Effect of Sharia Compliance, Islamic Corporate Governance, Islamic Social Reporting on Financial Performance at Islamic Commercial Banks in Indonesia

Aswin Hidayat Tarihoran¹, Irfan², Widia Astuty³
¹²³Universitas Muhammadiyah Sumatera Utara, Indonesia
aswinhidayat1@gmail.com

Abstract

This study aims to examine and analyze the effect of sharia compliance, Islamic corporate governance, Islamic social reporting on financial performance at Islamic Commercial Banks in Indonesia. This study uses three sub-variables of sharia compliance, namely Islamic income ratio, profit sharing ratio, and zakat performance ratio. The type of research in this study is causal associative. The population of this study are Islamic Commercial Banks registered with the Financial Services Authority in 2015-2019. The sample selection method uses purposive sampling (certain criteria), so the number of samples used is 12 Islamic Commercial Banks so that there are 60 sample data. Data analysis method using structural equation modeling (SEM)-partial least square (PLS) with a significance level of 5%. The results show that the Islamic income ratio has an effect on financial performance, profit sharing ratio has no effect on financial performance and zakat performance ratio has no effect on financial performance. Islamic corporate governance has an effect on financial performance. Islamic social reporting has no effect on financial performance.

Keywords

Sharia compliance; Islamic corporate governance; Islamic social reporting; financial performance

I. Introduction

The Islamic financial system is an important part of the wider order of Islamic economics, the aim of which is to introduce Islamic values and ethical systems into the economic environment. On this ethical basis, Islamic banking is present for most Muslims, not just a commercial transaction system, but also a religious obligation. Financial Services Authority data states that in 2017 Indonesia was ranked 8th in total Islamic financial assets in the world with total assets of USD82 billion (Otoritas Jasa Keuangan, 2018).

This achievement shows that Indonesia has a very important role in expanding the Islamic finance sector globally. Along with the development of Islamic finance, the Islamic banking sector also continues to develop and will have a direct impact on the magnitude of the challenges that must be faced by the Islamic bank, the biggest challenge is to maintain the image and good name as well as the survival of Islamic banks in facing economic problems that exist both in Indonesia and in the world.

Indonesia's Islamic banking assets are able to grow positively every year, in 2019 it grew to 494.04 T from 489.69 T in 2018 by contributing 39.03% of the total Islamic financial assets in Indonesia.

This increase in Islamic banking assets is the result of good performance from Islamic banking in Indonesia, the financial performance of Islamic banks can be measured with an accurate method, so that the company's ability to carry out operations is in accordance with the vision, mission and objectives that have been prepared. Measurement of financial
Performance evaluation of Islamic banks is used to assess the level of success of Islamic banks in a certain period based on work plans, reports on the realization of work plans, and bank periodic reports, compliance with regulations, and other aspects. The evaluation of the performance of Islamic banks in Indonesia is basically carried out by Bank Indonesia as the central bank. Performance evaluation can also be carried out by other parties for various purposes (Meilani et al., 2016).

One of the financial performance of Islamic banks can be seen from the return on assets (ROA). ROA describes how effective the company is in managing its assets to earn a profit (Rhamadhani, 2016). Data shows that for five years (2015-2019) the average ROA of Islamic commercial banks in Indonesia is still not stable but continues to increase. In 2015 to 2016 there was an increase, 2016 to 2017 did not experience any changes and in 2018 there was a fairly high increase. ROA describes management's ability to earn profits. The greater the ROA, the greater the profits achieved by the company and the better the company's position in the use of assets (Wahyuni and Pujiharto, 2018). The higher the ROA indicates that the better the company's performance. This will increase the attractiveness of investors, because the company can provide greater returns or dividends, and vice versa if the ROA is low, it indicates that the company cannot take full advantage of its assets to earn a profit. This model is taken based on signaling theory which explains ROA is net income from each unit of assets owned. This ratio describes how much the asset's ability to generate profit. The greater the ROA value, the better the company's performance, because the rate of return on investment is greater. This value reflects the company's return on all assets (or funding) provided to the company.

The basic framework for the preparation and presentation of Islamic financial statements is the provision of financial information plus information related to sharia principles, which are characteristics of Islamic Banks (Rifai, 2013). If discussed in depth, it can be concluded that the purpose of the financial statements of Islamic banks is still oriented to the interests of direct stakeholders.

