

Islamic Values and Voluntary Corporate Governance Disclosure

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Abstract: The aim of this study was to empirically examine the influence of Islamic values on the level of voluntary corporate governance disclosures in public companies in Indonesia and the influence of traditional ownership structures and corporate governance on the level of voluntary GCG disclosures. In this regard, this study was structured on the basis of Islamic values and voluntary corporate governance disclosures. The population in this study was banking sector companies listed on the Indonesian Stock Exchange from 2012–2016, which consisted of 43 companies. Data from 2012 to 2016 was used, representing the period after the adoption of the GCG code, and a purposive sampling technique was utilized. An examination of the influence of Islamic values on voluntary GCG disclosures was carried out by using multiple linear regression analysis, assisted by SPSS 24.0 software.

1 INTRODUCTION

The collapse of large-scale public companies is mostly caused by poor corporate governance (Hussainey & Al-Najjar, 2012; Ntim et al., 2012). The main characteristic of poor corporate governance is the self-interest of corporate managers, who ignore the needs of stakeholders, thus eventually leading to a drop in stakeholders' expectations with regard to gaining more benefits from the company's performance (Isnandar & Sudaryati, 2015). The collapse of large companies has a major impact on the economy of a country (Haniiffa & Hudaib, 2006), which is characterized by a number of employment terminations that subsequently have an impact on the country's unemployment rate (Ntim et al., 2012). In this regard, it can be inferred that poor corporate governance practices will have a major impact on the economy of a state. Such a condition has encouraged governments to improve the rules and develop policy reforms in relation to good corporate governance. In general, policy reforms require public companies to increase transparency, accountability, openness, independence, responsibility, and fairness to all stakeholders. Good corporate governance deals with the balance between economic and social goals and between individual and communal goals. A good corporate governance framework is designed to encourage the efficient and equitable use of resources, which requires accountability from the management of the resources. By so doing, the goal is to align the interests of individuals, enterprises, and communities (Choudhury & Alam, 2013).

However, the policy reforms undertaken to achieve good corporate governance are still largely dependent on the extent to which companies are willing to be involved

and to disclose corporate governance mechanisms in their corporate reports (Collett & Hraskey, 2005). With regard to companies disclosing corporate governance mechanisms more broadly, one important factor is the willingness to disclose corporate governance voluntarily. In this sense, voluntary corporate governance disclosure is a reflection of the extent to which a company provides broader information to the public on the basis of the company's desire to implement existing rules and provide protection to stakeholders regarding the company's operational mechanisms (Albassam et al., 2017).

Voluntary corporate governance disclosure aims to create a more transparent, accountable, independent, and fair corporate report, one which is a reflection of universal religious principles. A couple of the universal principles of all religions are honesty and fairness (Qur'an 11:85). In this regard, religion instills universal values in all people in relation to being honest and fair in social life. In the economic context, universal religious values teach each individual to be transparent by not reducing the dosage in trade (Qur'an 6: 152). In this context, the activities aimed at voluntarily disclosing corporate governance relate to the implementation of religious teaching in social life in that they are based on the view that every human activity in life, either vertically or horizontally, is governed by provisions that are in accordance with the commands of God. The underlying principles of every action are based on the sources of law from the holy books of each religion.

Indonesia, as a country with the largest Muslim population in the world, seeks to provide protection and comfort for every citizen, especially for the Muslim population, and governance structures must meet the expectations of the Muslim community by providing an acceptable Islamic business governance model. Therefore,

the trade sector, financial business, and all forms of economic transactions in general should reflect the principles of Islam. With regard to the standardization of regulations, corporate governance should comply with Shariah rules contained in the Qur'an and Hadith (Alnasser & Muhammed, 2012).

Islamic values are holistic guidelines for Muslims in practicing all aspects of daily living (Vinnicombe, 2010). In this sense, in everyday life, the activities of Muslims will consist of components of Islamic values and components of materialism/secularism. However, both aspects should be guided by religious values so that transparency, fairness, morality, and social justice can be accomplished in the daily activities of Muslims. The implementation of Islamic values in the company's operational activities relates to the incorporation of the principles of Shariah. The implementation of these principles will provide guidance for companies to adapt corporate values to those that apply to society in general in order to gain community legitimacy (O'Donovan, 2000).

