Determinants of Islamic Social Reporting in Indonesia and Malaysia

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Abstract—This paper aims to examine the determinants of Islamic Social Reporting (ISR) disclosure levels and examine whether legal origins affect ISR disclosure levels. This study examined samples from Islamic banks in Indonesia and Malaysia between 2013 and 2015 using regression analysis. The result shows that a bank’s size and age positively affect ISR disclosure level. Profitability negatively affects ISR disclosure level, and the number of Sharia Supervisory Boards did not affect ISR disclosure level. Legal origin affects ISR disclosure levels. It was also observed that banks in civil law countries have a higher disclosure level than banks in civil law countries.

Keywords—Islamic social reporting, disclosure, determinants, legal origin, common law, civil law

I. INTRODUCTION

Islam as Rahmatan Lil Alamin has clearly defined is involved in every aspect of our daily lives. Obligations to behave ethically for the ummah welfare and to protect the environment are those set out in the Qur’an and Sunnah [1]. Islamic banks are institutions that apply Islamic principles and are expected to carry out many social and environmental activities.

The social and environmental activities of Islamic banks are disclosed in the annual report. However, no standard governing this disclosure is in place; hence, the disclosure levels vary across institutions. This voluntary disclosure motivates research examining the determinant factors affecting different disclosure levels.

Islamic Social Reporting (ISR), introduced by Haniffa [2], views the need for a specific framework of social responsibility reporting according to Islamic principles. Haniffa [2] established the Islamic Social Reporting Index (ISRI), which contains items that should be disclosed within the ISR.

Previous studies have examined the determinants of the ISR disclosure where factors were conducted by Othman [3], Mallin [4], Mallin and Michelon [5], and Farook et al. [6], while Fitria and Hartanti [7], Rizkiningsih [8], and Lestari [9] conducted similar research in Indonesia. These studies examined factors affecting the differences in ISR disclosures such as bank’s size, bank’s age, profitability level, and governance. However, it appears there is no previous research that examines the effect of legal origins on the ISR disclosure level.

II. THEORETICAL REVIEW AND HYPOTHESES DEVELOPMENT

A. Stakeholder Theory

Stakeholder theory states that management must consider not only shareholders’ interest but also stakeholders’ interest when making a business decision [14, 15]. Activities and performances related to sustainability enhance a company’s long-term value that will also enhance its reputation. Based on the stakeholder theory, companies conduct Corporate Social Responsibility (CSR) not only to earn profit or avoid punishment but also to act ethically and be socially supportive [16]. Managers perform CSR to meet ethical, moral, and social obligations.

B. ISR

ISR is a social reporting concept that includes public expectations regarding the company’s role in both economic and spiritual perspectives [17]. ISR is a specific framework of social responsibility reporting that follows Islamic principles. The two main purposes of ISR are to make accountability to Allah and ISR as an improvement of business transparency by providing relevant information for decision makers [17].

Aribi and Gao [1] state that the underlying values of CSR according to Islam are “Tauhid” (the unity of Allah). All

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human beings will be accountable for their actions (Qur’an 4:86). Companies conduct CSR not to obtain financial benefits but to follow orders and stay away from God’s prohibition (Qur’an 99: 7, 8). The second value is the Maqasid Al Shariah, which states that the main purpose of ISR is the benefit of the ummah (Al-Ghazali in Basah, 2013). The third value is human as khalifah. Allah is the owner of everything that exists on Earth; wealth must be used in an efficient way to create prosperity and justice (Mettwalli, 1997 in Arbi and Gao [1]). The fourth value is Habluminannas or human relationships that make Islamic banks more concerned with social problems [1].

Islamic businesses are expected to operate according to the values of Sharia justice, honesty, and care for others (Hussain, 1999 in Arbi and Gao [1]). Islamic ethical values are conceptually consistent with the basic principles of CSR [18]. However, Haniffa and Hudaib [19] found a gap between actual reporting and indexes built on the ethical framework of an Islamic business.