The demand for compliance with the shariah compliance principle, when referred to the history of sharia banking development, becomes important because the main reason for the existence of sharia banking is the emergence of public awareness, especially Muslims who want to carry out all their financial activities based on the Qur'an and sunnah. Therefore, guaranteeing the implementation of all customer fund management activities by sharia banks in accordance with sharia compliance is very important in sharia bank business activities to reduce public preferences regarding doubts regarding compliance with sharia principles. Hameed et al. (2004) presents an alternative performance measurement for Islamic Banking, namely by using islamicity indices. The islamicity indices consist of two components, namely the islamicity disclosure index and the islamicity performance index. Measurement in terms of sharia objectives can use the islamicity performance index. This study uses three sub-variables of sharia compliance, namely islamic income ratio, profit sharing ratio, and zakat performance ratio. The profit sharing ratio shows how far Islamic Banks are in achieving existence by obtaining profit sharing from financing distribution to customers. Profit sharing ratio is used to see how Islamic Banks use profit sharing activities in their activities with total financing. This ratio compares the amount of financing with the principle of profit sharing with the total financing provided. The ratio for calculating profit sharing from financing carried out by Islamic banks includes mudharabah and musharakah. The higher the ratio of mudharabah and musyarakah financing launched to the public, the higher the financial health of Islamic bank in Indonesia.
The Islamic income ratio has the aim of assessing and measuring halal income from all sources of income. Islamic principles prohibit usury, gharar, and maysir transactions and require halal trade transactions. The ratio that compares the level of halal income with the entire value of income received by Islamic banks (halal and non-halal income). The level of value obtained is a measure of the success and lawfulness of implementing the basic principles that apply to Islamic banks, namely free from the element of usury in terms of income.

While the zakat performance ratio is a ratio that measures how much zakat is paid channeled by the bank compared to its net assets. Zakat is one of the objectives of sharia accounting, because zakat is one of the commands in Islam. Therefore, the performance of Islamic banks must be based on zakat paid by banks to replace conventional performance indicators, namely earning per share (EPS). Bank wealth should be based on net assets (net assets) rather than net profit (net profit) which is emphasized by the Conventional Bank method. The higher the net assets of the bank, the higher the zakat paid. Zakat performance ratio is used to measure the percentage of zakat paid by Islamic banks as evidence of compliance with Sharia where the provisions for the amount of zakat are 2.5% of net assets owned. Islamic banks are required to issue zakat if their assets reach 653 kg of grain or 524 kg of rice (Regulation of the Minister of Religion of the Republic of Indonesia No. 52 of 2014). So if the bank has high net assets, the higher the zakat that must be paid.

The existence of good islamic corporate governance disclosure practices will be able to improve the financial performance of Islamic banks (Safieddine, 2009). Islamic banks that have a corporate governance index in the high category operate significantly more efficiently and are able to obtain the highest profits, and conversely, Islamic banks with a low corporate governance index have significantly lower financial performance (Safieddine, 2009).

The procedure for filling out the self assessment working paper is carried out in the following stages:

1. Prepare a self-assessment analysis, by comparing the fulfillment of each Criteria/Indicator with the condition of the Bank based on relevant data and information. Based on the results of the analysis, the ranking of each Criteria/Indicator is determined. The ranking criteria are as follows:
   a) Rank 1: the results of the self-assessment analysis show that the implementation of bank GCG is in accordance with the criteria/indicators.
   b) Rank 2: the results of the self-assessment analysis show that the implementation of bank GCG is in accordance with the criteria/indicators.
   c) Rank 3: the results of the self-assessment analysis show that the implementation of bank GCG is quite in accordance with the criteria/indicators.
   d) Rank 4: the results of the self-assessment analysis show that the implementation of bank GCG is not in accordance with the criteria/indicators.
   e) Rank 5: the results of the self-assessment analysis show that the implementation of bank GCG is not in accordance with the criteria/indicators.

2. Determine the ranking of the sub-factors, based on the results of the self-assessment analysis, with reference to the ranking criteria as referred to in number.

3. Assign factor ratings, based on sub-factor ratings. In the event that there are no sub-factors, the rating of the factor in question is determined based on the results of the self-assessment analysis, with reference to the ranking criteria as referred to in number 1.

4. Prepare conclusions for each factor which also contains problems and corrective steps in a comprehensive and systematic manner along with the target time for implementation. To get the value of each factor, the Bank multiplies the rating of each factor with a certain weight. To be able to determine the level of condition of GCG in Islamic banks, banks can find out from the composite value. The composite value is
obtained from the sum of the values of all factors after being multiplied by their weights.

