Islamic Social Reporting (ISR), Sharia Supervisory Board (SSB), And Financial Performance: Empirical Evidence On Islamic Banks In The GCC Region

Rizkiana Iskandar[1*], Lilis Marlina[2] , Dian Urna Fasihat[3]

[1]Accounting Departement, Sekolah Tinggi Ilmu Ekonomi Yapis, Indonesia
[2,3] Management Departement, Sekolah Tinggi Ilmu Ekonomi Yapis, Indonesia
[*]Corresponding Author:
Email: rizkiana.iskandar@gmail.com

Abstract.

This study aims to determine the relationship between the disclosure of Islamic social reporting (ISR), the Sharia Supervisory Board (SSB), and the financial performance of Islamic banks in the Gulf Cooperation Council (GCC) region. The Islamic banks that were the sample of the study totaled 25 banks spread across Bahrain, Kuwait, Qatar, Saudi Arabia and the United Arab Emirates with a sample period starting from 2013 to 2017. This research uses multiple regression testing and is complemented by content analysis. The results of content analysis show that the average level of ISR disclosure in Islamic banks in the GCC area is 56.53%. That is, the issues of social responsibility have not become a major concern for most Islamic banks. Furthermore, based on the test results, the ISR disclosure level proved to have a positive effect on financial performance. In addition, the existence of SSB in Islamic banks is also proven to have a positive association with financial performance which is proxied by return on average assets. These findings indicate that there are special things in Islamic banking such as disclosure of ISR and SSB that can have a good impact on the financial performance of Islamic banks.

Keywords: *Islamic social reporting, financial performance, Sharia supervisory board, Islamic banks and Gulf Cooperation Council.*

I. INTRODUCTION

The concept of corporate social responsibility (CSR) has been a widely discussed topic and has garnered significant attention in recent decades [1]. CSR has emerged as a prominent subject of research in various countries, including those in Asia [2]; Suteja et al., (2016); [3]; and [4]. Research on CRS is important because of its implementation in companies. In addition to providing welfare for shareholders, the company is also obliged to contribute to society as a whole. Companies can implement CSR as a significant and real step in contributing to society. CSR is an increasingly important issue in the banking industry, not only in the conventional economy but also in the Islamic economy which can raise public awareness for sharia-based institutions. The Islamic banking sector is a growing global financing segment. There are more than 400 Islamic financial institutions in 75 countries with assets of more than USD $1.56 trillion at the end of 2020 (Laporan Stabilitas Industri Jasa Keuangan Islam, 2021) Related to the need to disclose the social responsibility of Islamic banks, the Accounting and Auditing Organizations for Islamic Financial Institutions (AAOIFI) issued items for CSR reporting, which are referred to as the Islamic social reporting (ISR) index. In social reporting, ISR plays an important role especially to provide full disclosure in the Islamic context and can be useful for Muslim decision makers [5]. ISR also functions as a mechanism to increase the transparency of business activities. Disclosure of social responsibility is more on the agenda of business organizations, because of its ability to increase the competitiveness of companies. In this perspective, previous research stated that corporate social responsibility provides a competitive advantage, which ultimately increases the financial strength of a business (Margolis, Elfenbein, and Walsh, 2009, dalam Suteja et al., (2016).

Based on stakeholder theory, social responsibility can improve financial performance [6]. In this scenario, stakeholders may possess a strong understanding of the significance of social reporting and actively request the provision of relevant information. Similarly, Muslim stakeholders may be well-informed about the concept of corporate social responsibility in relation to the status of "haram" (forbidden) or "halal" (permissible), and consequently, they may exert pressure on companies to disclose additional details [5].