C. Determinants of ISR Disclosure Level

Companies with good profitability will reveal more information [3]. Profitable banks are able to fund their ISR activities and disclosure. Mallin [4] used slack resource theory to explain the effect of profitability on ISR disclosures that is consistent with Mallin and Michelon’s study [5].

H1: Profitability positively affects the ISR disclosure level.

Large banks have more complex activities, more resources and a greater impact on communities, environment, and other stakeholders [3]. These banks have higher agency issues requiring more disclosure to reduce agency problems [20].

H2: Institution size positively affects the ISR disclosure level.

Banks that have operated as a financial institution for a longer period of time are more experienced in terms of financial reporting, and they are able to better understand stakeholder demands [9]. The bank’s age is positively associated with voluntary disclosure. ISR is more widely disclosed in companies with a history of operation because it is directly associated with its reputation (Roberts 1992 in Mallin [4]). Longstanding bank stakeholders expect transparent reporting from banks to disclose ISRs and their ethical behavior to the relevant parties [4].

H3: The institutions age positively affects the ISR disclosure level.

A large number of Sharia Supervisory Boards (SSB) will improve supervision of Islamic banks, thereby increasing the level of ISR disclosure [21]. The SSB comprises scholars and/or Islamic banking experts who understand Islamic law and are tasked with directing, supervising, and reviewing the activities and products of Islamic banks. Mallin [4] has shown that SSB play a vital role in supporting the social activities of Islamic banks. A high number of SSBs results in better supervision, review, and unification of ideas [6].

H4: The number of Sharia Supervisory Boards (SSB) positively affects the ISR disclosure level.

Legal origin has been proven to affect the level of disclosure in a country [10,11]. La Porta et al. [12] and Ball et al. [13] have examined the legal origin factors that comprise common and civil laws. Both legal origins (common and civil laws) have different agency problems. In common law countries, companies have a higher number of transactions with other parties (investors) and thus require more disclosure [13]. In civil law countries, the majority of companies is owned by insiders who get direct information from management; hence, the disclosure requirement is less [10]. Roe (1994) in Ball [13] states that disclosure standards in common law countries are higher thereby reducing agency problems.

H5: Legal origins affect the level of ISR disclosure.

III. RESEARCH METHODOLOGY

This study uses the quantitative approach that examines 52 samples from Islamic banks in Indonesia and Malaysia between 2013 and 2015. Samples were selected using purposive sampling techniques with criteria as in Table I. This research uses secondary data (financial and annual reports) from company websites. Content analysis is used to obtain ISR disclosure value and refers to Platonova index [22] (Appendix 1). Data were analyzed using multiple linear regressions (unbalanced panel), including R-squared test, F test, and the t test with previously performed classical assumption testing. The research model used to test the hypotheses is as follows:

\[ ISR_{it} = \beta_0 + \beta_1 ROA_{it} + \beta_2 SIZE_{it} + \beta_3 AGE_{it} + \beta_4 SSB_{it} + \beta_5 LEGAL_{it} + \epsilon_{it} \]

A. Research Variables

1) Dependent variable: ISR disclosure (ISR)

ISR disclosure score is the content analysis result of the annual report and refers to the Platonova index [22] developed based on AAOIFI [23], Haniffa and Hudaib [19], Arbi and Gao [1] and Arbi and Arun [24]. This index consists of five dimensions of mission and vision statements, products and services, zakah, charity and benevolent funds, and commitment to employees, debtors, and the community.

2) Independent variables

- Profitability (ROA). Profitability displays the ability of a company to generate profit proxied with ROA (income before extraordinary items/total assets).
Bank size (SIZE). The size of the bank is measured using the natural logarithm of the bank’s total assets.

- Age of bank (AGE). The age of the bank is calculated by subtracting the year of establishment of an Islamic bank from the research years used (2013, 2014, and 2015).