Reporting social responsibility is a practice that is formed based on the norms prevailing in society, Haniffa (2002) reveals that there are limitations in conventional social reporting, in sharia principles not only focusing on material, but must include spiritual and moral. So he put forward the conceptual framework of Islamic social reporting (ISR) based on sharia provisions which not only helps decision making for Muslims but also helps companies fulfill their obligations to Allah SWT and society.

After the ISR index scoring process has been carried out for each BUS, in the first part an analysis will be carried out on each ISR index theme for each BUS to determine the level of disclosure of the social performance of the BUS. Furthermore, a cumulative ISR index assessment is carried out at Islamic Commercial Banks (BUS) which will determine the level of disclosure of the social performance of the BUS. In this study, content analysis is used to identify the disclosure of the ISR index on the BUS by reading and analyzing the company's annual report. The analysis does not count how many occurrences of the subject matter disclosed in each company's annual report, as long as there is at least one subject that is disclosed in any form, the subject matter of the disclosure is stated to be available.

This study aims to examine and analyze the effect of sharia compliance, Islamic corporate governance, Islamic social reporting on financial performance at Islamic Commercial Banks in Indonesia.

II. Research Methods

The type of research in this study is causal associative by using a quantitative approach. Descriptive research is a type of research that aims to make a systematic, factual and accurate description of the facts and characteristics of the population of a particular area (Pandiangan et al., 2021). Using a quantitative approach because the data that will be used to analyze the relationship between variables is expressed by numbers or a numerical scale (Pandiangan, 2015).

The population is the entire collection of elements that show certain characteristics that can be used to make conclusions. The population of this study are Islamic Commercial Banks registered with the Financial Services Authority in 2015-2019. Samples are taken by purposive sampling. According Pandiangan et al. (2018) in Sugiyono, purposive sampling is the selection of samples based on certain characteristics that are considered to have relevance to the characteristics of the population that have been known previously. The sample selection method uses purposive sampling (certain criteria), so the number of samples used is 12 Islamic Commercial Banks so that there are 60 sample data.

Data source via library research. Library research of reference sources is a form of research that uses library facilities by examining theoretical discussions from various books, articles, and scientific works related to writing (Pandiangan, 2018). The type of data used in this research is secondary data. The secondary data referred to in this study are the audited financial reports and the annual reports of Islamic banks for the 2015-2019 period which have been published on the official websites of each bank and which are available on the Financial Services Authority (OJK) website. The annual reports referred to in this study include management reports, good corporate governance (GCG) implementation reports, and corporate social responsibility (CSR) reports, both integrated into a report or stand-alone. The research data covering the 2015-2019 period was chosen because it adequately describes relatively new conditions. Data analysis method using structural equation modeling (SEM)-partial least square (PLS) with a significance level of 5%. PLS-SEM which aims to perform
path analysis with latent variables (Tobing et al., 2018). Variant-based SEM which can simultaneously test the measurement model as well as test the structural model. In testing the hypothesis, it can be seen from the t-statistic value and probability value. To test the hypothesis by using statistical values, for alpha 5% the t-statistic value used is 2.004. This value is obtained from the attachment t-table which subtracts the number of samples with the number of variables, namely 55-5, obtained 55 with a t-table value of 2.004. So the criteria for acceptance/rejection of the hypothesis are that Ha is accepted and Ho is rejected when t-statistic > 2.004 or t-statistic < 2.004.

III. Discussion

3.1 Description of Research Object

Currently, Islamic banking in Indonesia continues to experience positive developments, the total assets of Islamic banks in Indonesia are estimated to reach Rp494,04 trillion in December 2019. The Islamic banking assets grew by 1% compared to 2018 (Otoritas Jasa Keuangan, 2018). Indonesia as a country with the largest Muslim population in the world, has a very potential Islamic banking market. Therefore, the Indonesian government is considered quite active in encouraging the development of sharia finance with several policies, including the presence of the Sharia Banking Law No. 21 of 2008. Financial Services Authority (BI) and Financial Services Authority (OJK) are also considered active in making regulations related to sharia banking in an effort to accelerate the growth of sharia finance in Indonesia.

Compliance with sharia principles in Indonesia is regulated by the National Sharia Council (DSN)-Indonesian Council of Ulama (MUI). DSN-MUI actively issues fatwas on financial regulations in accordance with sharia which are the reference for sharia financial institutions and the government in developing sharia financial products and services.