Islamic bank customers can respond to positive social performance by increasing their demand for banking products or services. In addition, some investors, especially certain institutions, are more willing to invest in companies with adequate disclosure of social performance (Barnett dan Salomon, 2006; Graves dan Waddock, 1994; Johnson dan Greening, 1999 dalam [7]. Meanwhile, according to Sun et al., (2010), one of the objectives of disclosing social responsibility is to attract investors to invest in the company. At the same time, stakeholders require assurance regarding the products and operational practices within the realm of Islamic banking. Islamic banks must operate in adherence to both banking regulations and Sharia principles.Hence, to ensure compliance in Islamic banking operations, the Sharia Supervisory Board (SSB) plays a crucial role by offering its services to Islamic banks [9]. SSB as an independent party that the role of SSB involves providing fatwa, conducting Sharia audits, calculating zakat, and distribution of non-sharia income and guiding the bank in its wider social role [10].

Furthermore, the presence of the SSB can serve as an additional advantage for Islamic banks, as it fosters heightened customer confidence in their banking operations [11].The results of research by Nomran et al., (2020) and Neifar et al., (2020) which reveal that SSB has an effect on the financial performance of Islamic banks is supported by the findings of Alam et al., (2021) in Bangladeshi Islamic banking where SSB can affect financial performance. This is because SSB carries out and functions in monitoring and reviewing banking activities as a whole. In addition, research on the relationship between the existence of SSB and its association with improving financial performance was carried out by [15] and [16] who also stated that the more SSB in Islamic banking, the better the financial performance of Islamic banks. This research will focus on Muslim countries that are members of the Gulf Cooperation Council (GCC) because Islamic bank assets are concentrated in the region. In addition, the countries share a similar socio-economic structure which allows researchers to control for macro and cultural effects and make comparisons and interpretations more meaningful [17]. The selection of cross-country samples is expected to make the research results relatively stronger and more generalizable [4] and [18]. This research is interesting because ISR is considered an important form of management accountability and the existence of SSB is a differentiator between Islamic and conventional banks so that it can convince stakeholders, especially Muslim stakeholders. Based on these various explanations, this study aims to examine the effect of ISR disclosure, the existence of SSB, and the financial performance of Islamic banks in the GCC area.

II. LITERATURE REVIEW

Disclosure of ISR and Financial Performance

Ethical social responsibility will lead to higher corporate performance if it reduces long-term exposure to risk. ISR activity can be positively associated with financial performance as it contributes to company reputation and innovation which enhances long-term corporate value [19]. In this instance, financial performance demonstrates its significance in bolstering the range of offerings provided by Islamic banks to investors. By means of the information conveyed in the ISR report, stakeholders, including customers, will develop increased confidence in the dedication of Islamic banks to upholding Islamic principles in their operational endeavors.Research on the relationship between social responsibility in general and financial performance has been researched by many literatures. Research by Suteja et al., (2016) show that better social responsibility in annual reports can improve financial performance at banks in Indonesia. Banks can increase profitability by implementing various policies related to social responsibility in human resources and community activities. The results of this study are supported by [2] who investigated the relationship between social responsibility and the financial performance of commercial banks listed on the Bombay Stock Exchange (BSE) for the period 2007 to 2016. In this case social responsibility reduces company costs, by creating value for stakeholders, and creating internal capabilities, such as being a first mover in an industry that contributes to a company's competitive advantage.

Bagh et al., (2017) research which aims to explain the impact of social responsibility on the financial performance of Pakistan's banking sector, using a sample of 30 commercial banks listed on the Pakistan Stock Exchange for the period 2006 to 2015. Empirical results show a positive and significant impact of social responsibility disclosure on the three the proxy for financial performance is ROA. Based on these results, the phenomenon of social responsibility is considered as an important growth element and a means of strengthening financial performance by the banking industry in Pakistan. Furthermore, from an Islamic perspective, Arshad et al., (2012) have examined the disclosure of Islamic corporate social responsibility (ICSR) of Islamic banks in Malaysia. As a result, there is an effect of ICSR on the level of bank performance as measured by ROA. However, so far empirical evidence regarding Islamic social responsibility through the ISR index and its effect on the financial performance of Islamic banks is still very limited. Based on the explanation and limitations of research results regarding the effect of ISR on financial performance, these arguments lead to the following hypothesis:

Hypothesis 1: Disclosure of Islamic Social Reporting (ISR) positively affects financial performance.

