as stakeholders, managers, account holders, and the general public. Furthermore, one of the most essential purposes of the Shariah committee is to offer high-quality financial transparency and complete disclosure of Shariah non-compliant income (SNCI) (Rosman et al., 2017). Thus, the performance of SNCI must be further reinforced.

Moreover, Shariah compliance is an unconditional obligation that must be reinforced by Takaful SSB to discharge their tasks based on the legitimate code

(Choudhury, 2018). Shariah compliance is a preventive ruling for the Takaful for optimal performance (Grais & Pellegrini, 2006; Hoepner et al., 2011). Absent of Shariah compliance with Shariah codes will impact the public's decision to accept or reject Takaful that will alter its performance, which can, therefore, subject Takaful to higher risk.

Regarding performance, the Shariah committees play a moderator role in running the Takaful industry's financial affairs, thereby enhancing its performance (Karbhari et al., 2018). To improve the quality of Shariah committees' functions in Takaful, they are required to be experts in the field of Islamic finance and jurisprudence (Ali, 2018a). They must also have the capacities to perform proficiently with perseverance and professional skills and are expected to know legitimate specialized guidelines (Ali et al., 2018b). The effectiveness of Shariah committees has a significant impact on the performance of Takaful. Furthermore, Shariah committee members must be up-to-date with review regulations, legislation, and modern advancements (Khalid et al., 2018). Also, they ought to engage in conduct to comply with the law and not to disgrace the profession (Ardi, 2017).

Shariah committee members have to judge with fair-mindedness, objectivity, and a mental state of mind to judge inclinations, pre-assumptions, and potential conflicts of interest (Ali, 2018a). The Shariah Committee and the Shariah audit committee must be independent of the management and engage in activities objectively (Zain et al., 2006; Daud et al., 2014) for the Takaful industry to perform optimally. More precisely, it intended to assess whether the impact of the CG on the financial performance varied with the different levels of SCQ.

The risk of Shariah incompliance may have serious consequences on the continuity of the activities of the IFIs in particular and the development of the Islamic financial system in general. More importantly, IFIs exist to serve the needs of the *ummah* (Sulaiman et al., 2015). That is why, the need for an efficient Shariah supervisory system is considered as one of the vital elements promoting the stability of the Islamic financial sector. With this aspiration, corporate governance in IFIs has to set institutional arrangements to supervise the Shariah-compliant aspects of their activities. One of the most powerful institutional arrangements is known as the SB which plays a crucial role in all Shariah aspects of the IFIs: supervision, monitoring, auditing and issuing rules and fatwa (Grassa, 2013). This study will examine the impact of Shariah committee quality (SCQ) as a moderator variable on Takaful financial performance.

Extensive research has been conducted on the relationship between CG structures, effectiveness, and the performance of Takaful in Malaysia (Ibrahim et al., 2016; Khalid et al., 2018). However, studies have not reported the individual CG structure and mechanisms under Takaful in connection with performance. The relationship between various CG structures in Malaysia is an area of great interest in the current study. It is unknown whether existing differences in institutional, regulatory, and CG practices also translate into differences in the relationship between CG and Takaful performance. To this end, this study seeks to determine whether a relationship exists between CG and the financial performance of Takaful companies in Malaysia.

1.2 Problem Statement

One leading cause of business failures from the 1980s up to now is the issue of improper ethical values and weak CG. The effects of CG on firm performance are a vital and essential issue that has risen since the last financial distresses worldwide. There is considerable debate about the causes and origin of the global financial crisis and many discussions about responsibility for it (Chukwu, 2020). Forecasting financial crises is based on the evidence that there are identifiable patterns or indicators consistent for all failed firms and failure is a gradual process (Muhamad Sori et al., 2001). Moreover, the Islamic community expects that IFIs place more importance on CG, as they are exposed to additional risks. However, it seems that many IFIs have been exposed to CG failures similar to conventional Business (Mnif & Tahir, 2020). It is a mistake to assume that IFIs do not need to institute prudent corporate governance just because the Islamic value system equitably protects the rights of stakeholders (Ginena, 2014).