The implementation of Islamic values in a company will encourage the company to be more transparent, accountable, and fair to all related parties. Such an implementation can be realized by the company through disclosing the corporate report more broadly so that the stakeholders can understand the company's operational processes more easily and clearly. From this perspective, applying Islamic values will encourage a company to provide transparent, accountable, and equitable company reports more voluntarily and in accordance with Islamic principles in *muamalah*.

Research conducted by Albassam et al. (2017) provides evidence that Islamic values in a company encourage more voluntary reporting on corporate governance. According to Albassam et al. (2017), companies with a greater commitment to incorporating Islamic values within corporate operational activities have a greater involvement in voluntary corporate governance disclosures. Incorporating Islamic values in corporate operations encourages companies to be more transparent in implementing their good governance practices.

The present study was conducted on banking sector companies, which are companies that have a lot of contact with Islamic values. Islamic values forbid *usury* in *muamalah* activities (Qur'an 2, pp. 278-281). *Usury* can be understood as a form of interest on loans or savings provided by banking companies. The implementation of Islamic values in banking sector companies is expected to provide confidence and convenience for Muslims to transact with banking companies without any presumption of such transactions violating Islamic values.

Based on the background outlined above, the main purpose of this study is to examine the extent of companies' commitment to incorporating Islamic values in their operational activities, and its effect on the level of information relating to corporate governance practices disclosed by the company. The study has clear practical implications for future research, practice, and the broader society in empirically demonstrating that corporations voluntarily incorporating Islamic values into their

operations are more likely to be transparent about their corporate governance practices, thereby providing new and important insights into the effect of Islamic values on voluntary corporate governance compliance and disclosure.

2 THEORETICAL BACKGROUND

Voluntary corporate governance disclosure is where corporate management aims to be more transparent in delivering company reports. The expected transparency of voluntary corporate governance disclosures is related to the intention of corporate management to minimize the information gap between shareholders and corporate managers. The effort to minimize the information gap can thus be seen as a manifestation of the desire of corporate management to create fairness for all of the company's stakeholders.

2.1 Agency Theory and Islamic Values

According to Jensen and Mekling (1976), agency theory describes the relationship that arises due to a contract between a principal and agent, in which the principal delegates authority to the agent. According to Eisenhardt (1989), there are two problems in the principal-agent relationship: the conflict between desires or goals, and the difficulty for the principal to verify what the management has done in managing the company. On the one hand, shareholders find it difficult to verify the operational activities of management, while, on the other hand, the management has more information on the operations and financial position of the company.

To overcome the information gap between principal and agent, the company should incorporate Islamic values into its corporate values. By so doing, Islamic values will encourage the company management (agent) to be more transparent and fair in conveying information to the shareholders (principal). The Islamic values held by the company will result in corporate managers (agent) being more honest in conveying information to the principal.

2.2 Islamic Values, Transparency, and Voluntary Corporate Governance Disclosure

Islamic values are those adopted by Muslims and derived from the Qur'an and Sunnah. These values are binding upon every Muslim and attach themselves to every activity in his/her life (Choudhury & Alam, 2013). The values embedded in Muslims encourage individuals to reflect on their daily lives (Vinnicombe, 2010).

The application of Islamic values in daily life activities encourages individuals to be more honest and open in their behavior. They are required to be more transparent in the work they do. However, in life, one

cannot be separated from the demands of one's worldly life, which means that the principle of materialism often leads to a conflict with Islamic values inherent in the individual. Therefore, it is important to understanding how to reduce the contradiction between the principles of materialism occurring in the activities of life and prevailing Islamic values.

A company, as an economic entity closely related to the principles of materialism, is expected to be a motivator in harmonizing the relationship between the principles of materialism and Islamic values, so as not to cause significant opposition, especially for those working in the company and society as a whole. The company is expected to be able to absorb Islamic values and apply them in its operational activities. The adoption of Islamic values into corporate values is expected to result in the company being better accepted by the wider community, reflected in the company's market share.

