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Research Paper

The Effect of Sharia Supervisory Board on Financial Performance, with Islamic Social Reporting as the Intervening Variable.

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ABSTRACT: *This study aims to examine and analyze the role of Islamic social reporting in mediating the relationship of sharia supervisory boards with financial performance. Islamic social reporting index is used as variables in this study because index can have an impact on improving the relationship of sharia supervisory boards with financial performance.*

The object of research in this study is Islamic Banks registered at Bank Indonesia and Otoritas Jasa Keuangan. The number of samples used in this study was 70, which were selected based on the purposive sampling method. This study uses the method of documentation and literature. Data will be analyzed using Path Analysis.

The results of the study show that (1) the sharia supervisory board has an influence on Islamic social reporting; (2) the sharia supervisory board does not affect financial performance; (3) Islamic social reporting has an effect on financial performance; and (4) the sharia supervisory board influences financial performance through the Islamic social reporting index.

KEYWORDS: *Sharia supervisory board, islamic social reporting, financial performance.*

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I. INTRODUCTION

Indonesian society consists of a majority of the population are Muslim. The majority of these residents certainly expect the existence of Islamic banks that can represent Islamic values. So that in 1988, Islamic banks and conventional commercial banks were born which opened sharia business units. The presence of Islamic banks in the midst of conventional banking that offers a sharia banking system for Muslim communities. A competition also arises between conventional banks and Islamic banks, as well as between Islamic banks. This banks must improve the performance of banks to be able to compete with other banks.

The bank's performance that is most often measured in various studies is financial performance. The bank's financial performance is an illustration of the bank's financial condition in a certain period, both covering aspects of fund collection and fund disbursement. Performance appraisal is important to attract customers and investors. Proxy of financial performance can be seen from its profitability. Profitability is the ability of a company to earn profits for a certain period. Profitability is important for banks to get investors to invest and increase public confidence in choosing these banks as a place to save savings.

The ratio of profitability or return on assets (ROA) of Islamic banks is only 1.23% as of March 2018. This is lower than the conventional bank ROA ratio of 2.55%. In fact, the ability of Islamic banks to make profits is fairly good. It can be seen from the growth of Islamic bank net profit of 15.29% to Rp 626 billion in the first quarter of 2018. Low profitability of Islamic banks is caused by several factors. One of them is the role of the sharia supervisory board. The sharia supervisory board is one of the corporate governance components applied in sharia banks and sharia-based companies. The Sharia Supervisory Board (DPS) consists of sharia experts who oversee the activities and operations of financial institutions to ensure compliance with sharia principles. Sharia councils carry out large duties and responsibilities and function as a stakeholder. they are protectors of the rights of investors and entrepreneurs who put confidence and trust in financial institutions. Norman (2018) found a positive relationship between the size of the sharia supervisory board on bank performance. The number of members of a large sharia supervisory board will provide better power in monitoring the performance of the company. Other variables that will also be tested in this study are Islamic social reporting variables. The Islamic social reporting (ISR) was first conceived by Ross Haniffa in 2002 and further developed more extensively by Rohana Othman, Azlan Md Thani, and Erlane K Ghani in 2009 in Malaysia and currently, Islamic social reporting is still being developed by next researcher.

The Islamic social reporting index is a benchmark for the implementation of sharia banking social performance which contains a compilation of CSR standard items set by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) which are further developed by researchers regarding CSR items that should be disclosed by an Islamic entity (Putri, 2014). ISR disclosure is also believed to be able to improve the company's financial performance, where investors tend to invest in companies that carry out ISR activities.

II. THEORETICAL CONCEPT

Resource Dependency Theory

This theory was put forward by Pfeffer and Salancik who focused mainly on the symbiotic relationship between the organization and its environmental resources. Preffer and Salancik (1978) mention there are three main factors that determine dependence on the provision of these resources. First, the importance of the resources around where these resources are needed in the operation and continuity of their business. Second, there are an interest groups that have policies on the allocation and use of resources. Then, the final reason is that there is an influence on resources by interested groups. Musibah and Sulaiman, 2014 assert that resource dependency theory is an influential theory with a crucial role played by corporate leaders in providing or maintaining essential resources to companies through their influence with the corporate environment.

