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# Islamic Corporate Governance Index and Islamic Social Reporting Disclosure Index for Enhancing Firm Value: An Empirical Study of Islamic Banking in Indonesia

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The purpose of this study was to examine which Islamic Corporate Governance Index can enhance the firm's value for Islamic banking in Indonesia. The Index is measured by using a composite value of the results of the self-assessment Islamic Commercial Bank GCG score and the Islamic Social Reporting Disclosure Index. This type of research is a quantitative study. The study population is a Sharia Commercial Bank registered with the Financial Services Authority in 2013 to 2017. Sample selection was obtained by the purposive sampling method and produced 45 samples. The data analysis technique used was multiple linear regressions. The results of this study indicated that the Islamic Corporate Governance Index can enhance the value of the Sharia Commercial Banks, while the Islamic Social Reporting Disclosure does not.

**Key words:** *Islamic Corporate Governance Index, Islamic Social Reporting Disclosure Index, Firm Value, Empirical Study, Islamic Banking.*

## Introduction

Islamic Banks are banks that operate based on a profit-sharing principle. The principle of profit sharing provides an alternative banking system that is mutually beneficial to the public and Banks. It also highlights: aspects of fairness in transactions; ethical investments; promoting values of togetherness and brotherhood in production; and avoiding speculative activities in financial transactions. Islamic banking provides a variety of products and diverse services through a more varied financial scheme. Islamic banking is an alternative credible banking system and can be enjoyed without exception, by all classes of Indonesian people. Islamic banking is positively associated with economic growth, even after controlling for various determinants of growth (Imam & Kpodar, 2016).

In an effort to improve the value or image of the company, be aware of applying good corporate governance or good corporate social responsibility. Whether or not the application of corporate governance in Islamic Banks can be seen from the results of self-assessment conducted by Islamic Banks in accordance with Bank Indonesia (BI) Circular Letter No. 12/13/DPbS regarding GCG implementation for Sharia Commercial Banks and Sharia Business Units. In the BI Circular, the assessment of the implementation of corporate governance is seen from the composite value of the results of self-assessment, where the smaller the composite value produced, the better the application of corporate governance at the Islamic bank. Islamic Banks provide an interesting setting in corporate governance studies due to several unique features, such as adherence to Sharia principles in operations and unrestricted Islamic Banks have unrestricted investment account holders (Darmadi, 2013).

Islamic Social Reporting (ISR) is one way to provide full disclosure in an Islamic context. ISR presents accounting concepts and practices in accordance with Islamic Sharia. The establishment of the ISR is expected to contribute to economic and business progress, as well as fairer and fairer trade practices, apart from international business practices. Company value is an entity's long-term goal. To improve the value or image of the company, one way is to apply good corporate governance and corporate social responsibility to the community and the environment which are the company's stakeholders. Implementation of corporate governance in Islamic Banks is very important, not only to foster the existence of Islamic Banks but also maintain the public image of Islamic Banks.

Based on the description, this study aims to examine whether the Islamic Corporate Governance Index as a measurement model of corporate governance and the ISR index as a model of measuring corporate social responsibility, can increase corporate value. The purpose of this study is to examine which Islamic Corporate Governance Index, that is measured by using a composite value of the results of self-assessment Islamic Commercial Bank Good Corporate Governance (GCG) score and the Islamic Social Reporting Disclosure Index, can enhance the firm’s value of Islamic Banking in Indonesia. The research problem formulation included: whether the Islamic Corporate Governance Index can increase the value of Islamic Bank Companies in Indonesia; and whether disclosure of Islamic social reporting can increase company value (Issaliyeva et al, 2018).

**Literature Review**

A company iss founded to fulfill various purposes. Increasing high company value is a long-term goal of a company (Retno & Priantinah, 2012). The value of the company is the price that the buyer is willing to pay if a company is sold and is the price of the applicable shares of the company's general shares (Rahardjo et al., 2016). Return On Equity (ROE) is a representation of the value of the company. ROE is used to measure the company's success in generating profits for shareholders. Therefore, ROE is considered as a representation of shareholder wealth or the value of the company. The value of the company is interpreted as the company's image, therefore the company is required to always look good in the eyes of the stakeholders (Arianti & Putra, 2018; Ghaderi & Mahdavi Panah, 2018).