A need for an efficient and effective governance system is very important in CG, especially after the high-profile falls of many IFIs (such as Ihlas Finance House in Turkey, Dubai Al Nakheel Sukuk, the Islamic Bank of South Africa and the Islamic Investment Companies of Egypt) and the difficulties that some of the others face (Dubai Islamic Bank and Bank Islam Malaysia Berhad, to name a few). Islamic institutions are no less vulnerable to crises and issues that arise from governance-related problems like other organizations (Sadek et al., 2020).

Famous IFIs crises Al Nakheel Sukuk, On November 25, 2009, the financial world was shocked when Dubai World requested a restructuring of $26 billion (USD) in debts. This debt standstill caused much disturbance in capital markets and became known as the "Dubai Debt Crisis". The main concern was the delay in the repayment of the $4 billion sukuk, or Islamic bond, of Dubai World's developer Nakheel, which was especially known for the construction of the Dubai Palm Islands. The restructuring request caused much distress among the sukuk holders, because several analyses by the lawyers of Dubai World and its creditors showed that the sukuk holders would probably not be able to rely on the level of protection they had expected. This crisis has shown that the legal implications of the Nakheel Sukuk were not connected to the legal structure of Islamic financial instruments as such, and weak CG system (Salah, 2010).

The latest financial collapse Weqaya Takaful and ReTakaful Saudi company, the main reason CG problem. According to the ruling, those board members and executives intentionally participated in acts and practices that created a false and misleading impression of the company’s securities. Among those practices were reducing the company’s losses and maximizing its revenues and assets contrary to the actual financial statements for the fiscal period ending Dec. 31, 2013, and the fiscal period ending March 31, 2014. According to Argaam data, the CMA decided in May 2017 to delist Weqaya from the Saudi Stock Exchange (Tadawul) due to the company’s inability to meet regulatory requirements and fulfil financial commitments (ARGAAM, January 07, 2021, 20:33).

In Malaysia affected by financial curtail failure and scandal, such as Renong Berhad in 2000, United Engineers (Malaysia) Berhad in 2001, and Transmile Group Berhad in 2007, and 1 Malaysia Development Berhad (1MDB) in 2019 (Chen, 2019). The statistic shows in Malaysia after the 2008 global financial crisis, its average corporate debt-to-GDP increased extremely from 75.60% (2009) to 94.10% (2015) (Ramli & Jamil, 2019). Serious efforts were made towards restoring public confidence. The poor financial performance of some Malaysian companies was attributed, amongst other reasons, to the poor governance practices (Kadir, 2002; Darrusamin et al., 2018).

Malaysia is one of the pioneers of Takaful and Shariah-compliant listed companies in Southeast Asia (Felker, 2017; Razak, 2018). However, the country is faced with challenges in persuading local and foreign investors to invest their wealth in the Takaful industry because of a lack of required quality and effectiveness of Shariah corporate structures. This is in addition to the considerable competition the Takaful industry in Malaysia is currently facing with conventional insurance in many areas due to competition in corporate fairness, accountability, transparency, stakeholders' value in international markets, and how companies organize themselves to meet the need of stakeholders.

Takaful and conventional insurance companies compete for the high quality of corporate mechanisms to place them at the top of financial services. The Takaful industry is a smaller size and younger than the conventional insurance industry when the assets and the establishment period of Takaful companies in Malaysia are compared. Nonetheless, the Takaful industry is governed by the Islamic code of practices that are expected to place them above any other institutions because of the spiritual and penultimate form of ethical principles controlling every individual involved. With the increasing number of companies in the Takaful market, a need exists to create new products to compete in the market, and the industry still needs more research to develop the Malaysian market. Indeed, many studies such as Johnes et al. (2010) have recommended increased research in evaluating Takaful companies' performance using financial ratios so that Takaful companies are evaluated like traditional insurance companies (Abdou et al., 2014).

