

Factors that Affect Islamic Corporate Governance

Citra Sukmadilaga and Tri Utami Lestari

Department of Accounting, Faculty of Economics and Business, Universitas Padjadjaran, Bandung

citra.sukmadilaga@unpad.ac.id, triutamilestari88@gmail.com

Keywords: Corporate governance disclosure, Corporate governance strength, Mudharabah investment account, Sharia supervisory board strength, Size of the Islamic Bank.

Abstract: Islam encourages people to do business activities (trying) to meet the economic needs. Conventional finance is the basic function of the concept of borrowing with the consequences of their interest payments and uncertainties. From the viewpoint of Islam, it is something that is forbidden. It attracted the attention of practicing Muslim to make Islamic financial institutions are implemented based on Islamic principles in the provision of services. The purpose of this paper is to explore the perceived importance of management about various corporate governance disclosure dimensions being practiced in the Indonesian Islamic banking context. Based on the results of research on the influence of corporate governance strength, sharia supervisory board strength, mudharabah investment account, and size of the Islamic bank toward the corporate governance disclosure in Islamic Bank in Indonesia, conclusions can be drawn in accordance with the formulation of research problems is corporate governance strength, sharia supervisory board strength, mudharabah investment account and size of the Islamic bank simultaneously have a significant influence on corporate governance disclosure. Corporate governance strength and mudharabah investment account partially has a positive significant effect toward corporate governance disclosure, and sharia supervisory board strength has a negative effect toward corporate governance disclosure, however size of the Islamic Bank has no influence toward corporate governance disclosure.

1 INTRODUCTION

Islam as a way of life provides a guide for Muslims to adapt and evolve according to the times. Islam allows Muslims to innovate in muamalah, but not in aqidah, worship and morals (Kamali, 1989). The purpose of Islamic economics for Islamic banks not only focuses on commercial purposes, but also must consider its role in providing welfare widely available to the public (Astuti, 2014). One such measure is the ability of human resources in managing companies that are integrated in corporate governance. In early 2000, company's corporate governance structure is under intense scrutiny after case of the Enron and Worldcom. The failure of corporate governance does not only affect shareholders but also affect the overall stakeholders, includes agencies, creditors, supplier, consumer, employee, retired, and society (Wan Abdullah, 2013). In Indonesia, This issue was brought up in particular when Indonesia was hit by the prolonged economic crisis, ie back in 1998. In the process of economic transition, corporate governance

practices can be an essence in ensuring the success of health investment climate (Hassaan, 2013).

The concept of corporate governance has gained great attention from various circles, especially accountants and academics. However, the current research on corporate governance in Islamic banks have not done. Related to that, Researchers are motivated to do research on corporate governance in Islamic banks. On other hand, Another motivation for doing this study is among the first, the high level of transparency of information disclosure about corporate governance and the importance of Sharia Supervisory Board report in increasing stakeholder confidence, particularly those related to compliance with Islamic principles. The information provided by companies has to be useful for the investors (Andreas et. al, 2016).

Second, Islamic banks have unique characteristics. Third, high corporate governance standards expected of Islamic banks because of the risks associated with equity participation, there is no interest on financial instruments, as well as their revenue-sharing agreements.

Our discussion has demonstrate that corporate governance strength, shariah supervisory board strength, mudharabah investment account, and size of the islamic bank has a effect toward the corporate governance disclosure in Islamic Bank in Indonesia. The paper is organized as follow: Section 2 reviews prior theoretical and empirical work on corporate governance dimensions and corporate governance disclosure of Islamic banks. This is followed by Section 3, which briefly discusses the characteristics of the sample banks and methodology. In Section 4, the results of CGDI scoring are presented and further discussed. Finally, Section 5 concludes the paper.

2 LITERATUR REVIEW

2.1 Corporate Governance

Shleifer and Vishny (1997) stated that corporate governance relates to the manner or mechanism to convince the owners of capital to obtain the return on investment that has been planted. (Iskander, Meyerman, Gray, & Hagan, 1999) stated that corporate governance refers to the framework of rules and regulations that enable stakeholders to make the company maximize the value and to obtain a return. In Indonesia, Code of Good Corporate Governance issued by the National Committee on Corporate Governance has five principles that must be done by each company of transparency, accountability, responsibility, independence and fairness.

Corporate governance at the company, which is based on sharia is different from the public company that is related to who the stakeholders. At the company, which is based on sharia, The main stakeholder is Allah SWT. This means that the company running the company running the company and report all related not to the benefit of man, but rather an attempt obedience to Allah SWT (Alamanda, 2014).