- Number of SSB (SSB). The number of SSBs shows the number of Sharia Supervisory Boards (SSB) of Islamic banks taken from the annual report.

- Legal Origin (LEGAL). Legal origin denotes the legal system of a country in which dummy 1 for common law and 0 for civil law are used.

IV. RESEARCH RESULT AND DISCUSSION

A. Descriptive Statistics

Table II displays the descriptive statistics. The ISR disclosure has an average of 52% and indicates that the sample companies disclose only half requirement, as in Platonova [22] ISR index. The ISR disclosure of Bank Jabar Banten Syariah from 2013 is a minimum value of 25%, whereas Bank Panin Syariah’s ISR disclosure from 2014 is a maximum value of 82%. The average number of ROA is 1%, which varies from -0.04% (by Maybank Syariah in 2015) to 0.05% (by BTPN Syariah in 2015). The lowest value of the total assets is Rp 1.3 trillion owned by Bank Victoria Syariah and the highest value of Rp 16 trillion owned by Bank Islam Malaysia Berhad. Established in 1983, Bank Islam Malaysia Berhad is the longest standing bank.

B. ISR Disclosure

Figure 1 shows the level of ISR disclosure since 2015. The highest disclosure is made by Panin Bank Syariah. It is the only Islamic bank listed on the Indonesia Stock Exchange. Figure 2 shows the ISR disclosures per dimension since 2015. It appears that the most disclosed dimension is the commitment to employees, and the least disclosed dimension is disclosure of items in vision and mission statements.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>Standard Deviation</th>
<th>Min</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td>ISR</td>
<td>.5260989</td>
<td>.1422634</td>
<td>.25</td>
<td>.8214286</td>
</tr>
<tr>
<td>ROA</td>
<td>.0101391</td>
<td>.0151692</td>
<td>-.047433</td>
<td>.0524</td>
</tr>
<tr>
<td>Total Asset</td>
<td>3.87e+13</td>
<td>4.62e+13</td>
<td>1.32e+12</td>
<td>1.62e+14</td>
</tr>
<tr>
<td>AGE</td>
<td>9</td>
<td>7.659417</td>
<td>0</td>
<td>32</td>
</tr>
<tr>
<td>SSB</td>
<td>.5</td>
<td>.5048782</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>LEGAL</td>
<td>.2692308</td>
<td>.4478876</td>
<td>0</td>
<td>1</td>
</tr>
</tbody>
</table>

ISR: ISR disclosure, ROA: profitability ratio (return on asset), Total Asset: proxy for size, AGE: bank’s age, SSB: no of Sharia Supervisory Board, LEGAL: legal origin: 1 Common Law, 0 Civil Law

Fig. 1. ISR Disclosure Level since 2015.
C. Factors Affecting ISR Disclosure

As shown in Table III, no coefficient of correlation exceeds 0.8. This indicates that there is no autocorrelation problem among variables.

The preliminary correlation test, regardless of causality, shows that ROA and ISR are negatively associated with ISR disclosure, whereas a bank’s size, bank’s age, the number of SSBs, and legal origin are positively associated with ISR disclosure.

According to Table IV, profitability has a negative effect on ISR disclosure, whereas bank’s size, bank’s age, and legal origin have a positive effect on ISR disclosure. Moreover, the number of SSBs does not significantly affect the ISR disclosure.

Negative effect of profitability is not in accordance with the hypothesis (H1). This result is not consistent with the slack resource theory, which states that banks with high profitability have enough funds to disclose ISR more comprehensively. This result is also not in line with the research of Othman [3], Mallin [4], and Mallin and Michelon [5]. This may be because the bank has made extensive ISR disclosures to mask the decline in profitability.