Even though Malaysia is a predominantly Muslim country with Shariah codes of practice, the Takaful sector has yet to significantly impact conventional insurance schemes (Nordin, 2018). This is due to the discouraging backdrop in financial performance witnessed worldwide, especially the Islamic financial institutions (IFIs) of Islamic countries and weak CG structures in the Takaful industry. This challenge is still very alive in Malaysia today (Alhabshi et al., 2017; Salleh et al., 2018; Samad

& Shafii, 2018). Regarding financial performance, Takaful corporates comprise only a small part of Malaysia's overall insurance companies, with 18.2% of the insurance industry's collective gross involvement (IFSB, 2019). This implies that the Takaful sector requires many mechanisms to overcome Malaysia's conventional insurance industry (Akhter et al., 2017).

Inadequate mechanisms and unsatisfactory Takaful financial performance are viewed as some of the most challenging factors facing the Takaful industry in Malaysia (Ismail, 2013; Ali, 2018a; Karbhari et al., 2018). In line with this, weak CG mechanisms such as boards of directors (BOD), board independence, audit committee, Shariah committee, and CEO are contributing factors to the challenges that have resulted in unsatisfactory financial performance in the Takaful industry in Malaysia (Razak, 2018; Remli & Rosman, 2018), just as has been witnessed in other various Islamic countries (Omar, 2018).

The BOD under Takaful is considered the most important useful tool in the effective functioning of internal CG mechanisms or structures (Ginena, 2014). In these internal mechanisms, the BOD operates shoulder to shoulder with the Shariah committee based on Shariah codes and guidelines (Husnah & Siregar, 2011; Bukair & Abdul Rahman, 2015). However, many Takaful companies do not adhere strictly to Shariah codes, and BODs often engage in non-compliance behaviours and search for shortcuts to assume and maintain control of companies. These non-compliance behaviours of BOD in Takaful firms have also caused conflicts of interest among their shareholders and management.

These non-compliance behaviours of BOD have to do with a lack of ethical principles and professional proficiency of the members, affecting their performance effectiveness and the companies' performance. In addition to education, knowledge, skills, and experiences possess, the BOD members of Takaful are also required to possess high ethical principles and professional proficiencies and are expected to have adequate knowledge in Shariah matters regarding insurance operations (Wardhany & Arshad, 2012; Muneeza & Hassan, 2014; Ali at al., 2019). However, these requirements are hardly met in the contemporary Takaful established companies in Malaysia because of the lack of adequate human capital and fully qualified personnel with appropriate Shariah knowledge, marring the Takaful industry.

One key CG mechanism in the IFIs is the Shariah Committee. This mechanism is defined as an independent body of specialized jurist in Islamic commercial jurisprudence and experts in Islamic finance (AAOIFI, 2010). Interestingly, the Shariah Committee was intended to ensure the compliance of products and services offered to consumers and investors with Islamic rules and principles (Hamza, 2013). In addition, Shariah Committee' scholars use Shariah to determine the general rules according to which the investment decisions are permissible (Majdoub & Mansour, 2014). In parallel with the increasing growth of Islamic finance globally and the complexity of the Islamic finance products and services The SB has become the most important component of the Shariah governance system in Islamic finance that has a deep influence on the day-to-day practice of Islamic finance in IFIs (Hassan, 2010). This growth is being realized due to Islamic finance's involvement in the establishment of financial products and services by IFIs for Shariah accepted underlying transactions and economic activities (Ismail & Muhamad Sori, 2017).

Shariah committees are primarily constituted to oversee the functions of the BOD under Takaful. Shariah committees and management are charged with responsibilities in matters related to Shariah and highlight the activities associated with Shariah board, BOD, Shariah audit, Shariah review, Shariah research, and Shariah risk management (Hosen et al., 2016; Nor et al., 2017; Noordin & Kassim, 2019).