Signalling Theory

Akerlof's article entitled "The Market of Lemons" in 1970 became the beginning of the development of Signaling Theory. Akerlof (1970) introduced information asymmetry that occurred in the sale of used cars. The car is likened to a lemon, which has an attractive appearance on the outside but a taste between sour and sweet. Akerlof (1970) found that when buyers do not have information regarding product specifications and only have a general perception of the product, the buyer will assess all products at the same price, both high-quality and low-quality products, thus harming the seller of high-quality products. Spence (1973) provides an illustration of the labor market (job market) and suggests that companies that have good performance (superior performance) use financial information to send signals to the market. From his research, Spence (1973) also found that the cost of a signal on bad news is higher than good news and companies that have bad news send signals that are not credible. This motivates managers to disclose private information to reduce information asymmetry in hopes of sending good news about the company's performance to the market.

Shariah Supervisory Board

The Sharia Supervisory Board is appointed and dismissed at the Islamic Financial Institution through the RUPS after obtaining a recommendation from the DSN. Undang-Undng No.10 of 1998 concerning Amendment to Undang-Undang No. 7 of 1992 concerning Banking states that in an Islamic banking must be formed a sharia supervisory board. Purwanti (2016) states that the greater the number of councils, the better the mechanism for monitoring corporate management. Thus, the greater the number of members of the Sharia Supervisory Board it will increase supervision of bank management in accordance with sharia principles, so there is no use of funds that are not sharia-compliant which can reduce profitability. Thus, bank profitability will increase.

Islamic Social Reporting

Haniffa (2002) argues that reporting on corporate social responsibility in conventional systems only focuses on material and moral aspects. Haniffa added that spiritual aspects should also be used as the main focus in corporate social responsibility reporting because muslim decision makers have expectations that companies disclose certain information voluntarily to help fulfill their spiritual needs. For this reason, he considers that there needs to be a special framework for reporting social responsibility in accordance with Islamic principles. The framework is not only useful for Muslim decision makers, but also useful for helping Islamic companies in fulfilling obligations towards Allah SWT and society. This framework is known as the Islamic Social Reporting (ISR).

III. RESEARCH METHOD

This research is explanatory research, namely obtaining an explanation of the index of disclosure of Islamic Social Reporting on Islamic banks in Indonesia registered in the Financial Services Authority and Bank

Indonesia and trying to find a verification answer that explains the causality relationship between the Sharia Supervisory Board variables on Financial Performance through disclosure islamic social reporting.

The population in this study is Islamic banks that were registered in the Financial Services Authority and Bank Indonesia from 2011 to 2017. The number of Islamic banks sampled in this study are 10 banks which are selected by purposive sampling method. The method of data collection in this study is documentation and literature by collecting written materials related to research problems and proceed with recording and calculating data regarding the sharia supervisory board, Islamic social reporting, and financial performance. This research uses a path analysis

IV. RESULTS AND DISCUSSIONS

T There are three stages in the research. First do the regression with Y_1 equation, second do multiple regression with Y_2 equation as intervening variable, and third determine path analysis.

Regression Analysis Y_1 equation.

Variable	Coefficient	t	Sig.	Result
(Constant)	0,256			
Sharia Supervisory Board	0,103	3,659	0,000	Significant

α = 5% = 0,05
R square = 0,326

Based on the results of the regression test above, mathematical equations can be arranged as follows.

$$Y_1 = 0{,}256 + 0{,}103\ X1 \ldots\ldots. (1)$$

Based on the equation, it can be seen that the coefficient for independent variables was positive. This indicates that the influence of independent variables, namely sharia supervisory board have a significant influence on islamic social reporting. This can be seen from the probability value of sharia supervisory board variable of 0.000 which is smaller than 0.05. The determination coefficient value of R square on the test results shows a value of 0.326 or 32,6%, this indicates that the sharia supervisory board can affect the islamic social reporting. While the remaining 67,4% is influenced by other variables outside the independent variables examined in this study.

