

## Islamic Social Reporting: Influencing Factors and Impact on Firm Value (Study of Islamic Banks)

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### Abstract

Islamic banking is the largest sector in the Islamic finance industry. Good bank performance can certainly add to a positive image so that it can result in company value. The covid-19 pandemic has made a person's survival dependent on others who provide assistance and donations, where this is included in the disclosure of corporate social responsibility as a form of accountability for Islamic banks to fellow humans and Allah SWT. The purpose of this study is to determine the board of directors, sharia supervisory board, and customer pressure can affect the disclosure of Islamic social reporting and have an impact on firm value. The research method used in this research is explanatory research with a quantitative approach. Analysis of research data using panel data regression analysis. The research sample is 62 Islamic banks from 9 countries with the time of 2019 and 2020. The results show that the sharia supervisory board has a significant negative effect on Islamic social reporting, customer influence has a significant positive effect on Islamic social reporting, and customer influence has a significant positive effect on firm value.

### Keywords

islamic social reporting; firm value; board of directors; sharia supervisory board; customer influence



## I. Introduction

Islamic banking is the largest sector in the Islamic finance industry. Islamic banks have evolved to create a competitive market for conventional banks in several Islamic countries, gradually consuming market share and offering products that match the level of service and scale of operation. The largest share of Islamic financial assets is GCC at 43.6%, MENA at 26.8%, Southeast Asia at 23.6% (Elgari et al., 2021). The increasing need among the Islamic population for Islamic banking causes its growth to be very rapid. The rapid growth and development of Islamic banking must be accompanied by good performance, both in financial and non-financial aspects. Sharia banking performance is the achievement that has been achieved during its operational activities (Utami et al., 2021). Good performance can certainly add to a positive image for Islamic banking so that it can result in better company value. Companies that have large total assets will make management more flexible to use assets in increasing the value of the company. The main operational activities carried out by Islamic banking are receiving and distributing funds. If the receipt and distribution of funds are indicated positive, it can be said that the banking performance is good and can increase the value of the company. On March 11, 2020, WHO officially declared covid-19 a pandemic (Dzulfaroh, 2021). As a result, many companies are disrupted in carrying out their operational activities, including Islamic banking. The risks from this pandemic are a slowdown in lending, a decrease in assets, and a decrease in income which can result in a decrease in company value (Iswahyuni, 2021). Another consequence of this pandemic is that many workers are laid off so that

unemployment and poverty rates are increasing and social inequality is widening. Most of the people lost their jobs which resulted in a person's survival depending on others who provided assistance and donations. As in Indonesia, PT Bank Syariah Mandiri and its employees distributed 26,000 aid in the form of food packages to communities affected by the covid-19 pandemic. In addition, the Malaysian Government Institution launched a program entitled Musa'adah Covid Fund. This step was taken as an initiative to provide assistance to residents affected by the spread of the covid-19 pandemic. Assistance and donations are included in the disclosure of corporate social responsibility or known as Islamic Social Reporting (ISR), which is a form of accountability for Islamic banks to fellow human beings and to Allah SWT because banking has the main function of collecting and distributing funds from and to the community. This responsibility can make the relationship between people better, because this responsibility reflects concern. Disclosure of ISR that can add to the value of the company for the better of course there are other factors that can influence it, such as the board of directors. The main function of the board of directors is to make decisions, including social responsibility decisions. If the board of directors can make this decision, the bank will gain high trust from the public and create good corporate value. In addition, there is the Sharia Supervisory Board (SSB) factor. His job is to monitor bank operational activities complying with sharia principles, such as supervision when distributing zakat, infaq, and shodaqoh funds which are included in the bank's social responsibility (Milenia & Syafei, 2021). Therefore, the SSB can encourage a company to disclose and carry out social responsibility, thus creating high trust from the community so that the assessment of the company is very good and creates excellent corporate value. Another factor is the customer. The bigger the company depends on customer deposits to fund its capital projects, the greater the customer's expectations regarding the role of Islamic banks in carrying out social responsibility activities so that company management is expected to be able to respond to the customer's expectations (Darus et al., 2015). If the customer's expectations are achieved, then the company's image will be better and increase the value of the company. Consequently, based on the background, we wanted to find out whether the factors of the Board of Directors, Sharia Supervisory Board, and Customer Influence can affect the disclosure of Islamic Social Reporting (ISR) and have an impact on Firm Value.

## **II. Review of Literature**

### **2.1 Shariah Enterprise Theory**

The concept of Sharia Enterprise Theory is that the main source of trust is Allah SWT and the resources owned by stakeholders are a mandate from Allah SWT which must be carried out because there is responsibility in it, with the methods and objectives that have been set. Islamic Social Reporting is one way for companies to inform stakeholders that the company is paying attention to the environmental and social issues caused by the company. The purpose of this disclosure is to show the company's activities and how they affect the community (Meutia, 2010).