2.1.1 Corporate Governance Strength

Corporate governance strength is a combination of several characteristics of corporate governance. Wan Abdullah (2013) in his study used three characteristics corporate governance as follows:

1. Board Of Director Size
2. Audit Committee
3. Independent Chair

2.1.2 Shari'ah Supervisory Board (SSB) Strength

Musibah dan Wan Sulaiman (2014) stated that a significant element in differentiating Islamic bank with conventional banks are sharia supervision element.

This study used three characteristics using SSB strength being adopted from the research Wan Abdullah (2013).

1. SSB Size
2. SSB Cross-membership
3. SSB Experience

2.1.3 Mudharabah Investment Account

Salman (2012) in his book mentions that mudaraba comes from the word adhdharby fil Ardhy is traveling for the deal. Mudharabah investment account is the biggest source of funding for Islamic financial institutions (El-Hawary, Grais, and Iqbal, 2007).

2.1.4 Size of the Islamic Bank

Size of the islamic bank is a measure of Islamic Banking to reflect the size of Islamic Banking which can be shown by total assets, the number of sales, average total sales, and average total assets (Sujianto, 2001).

2.1.5 Corporate Governance Disclosure

Corporate governance arises because there is a separation between the ownership of the controlling company, or often known as agency problems. Corporate governance is needed to reduce the agency problem between owners and managers. Some of the concepts of corporate governance among others proposed by Shleifer and Vishny (1997) stating corporate governance with regard to means or mechanism to convince the owners of capital in obtaining a return on investment that has been planted. Organisation for Economic Cooperation and Development (OECD) revealed the principles of corporate governance as follow:

“corporate governance involves a set of relationship between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the

company and its shareholders and should facilitate effective monitoring”.

Given the importance of desire and the drive to the mechanism of governance, corporate governance disclosure has become a component of every company's strategy to maintain the relationship between the company and its stakeholders (Gaa, 2009). (Holder Web, 2010) who found the structure of directors (BOD) which became one of the characteristics of corporate governance strength has a positive influence on corporate governance disclosure

3 METHODOLOGY AND MODEL

3.1 Characteristics of the sample banks

Target population in this study are all Islamic Bank in Indonesia. The sampling method used in this research is purposive sampling. Purposive sampling is not random sample selection in which information is obtained by using certain considerations tailored to the purpose or research problems. Criteria for selection of the sample in this study is:

Table 1: Criteria for selection of the sample.

Criteria	Qty
Islamic Banks in Indonesia	11
Islamic banks do not publish audited financial statements consecutive year 2011 - 2014.	(2)
Islamic banks do not publish annual reports consecutive years 2011 - 2014	(1)
The financial statements are not presented in rupiah	(0)
The samples used in the research object	8

Source: secondary data were processed, 2016.

Samples used in this study are 8 Islamic banks. The sample of the present study consists of 8 Islamic banks whose publish annual reports are available on their web sites, namely BNI Syariah, BCA Syariah, Bank Syariah Mandiri, Bank Mega Syariah, Bank Victoria Syariah, Bank Syariah Bukopin, Bank Panin Syariah, and Bank Muamalat Indonesia.

3.2 Measuring Independent Variables

1. *Corporate governance strength* (CG Strength): a combination of several characteristics of corporate governance that is represented be a score.
2. *Shari'ah Supervisory Board Strength* (SSB Strength): a combination of several

characteristics which represented the shari'ah supervisory board into a score.

3. *Mudharabah Investment Account* (IAHEQUITY): the ratio of investment to the equity account.
4. *Size of the Islamic Bank* (Size): total assets of Islamic banks.

The dependent variable in this study is the level of corporate governance disclosure. CGD index in this study using an index that adopts CGD research Wan Abdullah (2013) the disclosure of which section 13: (1) *general*, (2) *effective shari'ah compliance structures*, (3) *fair treatment of equity-holders*, GSIFI No 6, (4) *equitable treatment of fund providers and other significant stakeholders*, (5) *fit and proper conditions for board and management*, (6) *effective oversight*, (7) *audit and governance committee*, (8) *risk management*, (9) *avoidance of conflicts of interest*, (10) *appropriate compensation policy oversight*, (11) *public disclosures*, (12) *code of conduct and ethics*, dan (13) *appropriate enforcement of governance principles and standards* which consists of 81 items disclosure.

4 THE FINDINGS

4.1 Descriptive Statistic

Table 2: Corporate Governance Disclosure.

	2014	2013	2012	2011	2010
BCA Syariah	68%	65%	67%	74%	69%
Bank Mega Syariah	62%	63%	62%	62%	64%
Bank Muamalat	74%	74%	74%	74%	65%
Bank Panin Syariah	73%	73%	73%	73%	65%
Bank Syariah Bukopin	70%	73%	75%	73%	72%
Bank Syariah Mandiri	78%	78%	78%	78%	78%
Bank Victoria Syariah	73%	73%	73%	73%	73%
BNI Syariah	80%	79%	80%	79%	78%

Source: calculated, 2016

Based on Table II shows that from 2010 to 2014, the index of the highest Corporate Governance Disclosure owned by BNI Syariah. Meanwhile, the index of the lowest corporate governance disclosure is owned by Bank Mega Syariah.

