

Implementation of Islamic Corporate Governance, Islamic Corporate Social Responsibility and Financial Performance Toward Reputation

(Study of Sharia Commercial Bank in Indonesia)

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Abstract—The prospect of the Islamic finance sector in Indonesia is getting better, and the existence of Commercial Sharia Banks (CSB) in Indonesia is guaranteed Act. This study examines the effect of the implementation of the ICG, ICSR and the Financial Health of the reputation, a study of CSB in Indonesia. The results of this study to confirm the results of several previous studies, but on the other hand, does not support the results of testing several previous studies. This study examined the back while developing previous research by increasing the measurement variables for the soundness of banks using three variables representing the ratio of financial ratios of liquidity, profitability and solvency. Measurements on the independent variables, the ICG using GCG report which is a self-assessment of Islamic banking. Measurement Reporting ICSR using Islamic Social Index (ISR Index), while the variable is measured by calculating the reputation of third party funds of a bank divided by total deposits were then compared with the market average of total third party funds CSB. The population of this research is all CSB in Indonesia. The sampling technique used purposive sampling method and obtained a sample of 10 CSB with an eight-year study period, which was in 2011-2018. Financial health in this study was measured using the CAR, OER and FDR. This study using logistic regression analysis techniques with the result that the positive effect ICSR, CAR and FDR negatively affect the reputation, while ICG and OER has no effect on reputation.

Keywords: *Islamic Corporate Governance, Islamic social corporate responsibility, reputation, financial performance*

I. INTRODUCTION

The discussion on Islamic Corporate Governance (ICG) and the Islamic Corporate Social Responsibility (ICSR) on Islamic banking being conducted by researchers from the country that were not followers of the Muslim majority. Based on data from the Indonesian Banking Directory of the FSA in 2018, this time in Indonesia there are 200 Islamic banks consisting of 13 Commercial Sharia Banks (CSB), 22 Islamic Business Unit (IBU), and 165 Islamic Rural Banks (IRB). ICG related research conducted by Wardayati [1], Junusi [2], Izzati [3] and three of proving that the ICSR has a significant impact

on the reputation of Islamic banking, while the Khusnawati, and Andraeny results proves otherwise [4]. Research on the ICSR, from year to year also show the results have not been consistent. The ICSR has a positive and significant impact on reputation [4-8]. However, the research results proved that CSR does not have a proportional relationship with the reputation [9]. Unlike the two earlier opinions, Darsiya research, showed that CSR has a negative effect on the reputation of the CSB [10]. With the results of the different studies, then this article intends to re-examine and develop previous research by increasing the measurement variables for the soundness of banks. This study was made with a view to testing the Islamic Implementation of Corporate Governance, Islamic Social Corporate Responsibility.

A. Islamic Corporate Governance

Governance for CSB and IBU stipulated in Bank Indonesia, where CSB and IBU must run Islamic Corporate Governance [11]. ICG concepts contained in Undang-Undang Republik Indonesia number 21 year 2008 concerning Islamic Banking in particular on Article 30, paragraph 1 [12]. It is also contained in Bank Indonesia [11].

B. Agency Theory

The discussion on governance or corporate governance, can't be separated from the Agency Theory. Agency theory is the "agency relationship as a contract under the one or more persons (the principals) engage another person (the agent) to perform some service on their behalf the involves delegating some decision making authority to the agent" [13]. In this regard, good governance is necessary for banks to provide assurance to stakeholders, one of which is the customer.

C. Islamic Corporate Social Responsibility

The term Triple Bottom Line is closely related to CSR. Triple Bottom Line popularized by Elkington in 1997 in his book "Cannibals with Forks, the Triple Bottom Line of Twentieth Century CSBiness". Elkington view that companies that want sustainable must pay attention to "3P", namely:

profit, people and planet. Since the launch of ISO 26000 in early November 2010 by the agency the International Organization for Standardization (ISO) regarding Guidance on Social Responsibility, a component of triple bottom line plus one aspects: procedure [14]. That is, CSR is a concern for the company by setting aside part of the profit (profit) for the benefit of human development (people) and the environment (planet) in a sustainable manner by the proper procedure.

