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Effect on The Performance of Ethics Disclosure of Identity in Islamic Bank Indonesia

(Study in Islamic Banking Companies Listed in Bank Indonesia, 2008-2018)

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Abstract

strive for innovative Islamic banking in offering products and building a good reputation in following the development of the Islamic financial industry to trigger an increasingly competitive level of competition. Building a good reputation is largely determined by the identity of the company itself. Islamic banking has a higher moral responsibility than conventional banking or other public companies because there are social values and justice that must be met. study This was conducted to reveal that ethical identity significantly influences the financial performance of Islamic banking companies which have restrictions on Islamic commercial banks in Indonesia. This research will be conducted using secondary data in the form of annual reports issued from Islamic banks in Indonesia from 2008-2018 through the websites of each Islamic bank. The population of this study is Sharia banks that are listed on the Indonesia Stock Exchange or listed at Bank Indonesia. The update of this study is that this research will replace the measurement variable profitability from ROA to NPM and change the year from 2008-2018 compared to the previous study, using only the period 2010-2013.

Keywords: *Disclosure of Islamic Ethical Identity, NPM, BOPO, FDR.*

1. Introduction

Islamic banking strives to be innovative in offering products and building a good reputation in following the development of the Islamic financial industry so that it triggers an increasingly competitive level of competition. Building a good reputation is largely determined by the identity of the company itself. Islamic banking has a higher moral responsibility than conventional banking or other public companies because there are social values and justice that must be fulfilled (Fauziyah and Siswantoro, 2016). Lince and Ruslim's research (2018) states, in the Islamic view, the presentation of information in both the financial statements and the annual report should not be an element of concealment of existing information. So that information is not known by one of the users of the report. Unclear happens when someone changes something that should be reported to be unreported. In terms of the information disclosed in the annual

report of Islamic banking, it is certainly different from conventional banking. This is because Islamic banking has a higher moral responsibility than conventional banking.

Research conducted by Haniffa and Hudaib (2007) conducted a ranking test by measuring and comparing the level of the *Ethical Identity Index* (EII) on Islamic banks in the Arabian Gulf region. The results show different ratings and values for each Islamic bank in the Arabian Gulf region. Berrone *et al.*, (2007) in their research showed that companies that revealed EII were not enough to improve the company's financial performance. Whereas Chun *et al.* (2011) show that collective organizational commitment and *organizational citizenship behavior* (OCB) mediate the relationship between corporate ethics and corporate financial performance. Then Zaki *et al.*, (2013) examined the effect of disclosure of ethical identity on Islamic banks in Asia. The results show that only two of the eight dimensions of ethical identity affect financial performance. In a study conducted by Fauziyah and Siswantoro (2016) has the results of a correlation test between each dimension of ethical identity with financial performance has a significant relationship between the dimensions of service product disclosure and ROA, a significant relationship between the dimensions of service product disclosure and BOPO and a significant relationship between disclosure of commitments to debtors and FDR liquidity.

2. Research Issues

This research is a conceptual study that discusses the influence of ethical identity on the performance of Islamic commercial banks in Indonesia. In a previous study conducted by Fauziyah and Siswantoro (2016), the results of measurement of the Ethical Identity Index (IIE) of each sharia commercial bank as a whole based on 78 indicators in 2010-2013 almost every sharia commercial bank tended to increase in the value of IIE. The increase in IIE shows that companies are trying to improve information related to Islamic ethical identity in the annual report. During the 2010-2013 period, Bank Muamalat Indonesia consistently ranked first as the most sharia commercial bank communicating information related to Islamic ethical identity. However, Bank Syariah Mandiri was rated the same as Bank Muamalat Indonesia in the 2011 period. Meanwhile, the Islamic commercial banks that had the lowest IIE values were Bank Jabar Banten Syariah, Bank Victoria Syariah, and Bank Panin Syariah. In the period 2010-2013 Bank Victoria Syariah was the lowest. Then in 2010 Bank Panin Sharia was the lowest as Bank Victoria Syariah. During the period 2010-2013 Bank Jabar Banten Syariah as the second-lowest Sharia commercial bank which has an IIE value because it communicates the least information related to the ethical identity of Islam.

3. Literature Review

Signaling theory

Signaling theory Explains the relationship between disclosure of company information with investment decisions of parties outside the company. From the perspective of industrial or organizational psychology, *signaling theory* is not only a signal to consumers, investors or outside parties of the company but may also be a signal to current and future employees or companies (Karasek and Bryant, 2012).