4.2 Regression Result

All model are run based on linear regression. For further verification, ordinary least square (OLS) test has been performed.

Tabel 3: Multiple Regression Analysis.

$CGD_Index = + b_1Cg_Strength + b_2Ssb_Strength + b_3Iahequity + b_4Size +$	
Independen Variable	Model A OLS (N=32)
Konstanta	0.541848 (1.932939)
<i>Cg_Strength</i>	0.054106* (2.944027)
<i>Ssb_Strength</i>	-0.059734* (-4.392324)
<i>Iahequity</i>	0.011004* (2.828460)
<i>Size</i>	0.002768 (0.115881)
Std. Error	0.045668
F-statistic	11.56060
Sig. F	0.000013*
R square	0.631361
Adj. R Square	0.576748

Source: calculated by Eviews 7.0, 2016.

4.2.1 Simultaneously Testing

Based on the results of data processing using statistical software Eviews 7.0 the results obtained determination coefficient is 0.631361 which shows that the proportion of variables influence *cg_strength*, *ssb_strength*, *iahequity*, and *size* toward *cgd_index* at 63.13%. This means that corporate governance strength, shari'ah supervisory board strength, mudaraba investment accounts, and the size of Islamic banks have a proportion of influence on corporate governance disclosure at 63.13%.

4.2.2 Partially Testing

Partial testing was conducted to determine the effect of one independent variable on the dependent variable assuming other variables constant. To interpret the coefficient of the independent variable, can use the results of the regression analysis as presented in Table II. The regression model based on the analysis table II is:

$$CGD = 0.542 + 0.054 CG_STRENGTH - 0.060 SSB_STRENGTH + 0.011 IAHEQUITY + 0.002 SIZE + \quad (1)$$

5 DISCUSSION

The following are descriptions of the effect of each independent variable on the corporate governance disclosure.

5.1 Corporate governance strength (X₁) towards corporate governance disclosure (Y)

Based on table III seen that corporate governance strength variables has a significant effect on corporate governance disclosure. The effect of corporate governance strength on the disclosure of corporate governance has a positive influence, meaning that the higher the strength of corporate governance index, the higher the disclosures made by the Islamic bank. The results of this research in line with Arcay and Vazquez (2005) and (Holder Web, 2010) whose found that the combination of some of the characteristics of corporate governance strength that includes (*BOD size*, *audit committe*, and *independent chair*) can be an effective package in the mechanism of corporate governance and have a positive influence on the disclosure.

5.2 Shari'ah supervisory board strength (X₂) toward corporate governance disclosure (Y)

Based on table III seen that *shari'ah supervisory board strength variables* has a significant effect on corporate governance disclosure. Effect of shariah supervisory board strength against the disclosure of corporate governance has a negative effect, that mean the higher the index shariah supervisory board, the lower strength disclosures made by the Islamic bank. The results of this study indicate that the attention given by SSB to Islamic banks still fall into the category of less, so the SSB needs to optimize its role in enhancing the disclosure report. In line with Khoirudin (2013) whose stated that SSB size does not affect the disclosure of Islamic social reporting is because SSB are still focused on their duties and responsibilities in the operations of Islamic banking. In line with Wan Abdullah (2013) which revealed that the number of members of SSB, the SSB functions and tasks can be divided among the members so that members can focus on their respective banks reporting that they are responsible for the Review procedure sharia.

5.3 Mudharabah investment account (X₃) toward corporate governance disclosure (Y)

Based on table III seen that *mudharabah investment account variables* has a significant effect on corporate governance disclosure. Effect of mudaraba investment accounts to corporate governance disclosure have a positive effect, that mean the higher the investment mudaraba accounts represented by the ratio of investment to the equity account, then the higher the disclosures made by the Islamic bank. The results of this research in line with Al-Baluchi (2006) whose found that there is a positive relationship between the proportion of investment account with a voluntary disclosure. The relationship becomes an opportunity for Islamic banks to increase investment mudaraba accounts by doing more extensive disclosures (Wan Abdullah, 2013).

5.4 Size of the islamic bank (X₄) toward corporate governance disclosure (Y)

Based on table III seen that the variable size of the islamic bank has no significant effect on corporate governance disclosure. The results of this research in line with Wan Abdullah (2013) whose found that the size banks have no influence on corporate governance disclosure. However, these results are not in line with Ahmed and Curtis (1999) who found no evidence of a positive effect of disclosure of the size of the company. Further, Sharma (2012) found that there is a positive relationship between firm size and governance disclosure. In line with Farook and farooq (2013) who found that there is a positive relationship between size with voluntary disclosure. Companies with large scale would be more likely to disclose information widely.

