Analysis of Factors Influencing the Islamic Corporate Governance Disclosure Index of Islamic Banks in Asia

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Abstract— The purpose of this research is to determine empirically the effect of profitability, leverage, company size, audit quality, and institutional ownership on the disclosure of Islamic corporate governance in Islamic Banks in Asia. Populations of this research are the Islamic banks in Asia during 2011 to 2013 that have adopted AAOIFI standards set. There are 45 panel data determined by using purposive sampling method. Data analysis conducted by the classical assumption test and hypothesis testing multiple linear regression method. The results of this research show that profitability and company size have no significant influence on Islamic Corporate Governance (ICG) disclosure index of Islamic banks in Asia. Leverage has negative and significant influence on Islamic Corporate Governance (ICG) disclosure index of Islamic banks in Asia. Audit quality and Institutional ownership have a positive and significant influence on Islamic Corporate Governance (ICG) disclosure index of islamic banks in Asia.

Keywords— Islamic Corporate Governance, Profitability, Leverage, Company Size, Quality Of Audit, Institutional Ownership, Islamic Bank

I. Introduction

TODAYS, many companies rely on external capital (equity capital and loans) in financing their activities, investing and creating economic growth [1]. Therefore, the companies are required to ensure the external capital providers that the funds are used efficiently and appropriately, and to ensure the management to act in accordance with the interests of the company in achieving the goal. To ensure the need for good corporate governance system, which is able to provide value to external capital providers, employees, and community and government is commonly referred as a system of good corporate governance.

In 2006 corporate governance in Indonesia showed a development of regulation to implement the good corporate governance for commercial banks with regulation No. 8/14/PBI/2006 issued by Bank Indonesia [2]. Bank Indonesia also issued regulation No. 11/33/PBI/2009 on the implementation of Good Corporate Governance for islamic banks and islamic business units [3]. These regulations implement the five principles of good corporate governance, named transparency, accountability, responsibility, professional, and fairness.

Research of Abdullah et al., showed that the level of Corporate Governance disclosure Islamic banks in the annual report is less than 50 percent by using a standard derived from Islamic values and adjusted to the rules set Accounting and Auditing Organization for Islamic Institutions (AAOIFI) [4]. Islamic concept application of corporate governance will be one determinant for good performance.

The assessment of islamic corporate governance is important, as it is not only demanded by the IFIs' customers, but also other stakeholders, including institutional investors and Muslim society who are directly and indirectly involved in the institutions [5]. The main characteristic of weak corporate governance is selfish actions by ignoring the interests of investor, that it will cause the collapse of the investors' expectations about the return on investment that they have invested [6].

The profitability of a company will affect the policy of investors on the investment made. The company's ability to generate profits will be able to attract investors to invest their funds in order to expand its business, otherwise a low level of profitability that will cause investors to withdraw inquiry. Profitability is widely observed in many studies related to disclosure. Leverage also indicated many variables that have an influence on the broad disclosure of the company. However, the results also showed mixture results. Large size companies have a lower cost of information relating to the transparency of information disclosed. More shareholders also require more transparency of information due to the demands of shareholders and capital market analysts.

Audit conducted by an external auditor is an important element in the efficiency of capital markets. This is because the audit has been done can increase the credibility of financial information, which directly supports the practice of corporate governance through better transparency of financial reporting [7]. Nienhaus emphasize that the Corporate Governance should be oriented to value and develop reasonableness and fairness with regard to all stakeholders of the company [8].

Research of Hikmah et al. regarding the factors that affect the broad disclosure of corporate governance in the annual report of banking companies listed on the stock exchange Indonesia concluded variables of size companies, age listing, and the size of the board of commissioners positively influence on the wider corporate governance disclosures in

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annual reports. Meanwhile, the dispersion of ownership and profitability variable has no significant effect on the disclosure of corporate governance in the banking company's annual report [8].