Islamic corporate governance or also corporate governance in Islam is corporate governance that directs and controls the company to achieve company goals by protecting the rights and interests of all stakeholders by using the basic concepts of decision making based on Islam and monotheism to God (Endraswati, 2015). Corporate governance refers to the relationship of the company with its constituents (Bhatti & Bhatti, 2009). Islamic Banks are positively focused on sharing ownership, board independence, women directors, board expertise and the expertise of the Sharia board (Grassa, 2016). Islamic corporate governance focuses on retaining the Islam city of the whole corporation (Muneeza & Hassan, 2014; Sadeghpour et al., 2017). Corporate governance in Islam is different from conventional corporate governance practices in terms of standardisation of rules, where corporate governance in Islam must be based on Islamic Sharia contained in the Qur'an and Hadith (Al-Suhaibani & Naifar, 2013).

Islamic Social Reporting (ISR) is corporate social responsibility reporting that not only exposes the holistic expectations of the community regarding the company's role in society but also reports on social responsibility in a spiritual perspective (Cahya, Nuruddin, & Ikhsan, 2017). ISR is a form of corporate social responsibility towards the community and the environment that is adjusted to Islamic principles (Ningrum, Fachrurrozie, & Jayanto, 2013). Meanwhile, the basic foundation of ISR is Sharia principles (Hassan & Harahap, 2010). There is no doubt that global capitalism and imperialism are factors that hinder the possibilities of Islamic Banks and an Islamic finance system to materialise the spiritual and secular notions of social justice in Islamic teachings (Kamla & Rammal, 2013). Islamic Banks have higher liquidity risk, lower credit risk, lower insolvency risk, but encounter similar operational risk in comparison with conventional Banks (Safiullah & Shamsuddin, 2018).

Corporations are aware that in an effort to increase the value of the company it is necessary to pay attention to stakeholders. However, not just shareholders but also raising social responsibility reports and reports on the implementation of corporate governance on a regular basis. The application of corporate governance in several Islamic financial institutions can increase public confidence in Islamic Banks (Siswanti et al., 2017). Ensuring Sharia compliance is essential for upholding salient principles of Islamic banking (Ginena, 2014). The disclosure of Islamic social reporting is expected to improve the company's image and reputation which will have an impact on increasing the value of the company (Setiawan, Swandari, & Dewi, 2018). Maintaining customer trust is very important for the sustainability of Islamic Banks.

## Research Method

This research is quantitative research. The population in this study was all Islamic Banking in Indonesia. The sample in this study was Islamic Commercial Banks registered with the Financial Services Authority for the period 2013 to2017. The sampling method was done by purposive sampling. The documentation method was used as the data collection technique in this research . For data analysis the multiple linear regression technique was used . The dependent variable of this study was the firm's value. Return On Equity (ROE) is a representation of the value of the company (Mardiyanto, 2009). The ROE formula can be seen below.

$$ROE = \frac{\text{Net Profit}}{\text{Total Equity}} \text{ X } 100$$

The independent variables of this study were the Islamic Corporate Governance Index (ICGI), Islamic Governance Score (IGS) and Islamic Social Reporting (ISR). In this study, the Islamic Corporate Governance Index was determined based on the composite value of the results of Sharia Bank self-assessment. The Islamic Governance Score was determined by content analysis of the characteristics of the Sharia supervisory board as measured by: the number of Sharia supervisory boards; cross membership; educational background; and experience or reputation of the Sharia supervisory board. The ISR Index in this study consists of 43 disclosure items arranged in six themes in accordance with the research of Othma, Thani, and Ghani (Othman, Thani, & Ghani, 2009).

## Results and Discussion

### *Research Samples*

The sample criteria are Sharia Commercial Banks that were consistently registered with the Financial Services Authority from 2013 to 2017, Sharia Commercial Banks that publish annual reports from 2013 to 2017, Sharia Commercial Banks which publish corporate governance reports and corporate social responsibility in the reports yearly. Descriptive statistics of the sample can be seen in Table 1.