### **2.2 Signaling Theory**

Signaling Theory an explanation that issuers have the urge to provide financial-related information to outsiders. Issuers' encouragement to disclose information is due to information asymmetry between issuers and external parties. In order to avoid information asymmetry, issuers send signals to outsiders, in the form of reliable information about the issuer's finances (Sari & Zuhrotun, 2006). An understanding of signaling theory is

understood from market discipline, because when a bank has good performance, the bank will give a signal as a sign of providing information that shows the bank's performance is very high to the market. Disclosure of this information to the market is expected to encourage the market to discipline management (Ariffin et al., 2009).

### **2.3 Board of Directors**

The holder of power in a company is the board of directors who have the duty and responsibility to make decisions on every operational activity of the company according to the duties and functions of each member. The State of Indonesia regulates the number of members of directors of at least 3 (three) people consisting of directors, deputy directors, and directors who have been adjusted to the company (OJK, 2016). If the number of directors is adjusted to the rules that have been set, it is indicated to be able to provide more supervision of the operational performance carried out by the company so that the company's business activities can be properly monitored and controlled (Lidyah et al., 2019). The more the board of directors in a company, the better the corporate governance will be so that the company's operational performance will be better (Harun et al., 2020).

### **2.4 Sharia Supervisory Board**

Sharia Supervisory Board means sharia police for any forum whose operations are based on sharia principles. Sharia Supervisory Board means an independent institution (independent), as a special supervisor in financial transactions according to Islamic law. The main task of sharia supervisory board is to supervise the operational activities of Islamic Financial institutions in order to comply with sharia provisions and principles. SSB must have sharia expert members who understand the procedures and commercial law in Islam and are accustomed to using business contracts. Number of SSB members according to AAOIFI in GSIFI No. 1 minimum of three people (AAOIFI, 2010).

### **2.5 Customer Influence**

A customer can be defined as a person or organization who benefits from a product/service originating from a bank. Customers play a crucial role in the banking industry, because the funds deposited by customers in a bank are important funds for banks to carry out their business activities. The more the company depends on customer deposits for capital, the greater the level of company management to respond to customer expectations. These customer expectations are pressure for management from external parties to be able to fulfill the wishes expected by customers. This customer expectation will certainly suppress management behavior to discipline the market (Roberts, 1992).

### **2.6 Islamic Social Reporting (ISR)**

Islamic Social Reporting is a concept based on Islamic principles which is implemented in the form of responsibility. This form of responsibility is first responsible to the owner of this universe, namely Allah SWT. Both are responsible to fellow human beings. And the third is being responsible for the environment (Meutia, 2010).

### **2.7 Firm Value**

Firm value is an assessment of the market or depositors in a company. The increase in company value can be used as a reinforcement to maximize the welfare of shareholders so as to maximize share prices (Harjito & Martono, 2010). Management can increase operating profit without additional capital, which means that management can use

company assets to generate more optimal profits. Firm value is assessed as the ability of a company to manage its assets.

### III. Research Method

The research method used in this research is explanatory research with a quantitative approach. The data analysis of this research used panel data regression analysis. The models in panel data regression are the Common Effect Model, Fixed Effect Model, and Random Effect Model with the model selection method using the Chow Test, Hausman Test, and Lagrange Multiplier Test. As well as drawing conclusions using the t test statistic and F test statistic, as well as the coefficient of determination. So, there are two panel data regression equations in this study, namely:

$$Y_{1it} = \alpha + \beta X_1 + \beta X_2 + \beta X_3 + \varepsilon_{1it}$$

$$Y_{2it} = \alpha + \beta X_1 + \beta X_2 + \beta X_3 + \beta Y_1 + \varepsilon_{2it}$$

This study fully uses secondary data obtained from the 2019 and 2020 Islamic Bank Annual Reports. The sample used is 62 Islamic banks from various countries, including Saudi Arabia, Malaysia, UAE, Qatar, Kuwait, Indonesia, Bahrain, Turkey and Bangladesh. The sample was selected by purposive sampling method with certain criteria. The measurement of the variables in this study are:

**Table 1.** Indicator variable

Variable Name	Indicator
Board of Directors ( $X_1$ )	Proportion of the total number of the Board of Directors (Harun et al., 2020)
Sharia Supervisory Board ( $X_2$ )	Proportion of the number of Sharia Supervisory Board (SSB) <i>Dummy variable</i> , if: Total SSB $\geq 3$ , then 1 Total SSB $< 3$ , then 0 (Wardani & Sari, 2018)
Customer Influence ( $X_3$ )	Third Party Funds / Total Equity (Darus et al., 2015)
Islamic Social Reporting ( $Y_1$ )	Disclosure is measured based on the ISR items disclosed using <i>a dummy variable</i> , score 1 = disclosed; score 0 = not disclosed. Next, the number of disclosure items is divided by the total number of items (Othman et al., 2009)
Firm Value ( $Y_2$ )	EVA = NOPAT–Capital Charge (Adiguna et al., 2017)

Source: Review results, processed (2021)

### IV. Results and Discussion

#### 4.1 Results

The results of the panel data regression model selection in equation I are as follows:

**Table 2.** Regression model selection

Model	Prob.
Chow test	0,0000
Hausman test	0,7599

Lagrange Multiplier test	0,0000
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Source: Result of data processing (2022)

The results of testing the model in equation I get the Hausman test and the Lagrange multiplier test chosen by the Random Effect Model, so the decision for equation I uses the Random Effect Model.

The results of drawing conclusions in equation I using t and F statistical tests, as well as the coefficient of determination are as follows:

**Table 3.** Result t test statistic

Variable	Coefficient	Prob.
X1	0,005799	0,0846
X2	-0,065061	0,0035
X3	0,005914	0,0198

Source: Result of data processing (2022)

The results of the t-statistical test showed that X1 had a prob value.  $> 0.05$  so that X1 has no effect on Y1. The variable X2 has a prob value.  $< 0.05$  with a negative coefficient value so that X2 has a negative effect on Y1. The variable X3 has a prob value.  $< 0.05$  with a positive coefficient value so that X3 has a positive effect on Y1.

**Table 4.** Result F test statistic

Variable	Prob.
Y1	0,000946

Source: Result of data processing (2022)

The results of the F statistical test found that the prob value.  $< 0.05$  so that the variables X1, X2, X3 simultaneously affect Y1.

**Table 5.** Results of the coefficient of determination

Adjusted R-Squared	0,105310
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Source: Result of data processing (2022)

The results of the coefficient of determination above mean that only 10.5% of Y1 variations can be explained by variables X1, X2, and X3, while the remaining 89.5 % is explained by another variable.

The results of the selection of the panel data regression model in equation II are as follows:

**Table 6.** Regression model selection

Model	Prob.
Chow test	0,0000
Hausman test	0,3213
Lagrange Multiplier test	0,0001

Source: Result of data processing (2022)

The results of testing the model in equation II get the Hausman test and the Lagrange multiplier test chosen by the Random Effect Model, so the decision for equation II uses the Random Effect Model.

The results of drawing conclusions in equation I using statistical tests t and F, and the coefficient of determination are as follows:

**Table 7.** Result t test statistic

Variable	Coefficient	Prob.
X1	0,098882	0,1395
X2	0,973973	0,0567
X3	0,175772	0,0004
Y1	-0,785115	0,6548

Source: Result of data processing (2022)

The results of the t-statistical test showed that X1 had a prob value.  $> 0.05$  so that X1 has no effect on Y2. The variable X2 has a prob value.  $> 0.05$  so that X2 has no effect on Y2. The variable X3 has a prob value.  $< 0.05$  with a positive coefficient value so that X3 has a positive effect on Y2. The variable Y1 has a prob value.  $> 0.05$  so that Y1 has no effect on Y2.

**Table 8.** Result F test statistic

Variable	Prob.
Y1	0,000004

Source: Result of data processing (2022)

The results of the F statistical test found that the prob value.  $< 0.05$  so that the variables X1, X2, X3, Y1 simultaneously affect Y2.

**Table 9.** Results of the coefficient of determination

Adjusted R-Squared	0,197458
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Source: Result of data processing (2022)

The results of the coefficient of determination above mean that only 19.7% of the variation in Y2 can be explained by variables X1, X2, X3 and Y1, while the remaining 80.3% is explained by other variables.

#### 4.2 Discussion

The results of data analysis show that the Board of Directors (X1) has no effect on Islamic Social Reporting (Y1). The large size of the board of directors cannot encourage banks to disclose Islamic social reporting, because the implementation of banking is not fully based on Islamic principles contained in Islamic social reporting, so the number of boards of directors should be adjusted to their functions and duties. This study is in line with (Milenia & Syafei, 2021) which indicates that the board of directors has a superior position so that it does not share more information with other parties.