However, these responsibilities have not translated into an effective performance of Takaful companies, particularly in Malaysia. Thus, Shariah committee quality necessary to satisfactorily improve the Takaful industry's performance remains an area of challenge. Both Shariah committees and the BOD, as well as audit committees, have the potential to significantly impact the performance of the Takaful industry specifically in Malaysia because all contribute to the establishment, regulation, monitoring, and operation of the Takaful companies (Iqmal et al., 2017; Saad & Rahman, 2018). Without their contributions, it will be impossible for the Takaful industry to perform because it requires professionals and experience to succeed.

Many previous studies focused on conventional financial aspects, while research on CG effectiveness and financial performance in Takaful is mostly absent. Extensive investigations exist on the relationship between CG effectiveness and financial performance of IFIs in many of South East Asian countries including Malaysia as a whole (Andres & Vallelado, 2008; Aebi et al., 2012; Erkens et al., 2012). The relationship between Shariah committees and boards of directors that leads to high-quality performance has yet to be identified and reported. Hence, this gap calls for examining the Shariah committees and BOD jurisdictions and control in the Takaful industry (Ismail & Aziz, 2017; Heradhyaksa & Markom, 2018). Studies have not reported CG effectiveness under Takaful as a Shariah-regulated system in connection with performance.

The growth stimulated the research in various domains of Islamic finance which laid a solid foundation in developing Shariah, accounting, auditing, risk, governance, ethics and product development frameworks (Rashid & Ghazi, 2021). The Takaful industry has been under investigation recently due to the concerns raised over the conventional insurance functioning (Abdul Razak et al., 2021; Kantakji et al., 2020). According to (Nasir et al., 2021; Khairi et al., 2021) growing demand, both practitioners and academicians are taking a keen interest in Takaful. To explore the "Takaful" as a keyword, the Google Trend website was used.

Hence, the Takaful industry still needs more studies to develop the Malaysian market (Holderness, 2011). A review of relevant literature in Malaysia shows a gap in studies regarding CG effectiveness and financial performance in Takaful companies (Mollah & Zaman, 2015; Mohammad & Ahmed, 2016; Ali et al., 2018b; Nomran et al., 2018; Remli & Rosman, 2018). This may result from the low penetration rate of Takaful services or the lack of reliable CG effectiveness to increase shareholders' confidence.

1.3 Research Questions

This study aimed to get evidence on the impact of CG on Takaful performance in a developing country such as Malaysia because a question remains over whether CG practices have contributed to the Takaful companies as envisioned. More precise answers to the following questions are essential for policymakers in developing appropriate CG systems optimized for Takaful companies in Malaysia. In this study, the principal question was, "to what extent does CG effectiveness influence financial performance of Takaful companies in Malaysia?" Four specific questions were formulated to answer the principal question. These questions are as follow:

1. Does board of directors effectiveness at the individual level, namely (Board Size, Board Director Independence, Executive Membership, Muslims Directors, Board Meeting Frequency, and Board Gender Diversity) and effectiveness at an aggregate level (as composite score) affect the financial performance of Malaysian Takaful companies?
2. Does audit committee effectiveness at the individual level, namely (AC Chairman Specialization, AC Size, AC Independence, and Meeting Frequency) and effectiveness at an aggregate level (as composite score), affect Malaysian Takaful companies' financial performance?
3. What is the moderating impact of the Shariah Committee quality on the board of director's effectiveness on the financial performance of Malaysian Takaful companies?
4. What is the moderating impact of the Shariah Committee quality on audit committee effectiveness on the financial performance of Malaysian Takaful companies?

1.4 Research Objectives

The main objective of this study was to carry out an empirical investigation of the relationship between CG effectiveness and the financial performance of Takaful companies in Malaysia over the period 2010 to 2017. The evaluation of CG practices in the Takaful sector in Malaysia aims to provide a mechanism to improve investors' confidence and trust in management and promote the country's economic development. Therefore, this study aims to determine the impact of CG effectiveness affecting Takaful Company's financial performance and its responsibility to all parties to understand the governance effectiveness that contributes to enhancing the value of Takaful companies in Malaysia. This research will also determine the relationships between the CG practices, board director effectiveness, AC effectiveness, and SCQ, and Takaful companies' financial performance. Four specific objectives were developed to achieve the main objective of this thesis. These were to:

1. Examine the relationship between the board of directors' effectiveness (Board Size, Board Director Independence, Executive Membership, Muslims Directors, Board Meeting Frequency, and Board Gender Diversity) at individual and aggregate levels and Malaysian financial performance Takaful companies;
2. Investigate the relationship between AC characteristic (AC Chairman Specialization, AC Size, AC Independence and Meeting frequency) at individual and aggregate levels and financial performance of Malaysian Takaful companies;
3. Examine the moderating role of SCQ on the relationship between the BOD effectiveness and financial performance of Malaysian Takaful companies; and
4. Investigate the moderating role of SCQ on the relationship between AC effectiveness and financial performance of Malaysian Takaful companies.

1.5 Research Contributions and Significance

The findings of this study offer contributions to research, theory, and practice. The research regarding CG in Takaful companies contains several contributions to the research. First, this study fills the gap in the Shariah literature by empirically investigating the impact of BODE and ACE on financial performance. Second, this study focuses on the moderating effect of SCQ on the relationship between BODE and ACE and Malaysian Takaful performance. Third, to the best available knowledge, this is one of the first empirical studies to investigate the impact of CG in Takaful companies using the SCQ as a moderating variable on Takaful performance in Malaysia. The potential contribution is using SCQ as a moderating variable as a significant internal governance mechanism in financial reporting, which can aid the Takaful sector in the market, regulatory reforms, fluctuations, and update the reviewed MCCG in 2017.

In terms of theory, the findings will help increase the understanding of CG in terms of Agency Theory, Stewardship Theory, Resource Dependency Theory, and Stakeholder Theory in a Takaful firm in Malaysia.

The study also offers practical contributions. Malaysia is a developing country so that findings will be useful to other developing countries with similar economic, political, environmental, and cultural conditions, particularly the South East Asian countries. The results of the study will promote and improve CG practices in Takaful companies. Finally, the findings also provide a window into the prevailing situation of Takaful governance in Malaysia, which is of interest to local and foreign investors, managers, and academic researchers considering CG frameworks' roles.

This study's outcomes demonstrate Shariah Corporate Governance's impact, board effectiveness, and financial performance on corporate performance in Takaful companies in Malaysia. The findings are significant to the Bursa Malaysia, the Institute of Directors, Islamic Financial Institutions (IFIs), and Training Centers because the results provide needed information on Takaful performance in Malaysia, especially in Shariah Corporate Governance, board effectiveness, and financial performance. The outcomes will help these bodies to improve their regulations in Malaysia. Moreover, the outcomes are significant to the policymakers in government and their counterparts in the Takaful sector, the employees of the Takaful industries, and the general public in re-strengthening their commitment toward Takaful acceptability. This is because the findings will provide adequate statistics or required data to enhance the current laws and regulations on CG for Takaful in Malaysia.

Moreover, the findings are significant for improving better financial disclosures in Takaful firms, which is very useful to Takaful financial information users, including stakeholders, managers, account holders, and the general public. Because one of the most important Shariah management objectives is to offer financial transparency and complete disclosure of Shariah non-compliance income, the outcomes are highly significant to the Shariah committee to oversee the successful application of Shariah codes in the Takaful industry. Developing regulatory structures that helps control fraud, exploitation, and un-Islamic behaviour in the Takaful industry to avoid bankruptcies is essential. Finally, the findings are important to internal auditors who play a role in managing the financial events of the Takaful industry to enhance its performance.

The Takaful industry is in a significant growth stage, and many threats exist to this kind of Islamic transactions in light of the increase in the volume of investments. Therefore, the focus and attention should be placed on studying all aspects that help stabilize it and gain current and future investors' confidence.