D. Legitimacy Theory

The theory underlying the Triple Bottom Line is a legitimate theory, which is derived from the concept of the legitimacy of the organization. According to Dowling and Pfeffer, legitimacy is a condition or status that existed when the entity value system congruent with the value system of the larger society in place of the entity [15]. CSR reporting in Indonesia is compulsory (mandatory) with the formation of Undang-Undang Number 40 Year 2007 regarding Limited Liability Company, particularly in article 74, paragraph 1. In addition, the Law on Social Responsibility set forth in Undang-undang Republik Indonesia number 25 year 2007 on Investment [16,17]. Although reporting on CSR is required, but the ICSR reporting is voluntary and there has been no standard on CSR reporting sharia. There are 56 items that are a measure of social performance implementation of Islamic banking, which contains a compilation of items of the standards set by the Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI 2002). ICSR disclosure calculation formula is:

$$ICSR = \frac{\text{Total disclosure items CSB}}{\text{Total items in the index ISR}} \times 100\% \quad (1)$$

Disclosure ICSR be something that is very important for the reputation and performance of Islamic financial institutions because it will make the viewed as an entity that can be trusted by the Muslim community in channelling their funds [18].

E. Financial Health

In this study, the financial soundness of Islamic banks is measured using three (3) financial ratio variables. Liquidity is measured using a Capital Adequacy Ratio (CAR), Profitability measured through the Operating Expenditure Ratio (OER) and Solvency measured using Financing to Deposit Ratio (FDR).

F. Capital Adequacy Ratio (CAR)

Deregulation based BI dated February 29, 1993, which included the bank performs well if it has a CAR of at least 8%, in accordance with the conditions set by the Bank for International Settlements). CAR formula is:

$$CAR = \frac{\text{Capital}}{\text{ATMR}} \times 100\% \quad (2)$$

G. Financing to Deposit Ratio (FDR)

FDR is a ratio used to measure the liquidity of a bank to repay the withdrawal of funds by depositors. The higher the FDR, the higher the funds distributed to Third Party Fund (TPF). FDR formula is:

$$FDR = \frac{\text{Total Financing}}{\text{Total Fund Receipt}} \quad (3)$$

The total volume of financing is financing provided to the public, while the total acceptance of the funding comes from public deposits. Both of these must exist in one period for the calculation of FDR. The normal range FDR statutes is 85-100% of Bank Indonesia in 1993 and turned into a 78-100% through regulations issued in 2010.

H. Operational Expenditure Ratio (OER)

Operational expenditure is interest expense given to customers while operating income is interest earned on clients. The smaller value means more efficient OER of banks in operation. OER is calculated by the following formula:

$$OER = \frac{\text{Operational Expenditure}}{\text{Operational Income}} \times 100\% \quad (4)$$

I. Company Reputation

According to Dorcak and Dorcakova, Reputation: Perception that an agent creates through past actions about its intentions and norms [19]. Bank with a good reputation will be easier to obtain third-party funding. Reputation in this study was measured using the following formula:

$$\text{Reputation} = \frac{\text{Third Party Funds}}{\text{Total Third Party Funds}} \times 100\% \quad \text{vs} \quad \frac{100\%}{\text{Total CSB}} \quad (5)$$

J. Hypothesis

Research conducted by Wardayati [1], Junusi [2], Izzati [3] obtained results that sharia corporate governance has a significant positive effect on the reputation of Islamic banking. While Khusnawati and Andraeny, proved that Islamic corporate governance did not affect the company's reputation [4]. Based on the presentation, the hypothesis proposed in this study are:

H1= Islamic corporate governance (ICG) positive effect on reputation.

Branco and Rodrigues Research, showed that companies that have a high profile ICSR able to improve their interaction with customers, suppliers, and investors that the results are improving reputation [5]. The same result was shown by Khusnawati and Andraeny [4], Arshad et al. [6], Arifin and Wardani [7], and Reskino [8]. The opposite results shown by Bank Indonesia [10], while Hanzae and Sadeghian research proved that CSR does not have a proportional relationship with the company's reputation [9]. Based on the presentation, the proposed hypothesis is:

H2= Islamic corporate social responsibility (ICSR) positive effect on reputation.

According to Bank Indonesia on Chapter II in Article 6 says about Banks are required to conduct an assessment of the Bank on an individual basis using risk appOERch (Risk-based Bank Rating) as referred to in Article 2 paragraph (3), the scope of an assessment of the factors as follows: The risk profile (risk profile); Good Corporate Governance (GCG); earnings; and capital [20].

Capital Adequacy Ratio (CAR) is the capital adequacy ratio which is used to measure the ability of banks to absorb losses that are inevitable and can also be used to measure large-small fortune these banks or property owned by the shareholders its shares [21]. The greater the value of CAR reflects banking capabilities are getting better in the face of possible risk of loss. Based on the presentation, the hypothesis proposed in this study are:

H3= Capital Adequacy Ratio (CAR) positive effect on reputation.