A bank’s size has a positive effect on ISR disclosure. This is the ISR disclosure is more extensive if the bank is large. This result is in accordance with the hypothesis (H2) and consistent with Othman’s research [3]. A bank’s age has a positive effect on ISR disclosure. This shows that the longer the Islamic bank operates, the more ISRs are disclosed, whereas a bank’s size, bank’s age, and legal origin have a positive effect on ISR disclosure. Moreover, the number of SSBs does not significantly affect the ISR disclosure.

The number of SSBs has no effect on the ISR disclosure. This result does not support the hypothesis (H4) and is inconsistent with Mallin [4] and Farook et al. [6]. This may occur because the increasing number of SSBs makes the coordination more difficult.

Legal origin affects ISR disclosure and supports the hypothesis (H5) in accordance with Hope [10], Jaggi and Low [11], La Porta et al. [12], and Ball et al. [13]. There is a difference of ISR disclosure in common and civil law countries. The positive coefficient shows that companies in common law countries have more extensive ISR disclosure than those in civil law countries. Malaysia is a common law country that has a higher level of ISR disclosure than Indonesia, which is a civil law country.

![Fig. 2. ISR Disclosure for Each Dimension since 2015](image)

#### TABLE III. COEFFICIENT OF CORRELATION

<table>
<thead>
<tr>
<th>Variables</th>
<th>Coefficient</th>
<th>Standard error</th>
<th>z-statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>ISR</td>
<td>-.149</td>
<td>.000</td>
<td>1.00</td>
<td>.999</td>
</tr>
<tr>
<td>ROA</td>
<td>-.043</td>
<td>.000</td>
<td>1.00</td>
<td>.999</td>
</tr>
<tr>
<td>SIZE</td>
<td>-.036</td>
<td>.000</td>
<td>1.00</td>
<td>.999</td>
</tr>
<tr>
<td>AGE</td>
<td>-.036</td>
<td>.000</td>
<td>1.00</td>
<td>.999</td>
</tr>
<tr>
<td>SSB</td>
<td>-.036</td>
<td>.000</td>
<td>1.00</td>
<td>.999</td>
</tr>
<tr>
<td>LEGAL</td>
<td>-.036</td>
<td>.000</td>
<td>1.00</td>
<td>.999</td>
</tr>
</tbody>
</table>

**TABLE IV. REGRESSION RESULT**

Research Model:

\[ \text{ISR}_{it} = \beta_0 + \beta_1 \text{ROA}_{it} + \beta_2 \text{SIZE}_{it} + \beta_3 \text{AGE}_{it} + \beta_4 \text{SSB}_{it} + \beta_5 \text{LEGAL}_{it} + \epsilon_{it} \]

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<td>.000</td>
<td>1.00</td>
<td>.999</td>
</tr>
</tbody>
</table>

N: 52
R-squared: 41.51%
Prob (F-statistic): 0.000

V. CONCLUSION

This study has examined the determinant factors affecting ISR disclosure and the effect of legal origins on ISR disclosure. It can be concluded that three of the five hypotheses (H2, H3, and H5) are proven. Bank size and bank age have a positive effect on ISR disclosure, and legal origin affects ISR disclosure. The positive coefficient of legal origin indicates that companies in common law countries have more extensive ISR disclosure than companies in civil law countries. As companies try to mask poor performances by disclosing ISR, profitability has a negative effect on ISR disclosure (H1 is not proven). The number of SSBs has no influence on ISR disclosure (H4 is not proven) because an
increase in the number of SSBs leads to less efficient coordination.

This study has limitations of ISR measurement validity and generalizability. Content analysis may be imposed subjectivity in the scoring process. This study was conducted in only two countries over a three-year period. This study used the number of SSBs as a proxy of Islamic governance. Further research can use cross membership, educational background, and reputation of the SSB as proxies of Islamic governance, so that assessments are more comprehensive. Further research can be conducted in countries with a majority of Muslim population such as Gulf Cooperation Council countries.