Many researches on the influence of corporate governance has been done by some researchers such as Hikmah et al. and Sudaryati and Eskadewi [8][9], but research on islamic corporate governance is still relatively less. Therefore, this study would examine and analyze the factors influencing the Islamic corporate governance disclosure index on Islamic banking. The concept of islamic corporate governance indicators in this study would be proxied by the presence of DPS, DPS skill composition, board of directors, independent board composition, frequency of meetings of the board of commissioners, the size of the audit committee, the composition of an independent audit committee, and the number of audit committee meetings.

II. Literature Study

a. Agency Theory

Agency theory comes from agencies problems in the management of company that is separated from the owner. A contract between investor and manager can be categorized as a good contract if the duty of manager which is to manage the investor fund is clearly stated, and the specification of return sharing between the manager and investor [10]. According to Jensen and Meckling in the agency theory, the agency relationship can be made when one or some people hire other agents to give a service then delegate the authority to make decision to that agent [11]. Agent in this result is manager of islamic bank. Meanwhile, the principles are stakeholder which is consists of external capital providers, employees, community and government.

b. Islamic Bank (Definiton, Function and Role)

Islamic Bank is a bank which runs based on Islamic principles, especially Islamic customs and manners [12]. Based on UU No.21 Tahun 2008 about Islamic Banking which was issued by Bank of Indonesia, Islamic Bank is a bank which runs its activities based on shariah principles and it is classified into Public Islamic Bank and bank financing shariah [13]. According to UU No.10 Tahun 1998 about the Change of UU No.7 Tahun 1992 about Banking, it was stated that Islamic Bank is a Public Bank which runs its activities based on shariah principles in giving funding traffic service [14] [15].

The function and role of Islamic bank are as follow:

1. Investment Manager, Islamic Bank can manage the customer investment.
2. Investor, Islamic bank can invest its fund or customer fund which has been entrust to them.
3. Financial service provider and payment traffic, Islamic bank can do the common activities as other banking services do.
4. Implementation of social activities as the distinctive feature of Islamic finance. Islamic bank also has a duty to give and manage (to collect, to administer, to distribute) *zakat* and other social funding.[16]

c. Islamic Corporate Governance

Forum for Corporate Governance (FCGI) in their first publication used the definition of Cadbury Committee, in which: "A set of rules that regulate the relationship of shareholder, company manager, creditor, government, employee and all of the stakeholder related to their rights and duties, or in other words a system that control and manage the company" [17]. According to Bank Indonesia, the implementation of Good Corporate Governance in Islamic Banking Industry must be appropriate with sharia compliance and that implementation is one of the efforts to protect the stakeholders interest and to improve the discipline to the legislation and the custom and ethics in Islamic banking industry.

AAOIFI is one of system of Islamic corporate governance for Islamic financial institution. There are seven standards as follow:

1. Shari'ah Supervisory Board: Appointment, Composition and Report,
2. Shari'ah Review,
3. Internal Shari'ah Review,
4. Audit & Governance Committee for Islamic Financial Institutions,
5. Independence of Shari'ah Supervisory Boards,
6. Statement on Governance Principles for Islamic Financial Institutions,
7. Corporate Social Responsibility Conduct and Disclosure for Islamic Financial Institutions.

The implementation of islamic good corporate governance will be success if it can fulfill several principles that has been arranged by PBI Number 11/33/PBI/2009 contains the principles that manage good corporate governance for public Islamic bank and Islamic business as follow:

1. Transparency; transparency in giving materialism, openness, and relevant information in the decision making process.
2. Accountability; it is about the clarity of company function, structure, system, and responsibility so that the management can be carried out effectively.
3. Responsibility; it is about the obedience to rules in a bank management upon corporation principles and law that prevails.
4. Independency; a professionally bank management without any pressure from any party.
5. Fairness; fairness in fulfilling stakeholders rights based on Akad and prevailing law. This principle emphasizes that all parties, whether minority or foreign shareholder, need to be treated equal [3].

III. Hypotheses Development And Research Model

<u>The influence of Profitability to Islamic Corporate Governance disclosure index on Islamic Bank</u>

Profitability shows the ability of a company to make profit through all they have, and the existing resources [8]. Profitability can be an important consideration for the investor to make a decision because the bigger dividend (dividend payout) the smaller capital expense. In other side, the managers (insider) become much more powerful, even can increase their ownership due to dividend reception as the high profit [18].