1.6 Research Scope

This study covers licensed Takaful companies by Bank Negara Malaysia (BNM) and explores the impact of CG on the performance of these Takaful institutions. Additionally, it considers the Takaful sector's recovery phase after the recent financial crisis. The data and information gathered for the study were obtained from a sample of Takaful operators, quantitative in nature, and are collected via panel data. There are eleven listed Takaful companies in Bank Negara Malaysia; therefore, this study will cover those licensed Takaful companies from 2010 to 2017.

1.7 Operational Definitions

- **Corporate Governance** is the process and structure used to direct and manage the company's business and affairs towards promoting business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value while taking into account other stakeholders' interests (Security Commission Malaysia, 2017).
- **Takaful or Islamic insurance** is a scheme based on brotherhood, solidarity, and mutual assistance that provides mutual financial aid and assistance to participants in case of need whereby the participants mutually agree to contribute for that purpose (Takaful Act, 1984).
- **Shariah Committee** is an independent body of specialized jurists in fiqh al-mu'amalat (Islamic commercial jurisprudence). The Shariah Committee is entrusted with directing, reviewing, and supervising the Islamic financial institution's activities. The fatwas (legal opinions) and rulings of the Board are binding (AAOIFI, 2005).

1.8 The Organization of the Study

The following paragraphs present the organization of this study's chapters:

Chapter one is an introductory chapter that provides a preface to the study. It also introduces the thesis, background of the study, statement of the problem, research questions, objectives, the contributions and significance, scope, operational definitions, organization of the study, and summary.

Chapter two analyses critically review the literature and generally describes the nature of CG, code of CG in Malaysia and reserved, Islamic perspective CG, Takaful industry background and models, Takaful legal framework, compare between Takaful, conventional insurance, and shariah committee quality.

Chapter three discusses the theoretical perspective of CG. The chapter briefly explains the four most frequently used theories, including the Agency Theory (Jensen and Meckling, 1976), the Stewardship Theory (Donaldson, 1990), the Stakeholder Theory (Freeman, 1984), and the Resource Dependence Theory (Pfeffer, 1973). Researchers commonly employ these theories to explore the relationship between CG and firm financial performance. The chapter also presents the conceptual framework and highlight hypotheses development. The chapter addresses the empirical research questions and their translation into research hypotheses and provides a detailed explanation of the main research hypotheses and their subdivisions.

Chapter four discusses the research methodology and the techniques of statistical analysis used to test the impact of the CG on Takaful companies' performance. Additionally, the chapter explains how the research was conducted and how the data were obtained, focusing on the particular methods utilized. Besides giving the details of the methods used, the chapter illustrates the research processes, procedures, and reasons used. This is presented alongside the research design, the sample used, the data collection, and the methods used for measuring the selected variables.

Chapter five presents the findings of the research. Tests were performed to provide empirical evidence that would answer the research question.

Chapter six provides the conclusions of the thesis by summarizing the main findings and contributions of the research to the scholar's and practitioner's knowledge. The chapter also recognizes the research limitations while suggesting several recommendations for future research. It includes an overview of the findings of this research and considering them in light of previous studies. Moreover, it includes implications of the research for the market and policymakers.

1.9 Chapter Summary

CG has emerged as an important subject. The studies in the area are ongoing because it relates to an important sector of the economy by encouraging internal and external investment into the Takaful industry in Malaysia by providing information on asymmetry and better communication channels between participants and Takaful operators. According to available information, CG performance in the Takaful industry is influenced by corporate structure and mechanisms in Malaysia, especially board effectiveness, AC effectiveness, SCQ, and financial performance. However, a limited number of studies have examined CG structures and effectiveness in the Takaful industry. In the Malaysian context, little information exists on the direct impact of CG structures on Takaful performance. Thus, this study adds to the research pools. This study examined the effect of CG structures on the performance of Takaful companies in Malaysia.

In that respect, variables such as the effectiveness of the BOD and the SC were investigated. The impact of SCQ was also tested as a moderating variable between CG and the financial performance of Takaful companies. Control variables, including the size of the company, leverage, and firm age, were used to determine the extent of their impact on the performance of the Takaful companies. It will benefit many parties, and the results are theoretical and practical.