OER or Operating Expenditure Ratio is a ratio used to measure the efficiency of the bank's management capability in controlling operating expenses to operating income. If the value of the lower OER, means more efficient operational costs incurred by the bank. Based on the presentation, the hypothesis proposed in this study are:

H4=OER negatively affect the reputation.

Loan to deposit ratio (LDR) is a term used in the world of conventional banking, while the Financing to Deposit Ratio (FDR) is a term used in Islamic banking. FDR used the term because in Islamic banking is not known term debt (loan). Islamic banks only know financing or financing. According to Alissanda, the higher the ratio of FDR in Islamic banks will affect the poor ability of liquidity [22]. Based on the presentation, the hypothesis proposed in this study are:

H5= Financing to Deposit Ratio (FDR) negatively affect the reputation.

II. METHODS

The research data was processed using logistic regression. The independent variable in this research there are three, namely Islamic Corporate Governance (ICG), Islamic Corporate Social Responsibility (ICSR) and Financial Health. ICG is calculated by giving each assessment scale on a composite ranking of Islamic banks annually. Ranked composites obtained from the self-assessment of internal party banks included in the annual corporate governance report. ICG is then measured by the predicate with scale intervals as follows: number one, the title is very good given the scale of five; second place, a good rating, given the scale of four; number three, fairly well, given the scale of the three; fourth, the predicate is not good given the scale of the two; fifth, the predicate is not good, given the scale of one [23]. ICSR assessed through Islamic Social Reporting Index (ISR). According to Siddi et al. discloses "ISR index is a measure of the implementation of the company's performance which contains a compilation of items CSR standards set by the

Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) which was then developed by the researchers regarding CSR items that should be disclosed by an entity of Islam" [24]. The level of financial health in Islamic banks measured by the ratio of liquidity, profitability and solvency. liquidity is measured using a Capital Adequacy ratio (CAR), profitability measured through the Operating Expenditure Ratio (OER) and solvency measured using Financing to Deposit Ratio (FDR). Index ISR is a measure of the implementation of the company's performance contains a compilation of items CSR standards set by the Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) which was then developed by the researchers regarding the items of CSR should be disclosed by an entity of Islam ". Financial soundness in Islamic banks measured by the ratio of liquidity, profitability and solvency. Liquidity is measured using a Capital Adequacy Ratio (CAR), Profitability measured through the Operating Expenditure Ratio (OER) and Solvency measured using Financing to Deposit Ratio (FDR). Index ISR is a measure of the implementation of the company's performance contains a compilation of items CSR standards set by the Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) which was then developed by the researchers regarding the items of CSR should be disclosed by an entity of Islam ". Financial soundness in Islamic banks measured by the ratio of liquidity, profitability and solvency. Liquidity is measured using a Capital Adequacy Ratio (CAR), Profitability measured through the Operating Expenditure Ratio (OER) and Solvency measured using Financing to Deposit Ratio (FDR).

The dependent variable in this study is reputable. Reputation is measured by calculating a bank's third party fund divided by the total third party funds market is then compared with the average of the total third-party funds CSB. The result is that if a bank depositor funds above the average market it is considered that the bank has a good reputation, coded 1. Conversely, if the bank in deposits below the market average have a bad reputation, coded 0. Research was conducted by Reskino [8].

A. Population and Sample

The population used in this study are all CSB in Indonesia. Sample selection technique used is purposive sampling with multiple criteria. The data taken in the form of audited financial statements, disclosure statements governance and sustainability reports since 2011 until 2018. The criteria set is CSB conducting national in scope and reported in full accordance sustainability report study period. Of the 13 banks, selected 10 banks, namely: 1) Bank Muamalat Indonesia, 2) Bank Syariah Mandiri, 3) Bank Mega Syariah, 4) Bank BRI Syariah, 5) Bank Syariah Bukopin, 6) Bank BNI Syariah, 7) BCA Syariah, 8) Bank Victoria Syariah, 9) Maybank Syariah Indonesia, 10) Bank Panin Syariah. The study period is 10 years, which was in 2011-2018.