The results of data analysis show that the Sharia Supervisory Board (X2) has a negative effect on Islamic Social Reporting (Y1). The Sharia Supervisory Board has the task of supervising every operational activity carried out by banks, such as the distribution of zakat, infaq, and alms which are included in Islamic social reporting. The size of the sharia supervisory board can increase the level of disclosure of social responsibility, but if the size of the sharia supervisory board is more, it will cause Islamic social reporting to decrease because the sharia supervisory board only focuses on supervising bank operations to comply with sharia principles so that the sharia supervisory board will put pressure on it.

towards management to disclose social responsibility that only relates to Islamic principles, but other matters regarding social responsibility such as corporate governance are neglected. This study is in line with (Saputra & Adityawarman, 2016) which indicates that the larger the size of the SSB, the smaller the disclosure of the ISR.

The results of data analysis show that Customer Influence (X3) has a positive effect on Islamic Social Reporting (Y1). Customers have an important role for banking because customer funds are capital for banks from third party funds. The increase in customer influence will increase the disclosure of Islamic social reporting, because customer expectations regarding the role of corporate social responsibility are carried out well. Therefore, the more the company depends on customer deposits to fund its capital projects, the greater the level of management of the company is expected to respond to customer expectations in socially responsible activities. This study is in line with (Darus et al., 2015) which indicates that the greater the customer influence, the greater the customer expectations regarding the role of banking in social responsibility so that management will disclose social responsibility. so that customer expectations are met and will increase the disclosure of Islamic social reporting.

The results of data analysis show that the Board of Directors (X1) has no effect on Firm Value (Y2). The role of the board of directors is to make decisions for the continuity of banking operations. However, the board of directors only focuses on the profit generated by the bank rather than the value of the company which can measure the rate of return that is greater than the cost of capital. This study is in line with (Islami et al., 2020) which indicates that the board of directors only focuses on banking financial performance rather than firm value to attract investors. Financial performance is a measuring instrument to know the process of implementing the company's financial resources. It sees how much management of the company succeeds, and provides benefits to the community (Ichsan, R. et al. 2021).

The results of data analysis show that the Sharia Supervisory Board (X2) has no effect on Firm Value (Y2). The role of the sharia supervisory board is only limited to supervising banking operational activities in accordance with sharia principles, as well as providing input and suggestions regarding activities that banks should or should not do so that there are no violations of sharia principles. So, the role of the sharia supervisory board in a bank has nothing to do with profits or returns that are greater than the cost of capital. This study is in line with (Islami et al., 2020) which indicates that the sharia supervisory board does not have the authority to regulate profits and profit sharing for shareholders.

The results of data analysis show that Customer Influence (X3) has a positive effect on Firm Value (Y2). One of the bank's roles is to provide products/services to customers. Banks carry out transparency as a form that the funds obtained by the bank are used to increase the business activities of Islamic banks in order to obtain higher profits so as to increase the value of the company. With the increase in the value of the company, it is possible that there will be more new customers so that more funds are collected by the bank through third party funds. With such conditions, the business activities of Islamic banks will increase and banks can channel more funds so that it will bring even greater profits and create added value for the company. This research is in line with (Karolina, 2020) which indicates that the greater the customer's funds stored in the banking system, the better the bank's performance because it has a larger capital.

The results of data analysis show that Islamic Social Reporting (Y1) has no effect on Firm Value (Y2), with a negative sign on the coefficient. This shows that the higher the disclosure of Islamic social reporting, the lower the value of the company. This happens because banks disclose excessive Islamic social reporting which results in investors'

concerns about banks which can reduce their valuation. This study is in line with (Harun et al., 2020) with the results of a negative relationship between Islamic social reporting and firm value which indicates that excessive additional information has a negative effect on firm value, which means it can cause uncertainty for investors.

## V. Conclusion

The study found that the large size of the sharia supervisory board may not necessarily expand the disclosure of Islamic social reporting, because the task of a sharia supervisory board is only as a supervisor of sharia banking so that banking operations are in accordance with Islamic principles. The size of the sharia supervisory board can increase the level of disclosure of Islamic social reporting but only in the level of activities that contain sharia principles, while things outside of this are neglected, so that if the size of the sharia supervisory board is large, it will reduce the disclosure of Islamic social reporting. Customers are very important for banks because customers are capital for banks from third party funds. The more customers, the greater the customer influence. The customer influence is in the form of customer expectations who want the bank to carry out its role well and carry out social responsibility. The study found that high customer influence was able to expand the disclosure of Islamic social reporting, because customers are very important to banking, therefore the management as much as possible meets customer expectations in carrying out social responsibility. Likewise with the value of the company, the more customers, the higher the customer influence and the higher the value of the company. This is because if there are more customers, the banking capital will be greater and increase the business activities of Islamic banks in order to obtain higher profits so as to increase the value of the company.

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