According to Bank of Indonesia Regulation Number: 6/10/PBI/2004 About System of Public Bank Healthy Level Assesment, profitability can be measured by using return on assets (ROA) ratio, return on equity (ROE), net interest margin (NIM), and bank efficiency level [19]. In this study, the profitability is measured by using return on equity (ROE).

H1: Profitability has an influence on the Islamic Corporate Governance disclosure index on Islamic Bank.

The influence of leverage to Islamic Corporate Governance disclosure index on Islamic Bank

Retno and Priantinah stated that a company's manager also manage funds from creditor, whether from bondholder, banking or other parties. As stated in agency theory, management with a high level of leverage will decrease the company's exposure of corporate governance so that they will not get much attention from the debtholders. In this case, there are many conflicts between the manager and debtholders. The implementation of Islamic corporate governance is expected can minimalize the conflicts between any parties in the company. The research showed good corporate governance has a good impact to a company value with size control variable and leverage [17]. Meanwhile, research from Nur and Priantinah explore the analysis of factors that affect corporate social responsibility exposure in Indonesia showed that leverage has a negative effect and significant for corporate social responsibility exposure [20].

H2: Leverage has an influence on the Islamic Corporate Governance disclosure index on Islamic Bank.

The influence of company size to Islamic Corporate Governance disclosure index on Islamic Bank

Agency theory from Jensen & Meckling stated that a big size company has a higher agency expense than the smaller size company. A big company tends to give much information than a smaller one as an effort to decrease agency expense [11]. Research conducted by Rahmawati, Mutmainah and Haryanto proved that a company size affects the exposure scale and also proves that company size affect the broad disclosure mandatory [21]. Study from Ariny that examined the effect of company size, liquidity, leverage, and profitability to the extent of voluntary disclosure and proved that the firm size effect on the extent of voluntary disclosure [8]. Both of these studies are consistent because the disclosure of corporate governance in the annual report includes mandatory disclosure and voluntary disclosure. Another reason the extent of disclosure appropriate agency theory, in which the large companies that have greater agency costs will reveal more extensive information to reduce the agency costs. In addition, large companies are listed under the spotlight, greater disclosure is a form of corporate social responsibility [17]. The results of the study Hikmah et al. obtained by a conclusion that positive effect company size on the extensive corporate governance disclosure in the annual report [8].

H3: A company size has an influence on the Islamic Corporate Governance disclosure index on Islamic Bank.

The influence of quality of audit to Islamic Corporate Governance disclosure index on Islamic Bank

An audit that has been done by external auditor can increase the credibility from financial information which supports the practice of a better company management through financial report transparency [22][23]. The role of external auditor is to give assessment independently and professional upon reliability and genuineness in the presentation of company's financial report to the determined standard [7].

The markets response are different to the auditor quality, that has been showed with auditor Big 5 and Non Big 5 [24]. It means that the higher quality of the auditor, the higher credible of the report, resulting a bigger scale of financial report exposure. Che Haat et al. found the correlation between audit quality and transparency of information [23].

H4: Audit quality has an influence on the Islamic Corporate Governance disclosure index on Islamic Bank.

The influence of institutional ownership to Islamic Corporate Governance disclosure index on Islamic Bank

Institutional shareholders control a company by participating in the company management or by collecting information and improving the price impact of managerial decision [25]. Shares ownership by the institute or company can make an effective control to the company management as the business web density, loan, and company capital [26]. A high level of institutional ownership will trigger a greater control by the institutional investor so that it can avoid opportunistic manager behavior. In this context, the management has the duty to make as big scale of the information expressing as they can in order to keep the institutional investor [7].

There are good effect from ownership concentration to the exposure [27]. So, a higher dispersal of shares ownership, the more parties needs the company information. Public demands of the exposure of annual report are wider than a company that has centralized ownership [8].

H5: Institutional ownership has an influence on the Islamic Corporate Governance disclosure index on Islamic Bank.