III. RESULTS AND DISCUSSION

Testing the feasibility of the model using the Hosmer and Lemeshow and the result is a model that is used has compatibility with observations. Figures Negelkerke R Square

which is a modification of the Cox & Snell R Square figures show 64.3%, which means that the independent variable in this study were able to predict the dependent variable is a reputation CSB. Below is a table of test results logistics:

TABLE I. TEST LOGISTICS VARIABLES IN THE EQUATION

		B	S.E.	Wald	df	Sig.	Exp(B)
Step 1 ^a	ICG	0.849	0.753	1.269	1	0.260	2.336
	ICSR	15.980	4.273	13.987	1	0.000	870989 1.791
	CAR	-14.770	4.945	8.921	1	0.003	0.000
	BOPO	3.215	2.233	2.073	1	0.150	24.898
	FDR	-9.951	4.505	4.879	1	0.027	0.000
	Constant	-3.122	4.501	0.481	1	0.4888	0.044

^a. Variable(s) entered on step 1: ICG, ICSR, CAR, BOPO, FDR

Source: Data processing SPSS

The above table shows the test results of the logistics with the following equation:

$$Ln = \frac{P}{1-P} = -3.122 + 0.849 X_1 + 15.980 X_2 - 14.770 X_3 + 3.215 X_4 - 9.951 FDR$$

$$= e^{-3.122 + 0.849 ICG + 15.980 ICSR - 14.770 CAR + 3.215 BOPO - 9.951 FDR}$$

A. Logistics Test Results

From equation logistic regression test result that there is a positive effect amounting to 15 980 of the ICSR to the reputation CSB. Furthermore, there is a negative effect amounting to -14 770 from CAR. Finally, there is the negative effect of -9951 given FDR on reputation. While ICG and OER has no influence on the reputation of the CSB.

ICG does not have influence on the reputation CSB. This is not in line with the hypothesis, but the results of this study support the results of research conducted by Khusnawati and Andraeny [4], Fatchan and Trisnawati [25]. The reason is that investors tend to assess the performance and reputation through the profit generated and dividend payments. ICG assessment conducted self-assessment is not the main reason for investor consideration in assessing the reputation CSB. Despite the Sharia Supervisory Board (SSB).

ICSR has a significant positive effect on the reputation of Islamic banks. The test results are in line with the hypothesis. This study supports research Khusnawati and Andraeny [4], Arifin and Wardani [7], Reskino [8]. The more indicators that revealed it will bring good perception by investors that will enhance the reputation of Islamic banks.

CAR has a negative relationship with the reputation. This fact shows that the study results do not support the hypothesis. Banks with high capital adequacy ratio is able to provide loans to lenders however have an impact on the higher risk. Bank Indonesia implement the provisions of CAR (Capital Adequacy Obligation Fulfilment) by 8%. Islamic banking used in this study all had an average CAR of 25%. The high CAR caused banks cannot manage their funds well, which in turn decrease the reputation.

This study did not prove that OER affect the reputation of Islamic banks. OER is a proxy that shows the efficiency of Islamic banks [26]. But in this case Islamic banks do not take into account stakeholder management efficiency of Islamic banks. Allegedly there is also the influence of the ranking factors stipulated in Bank Indonesia Regulation No. 09/15/PBI/2007 about the Rating System for Commercial Sharia Banks [27]. The assessment process carried out by the Financial Factor Rating weightings of factors rank value Capital, Asset Quality, Profitability, Liquidity, and Sensitivity to Market Risk. In this case, the management efficiency not included in the weighted rankings.

FDR significant negative effect on the reputation of Islamic banks or in other words the fifth hypothesis is accepted. On average FDR studied in Islamic banking is 0.95. The higher the ratio of FDR in Islamic banks will affect the poor ability of liquidity, so naturally when FDR decline, impacting on reputation increases, and vice versa [22].

IV. CONCLUSION AND RECOMMENDATION

A. Conclusion

ICG does not have influence on the reputation of Sharia Commercial Banks. Investors tend to assess the performance and reputation of the company through profit and dividend payments compared to the sharia governance. ICSR has a significant positive effect on the reputation of Islamic banks. Disclosure ICSR be something that is very important for the reputation of Islamic banking because it would be seen as an entity that can be trusted by the community. CAR significant negative effect on the reputation of Islamic banking. The capital adequacy ratio which leads to high bank is able to provide loans to creditors but also pose a higher risk. This study did not prove that OER effect on the reputation of Islamic banks. Lastly, FDR significant negative effect on the reputation of Islamic banks because the higher the FDR, then the bank does not have enough reserve funds to meet the needs of the customers.

B. Implication

With the limitations of the study variables, further researches may include other factors that have not been studied such as ratings Risk Based Bank; Rating includes Risk Yield (Non Performing Financing /NPF) or Investment Risk (Composition and Level Concentration Based Financing For Results) then the implication is that the test results could have been different.

C. Recommendation

Future studies may focus on ICG disclosure items and sort out the items which have influence on the reputation and which items do not affect the reputation. Similarly to the item OER and CAR needs to discover the reason why no effect or a negative effect on reputation.

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