**Table 1:** Descriptive statistics

| Information | N | Minimum | Maximum | Mean | Std.Deviation |
|---|---|---|---|---|---|
| ICGI | 45 | 1 | 3 | 1,8453 | 0,58185 |
| ISRD | 45 | 0,47 | 0,72 | 0,5809 | 0,06359 |
| Corporate Value | 45 | -94,01 | 26,23 | 1,764 | 17,3871 |
| Valid N (listwise) | 45 | | | | |

***Results Coefficient of Determination (R2)***

Based on the results of the coefficient of determination in the Adjusted R Square column, the coefficient of determination (R2) of 0.205 or 20.5% was obtained. This shows that the variable corporate value can be explained by the variable Islamic Corporate Governance Index (ICGI), Islamic Governance Score (IGS) and Islamic Social Reporting Disclosure (ISRD) of 20.5% while the remaining 79.5% is explained by other factors which are not included in this study.

***Test Results F***

Based on multiple linear regression analysis, it is known that the F significance value is 0.006. The significance value is 0.006 <0.05, which means the variable ICGI, IGS, and ISRD jointly affect the value of the company.

***Hypothesis Test Results***

Hypothesis testing is a decision making method that is based on data analysis, both from controlled experiments and observations (not controlled). In statistics, an outcome can be said to be statistically significant if the event is almost impossible due to chance factors, according to predetermined probability limits. Hypothesis test results can be seen in Table 2.

**Table 2:** Hypothesis Testing Results

| Model | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | *(Constant)* | -2,293 | 27,658 | | -0,083 | 0,934 |
| | ICGI | -13,679 | 4,079 | -0,459 | -3,354 | 0,002 |
| | ISRD | 46,604 | 36,991 | 0,171 | 1,26 | 0,215 |

***Islamic Corporate Governance Index and Company Value***

The results of testing the first hypothesis in Table 2 show that the direction of the ICGI variable coefficient is negative (-13,679) with a significant value of 0.002. It can be interpreted that the better the implementation of corporate governance, (indicated by the value of the Islamic corporate governance index which is getting smaller), the better the increase in the value of the company. This can be proven by research data on Islamic Commercial Banks that have a minimum ICGI value. Namely Bank Mandiri Syariah in 2016 had an ICGI of 1.00 with a company value of 5.81. Whereas Bank Panin Syariah which had an ICGI value of 3.00 had a company value of -90.01. The results of this study support the research conducted by Mutmainah (Mutmainah, 2015) and Syafitri, Nuzula and Nurlaily (Syafitri, Nuzula, & Nurlaily, 2018) who found that corporate governance had a significant negative effect on firm value.

### *Islamic Social Reporting Disclosure and Company Value*

The results of testing the second hypothesis in Table 2 show insignificant results. This means that no matter how large, the Islamic social reporting disclosure does not affect the value of the company. This is because Islamic Banks carrying out their business activities do not have direct contact with the environment and the natural environment. Whereas in the items of environmental ISR disclosure is one of the disclosure themes that counts. The fact that ISR disclosure cannot increase the value of the company can be shown with research data on Islamic Commercial Banks that have ISRD with a value of 0.604651, namely BRI Syariah Bank in 2016 had a company value of 7.4. Whereas Islamic Commercial Banks that have ISR with a value of 0.465116, namely Maybank Syariah Bank in 2014, have a company value of 6.83. From those two data results, it can be concluded that Islamic Banks that have Islamic social reporting disclosure, large or small, do not have an influence on the value of the company. The results of this study does not support the research results of Purnama (Purnama, 2016) which provided empirical evidence that Islamic social reporting has a positive effect on firm value. However, the results of this study is supported by the research of Ramona (Ramona, 2017) which provided empirical evidence that disclosure of social responsibility has no effect on firm value.

## Conclusion

Based on the analysis that has been carried out, the conclusion is that the Islamic Corporate Governance Index measured by the composite value of the results of the self-assessment of the implementation of corporate governance in Islamic Banks can increase the value of the company in Islamic commercial Banks registered in the Financial Services Authority 2013 to2017 period. In contrast, this study has not been able to provide empirical evidence that the ISR disclosure index increases the value of Islamic Commercial Bank companies in Indonesia.

This study has limitations that might affect the results. Firstly this study is limited to Islamic Banks, so it cannot be generalised to Islamic Banks in Indonesia. Secondly the approach taken to measure the ISRD Index is content analysis so that the subjectivity of the researcher plays a role. Suggestions for improvement in further research, include: expanding the sample of not only Islamic Commercial Banks, but also including Islamic business units and Islamic people's finance Banks; and taking other approaches such as surveys with a direct observation on research objects, so the results are more valid.

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