Based on previous explanation and literature study, the related variable in this study can be formulated into a consideration framework as follow:

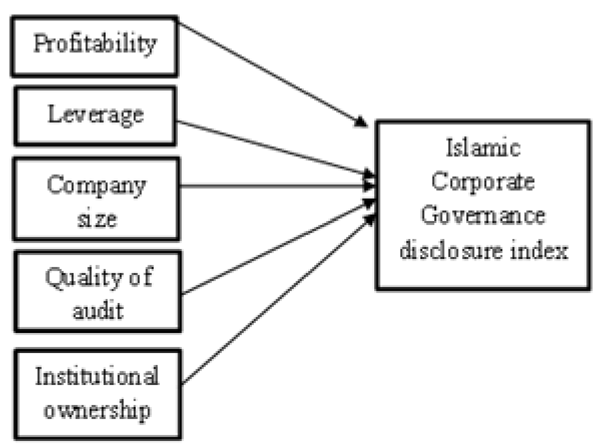

Fig. 1 Research Model

IV. Methods

This research was a quantitative study using financial data in the Islamic Bank of Asia. The object of this study was the Annual Report of Islamic banks in Asia 2011 – 2013 period. The population in this study was Islamic banks that have been adapting the regulations and standards set of AAOIFI located in Asia, during period 2011-2013. The sampling method used was purposive sampling. The data types used in this study were secondary data from annual reports from 2011-2013 obtained from their respective websites.

Data analysis was done through descriptive statistics, classical assumption test, goodness of fit, and multiple regression analysis. The mathematic equation for hypotheses testing is:

$$Y = a + b1X1 + b2X2 + b3X3 + b4X4 + b5X5 + e$$

Where as:

Y = *Islamic Corporate Governance* disclosure index
a = Constanta
X1 = Profitability
X2 = Leverage
X3 = company size
X4 = quality of audit
X5 = Institutional ownership
e = Residual Value
b1–b2 = Regression coefficient of independent variable

V. Results

a. Description of research sample

The population of this research is islamic banks that had adopted AAOIFI standards set in Asia during 2011 to 2013 from 39 islamic banks. Sample size in this research was determined by using purposive sampling technique. Samples were taken based on the criteria established by 15 Islamic banks in three years, bringing the total amount to 45.

The result of descriptive statistics is as follows:

Table I
Summary of Descriptive Statistic

Variable	Min	Max	Mean	Std. Deviation
Profitability	.000	.300	.120	.060
Leverage	.960	15.890	6.780	4.790
Company size	12.430	19.450	16.590	1.810
Audit quality	.000	1.000	.740	.280
Institutional owership	.130	1.000	.740	.280

b. Multiple Regression Analysis (MRA)

The result of MRA is as follows:

Table II
Summary of MRA

Variable	Regression Coefficient	t-statistic	t-table	Sig. value
Profitability	.896	1.474	2.023	.149
Leverage	-.017	-2.078	-2.023	.044
Company size	.019	.941	2.023	.352
Audit quality	.321	3.335	2.023	.002
Institutional owership	.595	3.264	2.023	.002

Based on data in Table 2, then the multiple regression equation can be written:

$$Y = -0.245 + 0.896X_1 - 0.017X_2 + 0.019X_3 + 0.321X_4 + 0.595X_5 + e$$

Statistically, refers to the multiple regression equation above, it can be explained as follows:

1) Constant value of -0.245 means that if the profitability, leverage, company size, audit quality and institutional ownership variables are assumed have value of zero, the Islamic Corporate Governance (ICG) disclosure index will decrease by 0.245 percent.
2) Regression coefficient of profitability variable shows a positive value of 0.896. It means that profitability has a positive influence on Islamic Corporate Governance (ICG) disclosure index, or it can be explained that if the level of profitability increases one percent, then it will be able to increase the Islamic Corporate Governance (ICG) disclosure index by 0.896 percent.
3) Regression coefficient of leverage variable shows a negative value of -0.017. It means that leverage has a negative influence on Islamic Corporate Governance (ICG) disclosure index, or it can be explained that if the level of leverage increases one percent, then it will be able to decrease Islamic Corporate Governance (ICG) disclosure index by 0.017 percent.
4) Regression coefficient of company size variable shows a positive value of 0.019. It means that company size has a positive influence on Islamic Corporate Governance (ICG) disclosure index, or it can be explained that the higher level of company size, it will be able to increase the Islamic Corporate Governance (ICG) disclosure index by 0.019 percent.
5) Regression coefficient of audit quality variable shows a positive value of 0.321. It means that audit quality has a positive influence on Islamic Corporate Governance (ICG) disclosure index, or it can be explained that if the better level of audit quality, then it will be able to increase the Islamic Corporate Governance (ICG) disclosure index by 0.321 percent.
6) Finally, regression coefficient of institutional ownership variable shows a positive value of 0.595. It means that institutional ownership has a positive influence on Islamic Corporate Governance (ICG) disclosure index, or it can be explained that if the level of institutional ownership increases one percent, then it will be able to increase Islamic Corporate Governance (ICG) disclosure index by 0.595 percent.

c. *Hypotheses testing*

a. First Hypothesis Testing

Based on the result summary of multiple regression analysis in Table 2, The $t_{statistic}$ value of profitability is less than value of t_{table}. So, the Ho is accepted and Ha is rejected. Then, it can be seen that profitability has a positive but not significant influence on Islamic Corporate Governance (ICG) disclosure index. Therefore, the first hypothesis stating that profitability has a significant influence on Islamic Corporate Governance (ICG) disclosure index is **rejected**.

b. Second Hypothesis Testing

Refers to the result of multiple regression analysis, it known that -tstatistic value of leverage is less than value of -ttable. Thus, the Ho is rejected and Ha is accepted, it shows that leverage has a negative and significant influence on Islamic Corporate Governance (ICG) disclosure index. Therefore, the second hypothesis which states that leverage has a significant influence on Islamic Corporate Governance (ICG) disclosure index is **accepted**.

c. Third Hypothesis Testing

Refers to the result summary of multiple regression analysis in Table 2 above, it is known that $t_{statistic}$ value of company size is smaller than value of t_{table}. So, the Ho is accepted and Ha is rejected. Then it can be seen that company size has a positive but not significant influence on Islamic Corporate Governance (ICG) disclosure index. Therefore, the third hypothesis stating that company size has a significant influence on Islamic Corporate Governance (ICG) disclosure index is **rejected**.

d. Fourth Hypothesis Testing

From the result of multiple regression analysis, $t_{statistic}$ value of audit quality is greater than value of t_{table}. So, the Ho is rejected and Ha is accepted, it known that audit quality has a positive and significant effect on Islamic Corporate Governance (ICG) disclosure index. Therefore, the fourth hypothesis stating that audit quality has a significant effect on Islamic Corporate Governance (ICG) disclosure index is **accepted.**

e. Fifth Hypothesis Testing

From the result of multiple regression analysis, $t_{statistic}$ value of institutional ownership is greater than value of t_{table}. So, the Ho is rejected and Ha is accepted. Then, it can be seen that institutional ownership has a positive and significant influence on Islamic Corporate Governance (ICG) disclosure index. Therefore, the fifth hypothesis which states that institutional ownership has a significant influence on Islamic Corporate Governance (ICG) disclosure index is **accepted**.

VI. Conclusion

1. *Profitability has insignificant influence on Islamic Corporate Governance (ICG) disclosure index of islamic banks in Asia.*
2. *Leverage has a significant influence on Islamic Corporate Governance (ICG) disclosure index of islamic banks in Asia.*
3. *Company size has insignificant influence on Islamic Corporate Governance (ICG) disclosure index of islamic banks in Asia.*
4. *Audit quality has a significant influence on Islamic Corporate Governance (ICG) disclosure index of islamic banks in Asia.*
5. *Institutional ownership has a significant influence on Islamic Corporate Governance (ICG) disclosure index of islamic banks in Asia.*

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