Regression Analysis After Y_2 as Intervening Variable

Variable	Coefficient	t	Sig.	Result
(Constant)	-1,773			
X1	0,024	0,207	0,837	Not-Significant
Y1	0,439	3,001	0,004	Significant

α = 5% = 0,05
R square = 0,757

Based on the results of the regression test above, mathematical equations can be arranged as follows:

$$Y_2 = -1{,}773 + 0{,}024\ X1 + 0{,}439\ Y1 \ldots\ldots.(2)$$

The determination coefficient value of R square on the test results shows a value of 0,757 or 75,7%. This indicates that sharia supervisory board and islamic social reporting can affect the financial performance. From table it is also known that x1 (sharia supervisory board) has a probability value of 0.837 which is above the significant standard value of 0.05. So, sharia supervisory board has not significant influence on financial performance. While the islamic social reporting have a significant effect on financial performance. We can see tabel which shows probability value of 0.004. It means 0,004 is smaller than value of 0.05.

We can see the success of intervening variables by calculating a sobel test. The calculation of the sobel test, it was obtained that the calculated value of 2.278 is greater than the table value of 1.669. It means that shariah supervisory board had an significant effect on financial performance through Islamic social reporting. This is the sobel test for islamic social reporting:

$$Sp2p3 = \sqrt{p3^2 Sp2^2 + p2^2 Sp3^2 + Sp2^2 Sp3^2}$$

$$= \sqrt{0{,}439^2 \ x\ 0{,}028^2 + 0{,}103^2 \ x\ 0{,}146^2 + 0{,}028^2 \ x\ 0{,}146^2}$$

$$= \sqrt{0{,}192721 \ x\ 0{,}000784 + 0{,}010609 \ x\ 0{,}021316 + 0{,}000784 \ x\ 0{,}021316}$$

$$= \sqrt{0{,}000151093 + 0{,}000226141 + 0{,}000016711}$$

$= \sqrt{0{,}000393946}$

$= 0{,}019848084$

$$T_{count} = \frac{p2 \; x \; p3}{Sp2p3}$$

$$= \frac{0{,}103 \; X \; 0{,}439}{0{,}019848}$$

$= 2{,}278$

V. CONCLUSIONS

Based on the results of testing the hypothesis and the discussion of the effect of sharia supervisory board on financial performance, with islamic social reporting as the intervening varaiable, the following conclusions can be drawn: that (1) sharia supervisory board has an influence on Islamic social reporting; (2) sharia supervisory board does not affect financial performance; (3) Islamic social reporting has an effect on financial performance; and (4) the sharia supervisory board influences financial performance through the Islamic social reporting index. This is also in line with resource dependency theory which explains that the crucial role of a company leader in providing or maintaining essential resources into the company. the sharia supervisory board as one of the leaders of the company must issue all its potential to enable the company to maintain the existence of the company.

The second hypothesis which states the results are not significant. This is in accordance with Asrori (2014) and Septiputri (2013) research. The thing that can cause this hypothesis is rejected by power or trust of the company towards the sharia supervisory board, so that the relationship between the sharia supervisory board and outside parties is less established. This causes the supervision of the management of banks based on sharia principles to be less effective. In other words, the role of sharia supervisory board in banks is less effective in increasing bank profitability. (Septiputri, 2013) The third and fourth hypotheses show a significant effect. This is in line with signal theory. The Signal theory which states companies must be able to provide signals to users of financial statements, so as not occur information asymmetry. Islamic social reporting conducted by the company is a signal given to users of financial statements. If this Islamic social reporting has a good signal, financial performance will increase. Because the report users gave a positive response to the existence of this information. One form of positive response that can improve financial performance, is the interest of prospective customers to invest their funds in the Islamic bank.

Based on the research conclusions, further research suggestions should be carried out to provide more comprehensive results as follows: (1) the expansion of the year of observation can be done so that the results of the study are stronger to explain the relationship of the influence and accuracy of the results of the study; (2) using other variables that might be the factors that influence the company's financial performance; (3) using other proxies in measuring sharia supervisory boards and sharia securities. For example, by using the frequency of sharia supervisory board meetings and compliance with the sharia supervisory board; and (4) for a company, it is better to increase the number of members of the sharia supervisory board, so that supervision of sharia activities in the bank is more optimal. The company must also give power or trust to the sharia supervisory board so that the sharia supervisory board is more confident in carrying out its duties.

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