Shariah Supervisory Board (SSB) dan Kinerja Keuangan

One of the main characteristics that distinguishes Islamic banks from conventional banks is the presence of SSB in their structure [16]. This SSB meeting will discuss opinions on all operational activities, products, and distribution of funds, including supervision of the distribution of zakat, infaq, alms, and waqf funds which are commonly used as a form of corporate ISR [21]. If the SSB holds more meetings, SSB coordination can be further improved and sharia-based supervision can be more effective. SSB can also provide regular input to management regarding the distribution of ISR funds or input on ISR disclosures to increase transparency [11]. The formation of SSB is an effort by the government so that Islamic banks can gain trust and convince the public in their function to apply sharia principles consistently. The purpose of establishing SSB is to monitor and control religiosity, behavior, morals and ethical aspects of company management such as products, services and transactions [15].

A competent SSB can optimize the intellectual value in the company, because intellectual capital is a variety of resources owned by the company's employees with expertise, experience and knowledge so that it will have an impact on financial performance. SSB which monitors every activity carried out by employees will be able to increase the sense of responsibility towards each employee because they have to prove good performance. Besides that, the existence of SSB in a bank will be able to maintain asset security, record keeping is accurate according to regulations, and the company's operational activities can be effective. The large size of SSB can affect the financial performance of Islamic banks, because more and more members of the SSB consist of intellectuals with experience and qualified skills as well as knowledge of Islamic law and fiqh will have an impact on the interpretation of products and operations of Islamic banks which will be better so that in the end the performance of Islamic banks will also increase. Research by Hassan et al., (2017) states that the more intensive the meetings and meetings held by the SSB, the better the coordination of the SSB and the supervision carried out according to sharia principles is more effective, and the SSB will more often provide contributions or input to management. Khotimah (2019), Ajili & Bouri (2018), Fitriana et al., (2019), and Pratama et al., (2021) also stated that the large number of SSBs in Islamic banking, the financial performance of Islamic banks can be better. Based on this explanation and the limitations of research results regarding the effect of SSB on financial performance, these arguments lead to the following hypothesis:

Hypothesis 2: The Sharia Supervisory Board (SSB) positively influences financial performance.

III. RESEARCH FRAMEWORK

The conceptual framework employed in this study is outlined as follows:

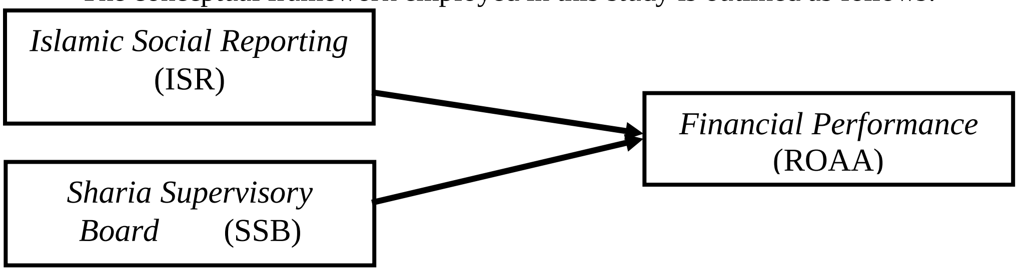

Fig 1. Research Framework

IV. METHODS

Data and Data Sources

This type of research is quantitative research using secondary data derived from annual financial reports published by Islamic banking through websites for the 2017-2021 period. There are several reasons researchers use annual reports as the main source of information, namely annual financial reports have been used by stakeholders as the main source of information for decision making. Furthermore, the annual financial report is the internal document that is most widely recognized and used by researchers because it includes information that has a high level of credibility, and is the only document that regularly provides information required by regulators [27] In addition, annual financial reports are more accessible to achieve one's research goals (Haniffa & Cooke, 2005).