The implementation of Islamic values in the company's operational activities is expected to provide incentives for corporate management to be more transparent in conveying information in its company reports. In this regard, Islamic values embedded in the company's rules will serve as a guide for corporate managers to be more honest and open in their operational activities. The practical realization of openness in the corporate report can be manifested through a broader reporting of corporate governance activities. Companies that apply Islamic values will strive to provide transparent information by presenting all the available information to the stakeholders. The compliance of the company with good corporate governance can also manifest itself in the form of voluntary additional information in the company report. Thus, companies that have a commitment to implementing good corporate governance will disclose corporate governance information more voluntarily. This is based on the fact that companies that are committed to increasing their voluntary corporate governance disclosures can undoubtedly fulfil their primary obligations with regard to implementing good corporate governance. Based on the above background, the hypothesis for this research is as follows:

H1: Islamic values have a positive effect on voluntary corporate governance disclosures.

3 RESEARCH METHODOLOGY

3.1 Data Collection

It is interesting to analyze the implementation of Islamic values in relation to the effort to increase voluntary corporate governance disclosure in banking companies in Indonesia because, first, banking companies in Indonesia apply the principles of corporate governance, and secondly, banking companies in Indonesia apply Shariah-based principles that are disclosed in their annual reports. This study collected data from multiple channels. In this

sense, the required information was obtained from the Indonesian Stock Exchange (IDX) by identifying banking sector companies operating from 2012–2016. The population of this study was 154 banking companies. The researchers collected data on related variables, i.e. Islamic values and voluntary corporate governance disclosures, as well as data on control variables such as audit quality, the percentage of institutional ownership, the number of boards of directors, the percentage of total capital expenditure to total assets, dividend payout, leverage, the percentage of operating profit to total assets, and sales growth.

3.2 Definition and Measurement of Variables

The researchers designed certain variables for this research, and Table 1 describes the variables as well as the measuring method.

Dependent Variable	
GINDX	Indonesian corporate governance index constructed by Albassam (2014) (see Appendix 2, pp. 341-348). It takes a value of 1 if each of the 65 CG provisions is disclosed, 0 otherwise.
BDIR	Sub-index of GINDX related to the board of directors, consisting of 35 provisions. It takes a value of 1 if each of the 35 CG provisions is disclosed, 0 otherwise.
DTRA	Sub-index of GINDX related to disclosure and transparency, consisting of 14 provisions. It takes a value of 1 if each of the 16 CG provisions is disclosed, 0 otherwise.
INCR	Sub-index of GINDX related to internal control and risk management, consisting of 6 provisions. It takes a value of 1 if each of the 6 CG provisions is disclosed, 0 otherwise.
SHAR	Sub-index of GINDX related to the rights of shareholders and general assembly, consisting of 8 provisions. It takes a value of 1 if each of the 8 CG provisions is disclosed, 0 otherwise.
Independent Variable	

IVDI	Islamic values (IV) voluntary compliance and disclosure index, consisting of 10 provisions. It takes a value of 1 if each of the 10 IV provisions is disclosed, 0 otherwise; scaled to a value between 0% and 100%.
Other Explanatory Variables	
AUFZ	1 if a firm is audited by one of the big four audit firms (i.e. PricewaterhouseCoopers, Deloitte & Touché, Ernst & Young, and KPMG), 0 otherwise.
BODZ	Natural log of the total number of directors on the board of a company.
INON	Percentage of shares held by institutional shareholders.
Control Variables	
CEXP	Percentage of total capital expenditure to total assets.
DVPS	1 if a firm paid dividends during the financial year, 0 otherwise.
LEVG	Percentage of total debt to total assets.
PROF	Percentage of operating profit to total assets.
SAGR	Percentage of current year's sales minus previous year's sales to previous year's sales.

Table 2: Descriptive Statistic

Var	Min	Max	Mean	Std Deviation
VG	.6615	.9231	.879520	.0386093
IVDI	.00	.90	.3805	.26124
AUFZ	0	1	.69	.465
BODZ	3	12	7.06	2.538
INON	.4358	1.000	.758026	.1612936
CEXP	.0001	.0233	.002867	.0030443
DVPS	0	1	.42	.496
LEV	.7399	.9479	.864409	.0424926
PROF	-.0972	.1144	.014323	.0203630
SAGR	-3.5933	.8377	.106371	.4649905

Based on the results shown in Table 4.2, the mean value of voluntary corporate governance disclosure (VG) is 0.87952, with a deviation rate of 0.0386, indicating that the voluntary corporate governance disclosures of banking companies in Indonesia have considerable value, since the mean value is close to 1. The mean value of Islamic values is 0.3805, with a deviation rate of 0.26124, indicating that the Islamic values absorbed by banking companies in Indonesia are still low, since the value is less than 0.5.