The sample used in this study is Islamic Commercial Banks registered with the OJK from 2015-2019 as many as 12 Islamic banks. The data analysis method used in this research is statistical analysis method using structural equation modeling (SEM)-partial least square (PLS). The analysis begins by collecting data using Ms. Excel. Next, import data from Ms. Excel into the SEM-PLS software and generate output according to the specified data analysis method.

3.2 SEM-PLS Test Results

The results of the effect of sharia compliance, islamic corporate governance (ICG), islamic social reporting (ISR) on financial performance or return on assets (ROA) at Islamic Commercial Banks in Indonesia using three sub-variables of sharia compliance, namely islamic income ratio (ISIR), profit sharing ratio (PSR), and zakat performance ratio (ZPR) are as follows:

| Information | Original Sample (O) | Standard Deviation (STDEV) | T Statistics (|O/STDEV|) | P Values |
|-------------|---------------------|-----------------------------|---------------------------|----------|
| ISIR -> ROA | 0.292               | 0.13                        | 2.239                     | 0.026    |
| PSR -> ROA  | -0.215              | 0.147                       | 1.462                     | 0.145    |
| ZPR -> ROA  | -0.196              | 0.106                       | 1.86                      | 0.063    |
| ICG -> ROA  | -0.561              | 0.183                       | 3.074                     | 0.002    |
| ISR -> ROA  | -0.084              | 0.159                       | 0.527                     | 0.599    |

Source: Results of Data Processing (2021)
The results show that the Islamic income ratio has an effect on financial performance, profit sharing ratio has no effect on financial performance and zakat performance ratio has no effect on financial performance. Islamic corporate governance has an effect on financial performance. Islamic social reporting has no effect on financial performance. Socialization is considered important because Islamic dress policy is a new regulation issued by the Regional Government (Irma, 2020).

IV. Conclusion

The results show that the islamic income ratio has an effect on financial performance, profit sharing ratio has no effect on financial performance and zakat performance ratio has no effect on financial performance. Islamic corporate governance has an effect on financial performance. Islamic social reporting has no effect on financial performance. or aspects of its Islamic economics, what needs to be concluded here is that based on a number of references (Kamal. 2019).

Suggestions in this study are:
1. Suggestions for further researchers to use or add variables both independent variables and dependent variables such as return on equity (ROE), debt to equity ratio (DER), earning per share (EPS) on the dependent variable and also other independent variables such as intellectual capital, which may have an influence on the financial performance of Islamic banks, considering that the independent variables in this model can only explain 22.4% of the variation of financial performance variables in Islamic banks. In further research, it is also hoped that the Islamic Commercial Bank (BUS) will not only use the Islamic banking industry, but also other Islamic banking industries such as the Sharia Business Unit (UUS) so that the results of the research are more in-depth and detailed.

2. Advice for Companies
The author hopes that the company will further increase profit-sharing financing, namely musharaka and mudharabah, this is an important part for Islamic banking in reflecting the principles of sharia compliance in terms of profit sharing, not only focusing on financing that has minimal risk and greater profits. such as murabahah financing, but must still uphold the values of sharing and helping as expressed in the Al-Quran and Hadith.

The presentation and management of BUS zakat funds must pay more attention to the quality of financial reporting on the side of the annual zakat fund report. This is because some Islamic banks have not displayed complete figures on the collection and distribution system of zakat funds. In the future, Islamic banks must comply more with and adjust zakat payments in accordance with established regulations so that people in need can feel the zakat distributed by BUS. Zakat that is distributed has a better system in the management of sources and distribution of zakat funds will greatly affect the positive view of the community towards Islamic banks and reflect that Islamic banks have complied with sharia principles, one of which is concerned with the welfare of the people.

Disclosure of social performance of Islamic commercial banks is still not optimal, this is because it is still voluntary in distributing funds for social activities in the form of Islamic social reporting, it is hoped that in the future, payment of funds for bank social responsibility becomes an obligation that must be channeled and becomes an important agenda in each bank's goals. Islamic banking so that the public can feel that the presence of Islamic commercial banks is very useful and in accordance with the principles it carries out, namely not only the interests of the company but the interests of the community at large. Such as increasing the activities of empowering school graduates and students so that they can do
internships and get the opportunity to pursue a career in Islamic banks, as well as providing opportunities for the younger generation to continue their careers such as sports, arts, and other activities in terms of participating in trainings that are formed. from funds distributed by Islamic banks through Islamic social reporting.

References