Population and Sample

The population in this study consists of Islamic banks operating in the Gulf Cooperation Council (GCC) countries, namely Bahrain, Kuwait, Qatar, Saudi Arabia, the United Arab Emirates and Oman because the largest proportion of Islamic banking assets is concentrated in these countries. namely 37.6 percent of total global Islamic finance assets (Mi'raj Islamic News Agency, 2018). The selection of samples in the GCC region was carried out because the results of research from cross-country data were relatively stronger [4]. In addition, research with specific samples for one industry or one particular country is less generalizable. Furthermore, according to Haniffa & Hudaib (2007) the countries in the GCC region have a similar socio-economic structure, which allows researchers to control for macro and cultural effects and make comparisons and interpretations more meaningful.

Variable Operationalization

a. Variable Islamic Social Reporting (IS)

The ISR variable is measured by the Islamic Social Reporting Index (ISR index). Measurement using the ISR index is carried out by placing a checklist on each item that reveals social activity in the annual financial reports of Islamic banks. If there is one item disclosed, it will be given a score of "1", and if not, it will be given a score of "0". Furthermore, the value obtained by each Islamic bank is added up to find out the total value of the ISR index. Calculation of the ISR index can use the following formula:

$$\text{Index ISR} = \frac{\text{Total ISR score of Islamic banks}}{\text{Maximum ISR score}}$$

b. Variable Shariah Supervisory Board

Shariah Supervisory Board (SSB), the more members of the SSB will provide more effective and more consistent monitoring so that all transactions and products offered by Islamic banks comply with sharia rules and principles. Therefore, the existence of SSB will encourage Islamic bank management to disclose greater ISR information [22]. Measurement of the SSB variable uses the number of SSB in banking.

c. Financial Performance Variables

The variable of Islamic bank financial performance is measured by return on average assets (ROAA). ROAA is an indicator of a bank's financial performance and managerial efficiency because it describes how competent management is in generating profits from assets and how efficient it is in managing assets to generate profits. This ratio has been used in various financial literature as a fundamental bank financial performance ratio (Dietrich and Wanzenried 2011: 311 in Platonova et al., 2018). ROAA calculation can be formulated as follows:

$$\text{ROAA} = \frac{\textit{Earning Before Tax}}{\textit{Average Asset}}.$$

V. RESULT AND DISCUSSION

Descriptive Test

The classic assumption test includes the normality test, heteroscedasticity test, and multicollinearity test. A summary of the results of the data normality test is contained in Table 1. The Kolmogorov-Smirnov test results yielded that the data from the regression model of this study were normally distributed because of a significance value of 0.409 > 0.05.

Table 1. Data Normality Test Results

	Unstandardized Residual **Regression Models**	**Conclusion**
N	150	
Kolmogorov-Smirnov Z	0,598	Distribusi Normal
Asymp. Sig. (2-tailed)	0,867	

Source: Processed data, 2023

Based on the results of the heteroscedasticity test, it shows that the significance value of all independent variables in this study is now above 0.05, which means that the regression model fulfills the assumption of heteroscedasticity, or the regression model does not have homogeneous data variations. Table 2 below shows a summary of the results of the heteroscedasticity test.

Table 2. Heteroscedasticity Test Results

Model	**t**	***Sig.***	**Conclusion**
(Constant)	1,555	0,122	
Islamic Social Responsibility	0,321	0,748	Passed the Heteroscedasticity test
Shariah Supervisory Board	0,551	0,583	

Source: Primary data processed, 2021

Furthermore, the multicollinearity test in Table 3 shows that the VIF value of each independent variable is < 10 and the tolerance value is > 0.10. Therefore, it can be ascertained that there is no multicollinearity problem between the independent variables in this study.

Table 3. Multicollinearity Test Results

Variable	***Collinearity Statistics***		**Conclusion**
	Tolerance	**VIF**	
Islamic Social Responsibility	0,999	1,001	There is no presence of multicollinearity among the variables used in the study.
Shariah Supervisory Board	0,999	1,001	

Source: Primary data processed, 2021

Hypothesis test

The regression model is used to determine the effect of independent variables, namely: human resource competence, time budget pressure, facilities and infrastructure, internal control systems and audit quality probity on fraud detection variables. The research results are summarized in Table 4.