4 RESULT AND DISCUSSION

The researchers tested a five-year period (from 2012 to 2016) and a total of 154 observations. The description of the research results will explain the descriptive analysis and hypothesis testing.

4.1 Descriptive Analysis

Descriptive analysis was used to provide an overview of the data used in the study, which can be seen in Table 4.2.

4.2 Regression Analysis

In this research, the method of analysis used was multiple linear regression analysis, which aimed to determine the effect of Islamic values on voluntary corporate governance disclosures. The regression analysis results used to determine the regression equation can be seen in Table 4.3.

Table 3: Regression Coefficient Values

Model	Unstandardized Coefficients	p-value
	B	
(Constant)	.874	.000
IVDI	.062	.000
AUFZ	-.005	.521
BODZ	.004	.004
INON	.011	.537
CEXP	.452	.626
DVPS	-.002	.801
LEV	-.058	.364
PROF	-.116	.476
SAGR	-.008	.193

From Table 4.3, it can be seen that the regression coefficient values of the output resulted in the following regression equation model:

$$VG = 0.874 + 0.062 \text{ IVDI} - 0.005 \text{ AUFZ} + 0.004 \text{ BODZ} + 0.011 \text{ INON} + 0.452 \text{ CEXP} - 0.002 \text{ DVPS} - 0.058 \text{ LEV} - 0.116 \text{ PROF} - 0.008 \text{ SAGR} + \varepsilon$$

4.3 Results of Coefficient of Determination Testing

The coefficient of determination test aimed to determine the level of influence of the variables used in this study on voluntary corporate governance disclosures, the results of which can be seen in Table 4.4.

Model	R	R ²	Adjusted R ²
1	.573 ^a	.329	.287

Based on Table 4.4, it can be seen that the value of Adjusted R² is 0.287, indicating that voluntary corporate governance disclosures can be explained by 28.7% of the influence of the independent variables used in this study.

4.4 Hypothesis Testing

Hypothesis testing was carried out by using the t test obtained from the multiple linear regression analysis. Based on the results of the t-test from the multiple linear regression analysis in Table 4.3, it can be concluded that Islamic values and the number of directors in the company have a positive and significant effect on voluntary corporate governance disclosures, since the regression coefficient value is positive and the p-value is < 0.05.

Based on the results of the t-test from the multiple linear regression analysis, it can be concluded that the financial performance ratios do not affect voluntary corporate governance disclosures, since the p-value is < 0.05. In addition, the quality of the auditor and the proportion of institutional ownership have no effect on voluntary corporate governance disclosures.

5 CONCLUSIONS

The research results show that Islamic values have a positive effect on voluntary corporate governance disclosure. In this regard, a company's commitment to providing broader and more transparent information through voluntary corporate governance disclosures can be enhanced by absorbing Islamic values into the company's prevailing rules. Attempts to absorb Islamic values into corporate rules will encourage companies to be fair and transparent with regard to voluntarily disclosing corporate governance. In addition, the research results show that financial performance ratios do not affect voluntary corporate governance disclosure, thus highlighting that a predisposition to disclose corporate governance more openly is not based on the size of a company's financial performance, but on the existence of moral awareness within the company to be fair to stakeholders and to understand the impact of the company's operational activities.

The number of directors in the management structure also determines the size of voluntary corporate governance disclosures. In this sense, the greater the number of directors in the management ranks, the bigger the impetus to publicize all the company's operational activities to the stakeholders. A large number of directors will provide more stress on the importance of being more open and transparent to the public, particularly in relation to systems of corporate governance already in place.

The quality of the auditor and the degree of institutional ownership do not have a major impact on voluntary corporate governance disclosure. Auditors should always provide positive inputs in relation to the sustainability of a company's operations. In addition, auditors should always direct managers to be transparent

in their reports for the benefit of all parties. Thus, audit quality does not have a significant impact on voluntary corporate governance disclosure. Those making up a company's institutional ownership, whether large or small, are always eager to obtain clear information on the activities of company managers. In this regard, institutional owners will always expect corporate managers to disclose corporate governance voluntarily

Because of the number of banking companies that did not provide the data needed for the research, this study has limitations in relation to the number of samples used. With this in mind, future research should use all companies that voluntarily disclose components of corporate governance and adopt Islamic values in their company rules.

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