REFERENCES


### Appendix 1. CSR Disclosure index (Platonova, 2015)

<table>
<thead>
<tr>
<th></th>
<th>Mission and vision statement</th>
<th>Products and services</th>
<th>Zakah, charity and benevolent funds</th>
<th>Commitment toward employees</th>
<th>Commitment toward debtors</th>
<th>Commitment toward community</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Mission and vision statement</td>
<td>Commitments in operating within Shari’ah principles/ideals Commitments in providing returns within Shari’ah principles Current directions in serving the needs of the Muslim community Commitments to fulfill contractual relationships with various stakeholders via contract (uqud) statements Future directions in serving the needs of the Muslim community Commitments to engage only in permissible financing activities Commitments to fulfill contracts via contract (uqud) statements Appreciation to customers Focus on maximizing stakeholders returns</td>
<td>No involvement in non-permissible activities Involvement in non-permissible activities -% of profit Reason for involvement in non-permissible activities Handling of non-permissible activities Introduced new product Approval ex ante by SSB for new product Basis of Shari’ah concept in approving new product Glossary/definition of products Investment activities: general Financing projects: general</td>
<td>Bank liable for zakah Amount paid for zakah Sources of zakah Uses/beneficiaries of zakah Balance of zakah not distributed–amount Reasons for balance of zakah SSB attestation that sources and uses of zakah according to Shari’ah SSB attestation that zakah has been computed according to Shari’ah Zakah to be paid by individuals-amount Sources of charity (sadaqa) Uses of charity (sadaqa) Sources of qard al-hassan Uses of qard al-hassan Policy for providing qard al-hassan Policy on non-payment of qard al-hassan</td>
<td>Employees appreciation Number of employees Equal opportunities policy Competitive salary Employee welfare Training: Shari’ah awareness Training: other Training: student/recruitment scheme Training: monetary Reward for employees</td>
<td>Debt policy Attitude towards debt products Amount of debts written off Type of lending activities-general Type of lending activities-detailed</td>
</tr>
<tr>
<td>2</td>
<td>Products and services</td>
<td>No involvement in non-permissible activities Involvement in non-permissible activities -% of profit Reason for involvement in non-permissible activities Handling of non-permissible activities Introduced new product Approval ex ante by SSB for new product Basis of Shari’ah concept in approving new product Glossary/definition of products Investment activities: general Financing projects: general</td>
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<td></td>
</tr>
<tr>
<td>3</td>
<td>Zakah, charity and benevolent funds</td>
<td>Bank liable for zakah Amount paid for zakah Sources of zakah Uses/beneficiaries of zakah Balance of zakah not distributed–amount Reasons for balance of zakah SSB attestation that sources and uses of zakah according to Shari’ah SSB attestation that zakah has been computed according to Shari’ah Zakah to be paid by individuals-amount Sources of charity (sadaqa) Uses of charity (sadaqa) Sources of qard al-hassan Uses of qard al-hassan Policy for providing qard al-hassan Policy on non-payment of qard al-hassan</td>
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<tr>
<td>4</td>
<td>Commitment toward employees</td>
<td>Employees appreciation Number of employees Equal opportunities policy Competitive salary Employee welfare Training: Shari’ah awareness Training: other Training: student/recruitment scheme Training: monetary Reward for employees</td>
<td>Debt policy Attitude towards debt products Amount of debts written off Type of lending activities-general Type of lending activities-detailed</td>
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<tr>
<td>5</td>
<td>Commitment toward debtors</td>
<td>Debt policy Attitude towards debt products Amount of debts written off Type of lending activities-general Type of lending activities-detailed</td>
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<tr>
<td>6</td>
<td>Commitment toward community</td>
<td>Women branch Creating job opportunities Support for organizations that provide benefits to society Participation in government social activities Sponsored community activities Commitment to social role Conferences on Islamic economics and other educational areas</td>
<td></td>
<td></td>
<td></td>
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</tbody>
</table>