Table 4. Regression Model Testing Results

Model	***Unstandardized Coefficients***		**T**	***Sig.***	**Conclusion**
	B	***Std. Error***			
(*Constant*)	-0,712	2,902	-0,245	0,807	
Islamic Social Responsibility	0,098	0,042	2,352	0,020	supported
Shariah Supervisory Board	0,526	0,201	2,613	0,010	supported
Dependent Variable:	Financial Performance				
N	150				
R Squared	0,447				
Adjusted R Squared	0,401				
F Statistic	6,357				
Prob. (F-Statistic)	0,002[b]				

Source: Primary data processed, 2021

Based on the results of the regression model test which are summarized presented in Table 7, the coefficient of determination R2 is 0.401. This means that 40.1% of the ability of banking financial performance can be explained by several independent variables in this study, namely Islamic social responsibility and shariah supervisory boards. While the probability (F statistic) shows a value of 0.002 (test statistic <0.05). Therefore, all independent variables are said to influence the dependent variable or at least there is one independent variable that has a significant influence on the dependent variable. Furthermore, hypothesis 1 (H1) is declared supported because it is significant at 0.020 less than the value (0.05), which means that Islamic social responsibility influences banking financial performance. Hypothesis 2 shows a significance value of 0.010 <0.05, which means that it has the influence of the shariah supervisory board variable on banking financial performance.

A. ISR and Financial Performance

Based on the output results show that Islamic social reporting (ISR) has an effect on financial performance. Islamic social reporting is the concept of corporate social responsibility with dimensions of Islamic economics, Islamic ethics and Islamic philanthropy based on Islamic values found in the Al-Qur'an and Al-Hadith. The ISR index reveals matters relating to zakat, waqaf, infaq, qaardlul hasan, sharia compliance status and status that is free from elements of usury and gharar. [31]. The purpose of corporate reporting is for businesses to comply with Islamic sharia principles. This argument forms the basis of accounting practices for all financial institutions in general and Islamic banks in particulara [32]. Islamic Social Reporting is also important for the reputation and performance of Islamic financial institutions, because by disclosing the ISR, Islamic financial institutions that can disclose their ISR very well will be seen as institutions that can be trusted by the Muslim community in channeling their funds [33].

The relationship between ISR and financial performance is in line with stakeholder theory. The theory suggests that when a company has various stakeholder expectations, the company will be better able to create extraordinary company performance (Freeman, 1984). As for Muslim stakeholders, they may be aware of the social responsibility of Islamic banks in terms of haram or halal status, thus demanding companies to disclose further information [20]. Information disclosed by Islamic banks in ISR reporting will facilitate ethical Islamic decision-making for stakeholders [20]. In addition, disclosure of social responsibility using Islamic Social Reporting in Islamic commercial banks in the Gulf Cooperation Council (GCC) region can be used as steps to improve the company's financial performance. The financial performance of a bank is a true picture of the bank's financial condition in a certain period, both covering aspects of channeling funds and raising funds. Loyalty and trust of fund owners to the bank is a factor that is very helpful and makes it easier for bank management to formulate a good business strategy [34]. On the other hand, the conventional financial reporting model is based on aiding for economic decision making. Currently the desire to know the disclosure of corporate social reporting is getting higher. The company is expected not only to prioritize the interests of management and the company but also the interests of society. The company has a social responsibility towards parties outside the company who have an interest in the company [35].

According to a study conducted by Adisaputra & Kurnia (2021), their research confirms that there is a relationship between Islamic Social Reporting (ISR) and the financial performance of Islamic Commercial Banks (BUS) in Indonesia. Increasing the disclosure of corporate social responsibility will have an impact on improving financial performance. In other words, the social responsibility disclosure factor, which is the duty of the company to create economic sustainability, is a consideration for the community in choosing and conducting financial traffic at certain banks, considering that the function of a bank is as an intermediary institution that requires banks to obtain legitimacy from the public. This means that the ability of a bank to generate profits is also influenced by the social activities carried out by Islamic banks, the implementation of corporate social responsibility will shape the company's image. The results of this study support the research of Maqbool & Zamir (2019), Okafor et al., (2021), Javed et al., (2020) and Maqbool & Zamir (2021) who found a positive effect of social responsibility disclosure on financial performance. In this case, banks can increase profitability by implementing various policies related to the disclosure of social responsibility in human resources and community activities. In addition, meeting the needs of various stakeholder groups will result in increased financial performance on the grounds of greater effectiveness and efficiency.