6 CONCLUSION

Based on the results of research, corporate governance strength, shariah supervisory board strength, mudharabah investment account and size of the islamic bank simultaneously have a significant influence on corporate governance disclosure. Corporate governance strength and mudharabah investment account partially has a positive significant effect toward corporate governance disclosure, and sharia supervisory board strength has a negative effect toward corporate governance disclosure,

however size of the Islamic Bank has no influence toward corporate governance disclosure.

Referring to the results of research, average corporate governance disclosure index Syariah Bank in Indonesia which is 70% included in the category enough and Bank Syariah could still improve corporate governance disclosure index. Bank Syariah has unique characteristics, the high level of transparency of corporate disclosure disclosure is an important thing in improving stakeholder confidence against sharia compliance at Islamic Bank.

REFERENCES

- Ahmed, K., Curtis, J. K. 1999, *Associations Between Corporate Characteristics And Disclosure Levels In Annual Reports: A Meta-Analysis*. The British Accounting Review, 31(1), 35-61.
- Alamanda, Amelia Rizky. 2014, *Pengaruh Sharia Intellectual Capital dan Sharia Social Responsibility terhadap Efisiensi Bank Syariah di Indonesia dengan Variabel Moderasi Sharia Corporate Governance*. Thesis, Padjadjaran University.
- Al-Baluchi, A. E. A. 2006, *The Impact of AAOIFI Standards and Other Bank Characteristics on the Level of Voluntary Disclosure in the Annual Reports of Islamic Banks*. School of Management University of Surrey.
- Andreas, Tan., Benni, Desmiyawati., and Liani, Warda. 2016, Determinants of CSR Disclosure and Investor Reaction. *International Journal of Economics and Financial Issues (IJEFI)*, 6(S4), 11-17.
- Arcay, R.B., Vazquez, F.M. 2005, Corporate Characteristics, Governance Rules and the Extent of Voluntary Disclosure in Spain. *Advances in Accounting*, 21, 299-331.
- Astuti, Tri Puji. 2014, *Faktor-faktor yang Mempengaruhi Pengungkapan Islamic Social Reporting (ISR) pada Bank Syariah di Indonesia*. Naskah Publikasi Universitas Muhammadiyah Surakarta.
- El-Hawary, D., Grais, W. and Iqbal, Z. 2007. Diversity in the regulation of Islamic financial institutions. *The Quarterly Review of Economics and Finance*, 46(5), 778-800.
- Farook, Sayd and Farooq, Mohammad Omar. 2013, *Shari'ah Governance, Expertise and Profession: Educational Challenges in Islamic Finance*. *International Journal of Islamic Finance*, 5(1), 137-160.
- Gaa, J. C. 2009. Corporate Governance and the Responsibility of the Board of Directors for Strategic Financial Reporting. *Journal of Business Ethics*, 90(2), 179-197.
- Hassaan, Marwa. 2013, The Introduction of Corporate Governance Codes in a Transitional Economy and Its Impact on Compliance with Mandatory Disclosure: The Case of Egypt. *International Journal of Research in Business and Social Science*, 2(1), 7-21.

- Iskander, M., Meyerman, G., Gray, D. F., & Hagan, S. (1999). *Finance and Development*, 36, 42.
- Kamali, M. H. 1989, *Source, Nature and Objectives of Shariah*. The Islamic Quarterly.
- Khoirudin, Amirul. 2013. *Corporate governance dan Pengungkapan Islamic Social Responsibility pada Perbankan Syariah di Indonesia*. *Accounting Analysis Journal*, 2(2), 227-232.
- Musibah, Anwar Salem and Wan Sulaiman, bin Wan Yusoff Alfattani. 2014, The mediating effect of financial performance on the relationship between shariah supervisory board effectiveness, intellectual capital and corporate social responsibility, of islamic banks in gulf cooperation council countries. *Asian Social Science*, 10(17), 139-164.
- Salman, Kautsar Riza. 2012, *Akuntansi Perbankan Syariah Berbasis PSAK Syariah*. Padang: Akademia.
- Sharma, Narendra. 2012, *A Correlational Study of the Extent and Determinants of Corporate Governance Disclosure in the Nepali Financial Industry*. Dissertation, Northcentral University.
- Shleifer, A. dan R.W. Vishny. 1997, *A Survey of Corporate Governance*. *Journal of Finance*, 52(2), 737-783.
- Sujianto, 2001. *Dasar-dasar management Keuangan*. Yogyakarta: BPFE.
- Wan Abdullah, Wan Amalina. (2013), *Determinants of Corporate Governance Disclosure Practices of Islamic Banks*. Doctor of Phylosophy: Griffith University.