B. Shariah Supervisory Board (SSB) and Financial Performance

The results of this study indicate that the shariah supervisory board (SSB) has an effect on financial performance. SSB can be interpreted as a strategic body in Islamic banking because SSB is the one who supervises and ensures that all financial transaction records are in accordance with applicable standards. [15]. Not only that, SSB's role involves providing certification of newly developed financial products, ensuring that products comply with Sharia law, calculating zakat, and acting as the backbone of Islamic banking. [10]. The ultimate goal of SSB is to maintain the credibility of Islamic finance and increase stakeholder confidence in the products and activities offered by Islamic banks [9]. Therefore, SSB must have high knowledge, experience, and education, so as to enhance SSB's ability to carry out in-depth analysis. [16]. In addition, SSB in carrying out supervision must act professionally in order to provide effective decisions and be able to choose and determine a rule that is in accordance with sharia principles or not.

The educational qualification of SSB members is an important factor because it can be the quality of SSB members in producing good performance. SSB with a larger number can affect the financial performance of Islamic banks. This is because members of the SSB who consist of undergraduates and higher levels accompanied by knowledge will have a lot of experience and skills regarding Islamic law and fiqh. SSB members certainly play an important and strategic role in providing a lot of input and suggestions for Islamic banking, including being responsible for ensuring that all products and procedures comply with sharia principles (Ilyas, 2021). In the end, the interpretation of products and operations of Islamic banks will be better so that the impact on the performance of Islamic banks will also increase [16].

The results of this study are in line with Nomran et al., (2020), Neifar et al., (2020) which revealed that the shariah supervisory board has an effect on the financial performance of sharia banks. This is because the SSB carries out and functions in monitoring and reviewing banking activities as a whole including reviewing products, services, contracts, preparing guidelines for sharia banking governance, and ensuring principles and compliance with regulations in their records. This can also be an added value for these Islamic banks because with the SBB, customer confidence in banking activities will increase [41]. Therefore, customers will entrust their funds to be managed by Islamic banking which has an impact on improving financial performance.

VI. CONCLUSION

This study aims to examine the relationship between Islamic social reporting (ISR) and Sharia Supervisory Board (SSB) disclosures with financial performance in Islamic banks in the Gulf Co-Operation Council (GCC) region. The data analysis conducted shows that the average level of ISR disclosure in Islamic banks in the GCC region ranges from 50.58% to 62.40%. In this case the issues of corporate social responsibility are not a major concern for most Islamic banks. The results of the study show that the level of ISR disclosure is positively related to the financial performance of Islamic banks. In line with stakeholder theory, Muslim stakeholders may be aware of the disclosure of Islamic bank social responsibility in the ISR as a form of Islamic bank commitment to Islamic principles in its operational activities. Furthermore, the existence of the Sharia Supervisory Board (SSB) also positively influences financial performance.

The size of the SSB is indicated by the number of SSB members who have sufficient skills and experience which will have an impact on better interpretation of Islamic bank products and operations so that in the end the performance of Islamic banks will also increase.This research has several limitations. First, this research only focuses on Islamic banks in the GCC area as areas that have implemented AAOIFI standards both mandatory and voluntary. Meanwhile, no research has been conducted in the Southeast Asian region, especially Indonesia and Malaysia, which have a fairly rapid level of development of Islamic banks, but the implementation of AAOIFI standards has only been used as the basis of guidelines. Based on this, further research needs to explore more broadly by taking samples of Islamic banks in Southeast Asia. Furthermore, the financial performance in this study only focuses on internal performance using the return on average asset (ROAA) proxy. Future research can test financial performance using market performance measurements so that research results can be more valid.

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