In its consideration investors are expected to not only consider the company's financial information but also include ethical information in their assessment of the company. Ethical statements can be a positive signal about company resources because ethical statements are only owned by companies with sufficient resources (Waddock and Graves, 1997).

3.1. Corporate Ethics Identity

Disclosure Identity of corporate ethics is one of the information conveyed by the company, where disclosure will add information that is conveyed related to the function of each entity in providing benefits to the community and the surrounding environment. In view of the community, the Syariah bank is an institution that has a positive perception in terms of organizational culture and social disclosure (Oktaviana, 2015).

Disclosure of Islamic ethical identity guarantees *stakeholders* the suitability of operations with the ideal identity that Islamic banks must-have. the higher the value of the expression of Islamic ethical identity, the higher the level of compliance with Islamic principles. Thus generating commitment and loyalty from *stakeholders* in the company which can ultimately improve financial performance. (Muhibbai and Basri, 2017).

3.2. Ideal Islamic Ethics Identity

Act Number 21 of 2008 concerning Sharia Banking with the enactment of the Law on Sharia Banking, there are 2 (two) Laws regulating banking in Indonesia, namely Law No.7 of 1992 concerning Banking, banks that its business activities are carried out based on the Sharia Principles called "Banks Based on Profit Sharing Principles". as amended by Law No. 10 of 1998, the term used is "Banks Based on Sharia Principles". Bank operations are Islamic sharia provisions, hence such banks are called "Sharia Banks", and Law No. 21 of 2008 concerning Islamic Banking. In the definition of Sharia Principles, there are two important things, namely: (1) the principle of sharia is the principle of Islamic law, and (2) the determination of the party/institution authorized to issue a fatwa which is the basis of sharia principles. The function of Islamic banking, in addition to performing the function of collecting and channeling public funds, also performs social functions, namely: (1) in the form of Baitul Maal institutions that receive zakat, infaq, alms, grants and other funds to be distributed to zakat management organizations, and (2)) in the form of an Islamic financial institution that receives money endowments which receives money endowments and distributes them to manager (*Nazir*the designated) (Article 4).

In general, sharia banks are prohibited from conducting business activities that are contrary to sharia principles, the Sharia Banking Law also requires the establishment of Sharia Supervisory Boards in each Sharia Bank with duties such as providing advice and advice to directors and supervising bank activities to comply with sharia principles (article 32). The Sharia Supervisory Board was appointed by the General Meeting of Shareholders on the recommendation of the Indonesian Ulema Council. (Rasyid, 2015)

Based on the explanation cited from Hannifa and Hudaib (2007) there are five main features of Islamic ethical identity, including;

a. The underlying philosophy and values

Every Islamic banking or other Islamic financial services institution must be morally responsible in business conduct. Morally responsible means fulfilling a commitment to be based on philosophy and values in the Islamic economic and financial system. As explained by Omar and Haq (1996) that the philosophy and the principles underlying Islamic banking is the provision of sharia (*Islamic rule*) and operational activities based on ethics (*ethical based*) with additional social functions.

b. Provision of usury-free products and services

Islamic banking must inform stakeholders that all products and services offered do not contain usury. The information conveyed ensures that the product mechanism complies with sharia provisions and has been approved by the Sharia Supervisory Board (DPS). (Hannifa and Hudaib, 2007)

c. Transactions or agreements that are following Islamic principles

Legitimate transactions or contracts are one of the main points that are very important for Islamic banking because their activities are mostly related to financial transactions and services. Thus, in the ethics of an ideal Islamic identity, information about the transaction mechanism must be clear and include the type of contract used.

d. A focus on development and social goals

Islamic banking is expected to be more socially responsible than conventional financial institutions because Islam emphasizes social justice. The forms of contribution that can be made by Islamic banks include the management of zakat, alms, and funds *Qardh Hassan*, employee welfare, concern for debtors and public services.

e. Compliance with the Sharia Supervisory Board (DPS).

Islamic banking has a Sharia Supervisory Board (DPS) whose role is to ensure that each new formulation, product, and service is following sharia principles and is within the scope of Islamic norms. In connection with the ideal ethical identity, Islamic banking is expected to disclose information about parties on the Sharia Supervisory Board (DPS).

3.4. Ideal Islamic Ethics Identity and Financial Performance

ratio *Net Profit Margin* (NPM) shows how much percentage of net income earned from each sale. According to Harahap (2011), the greater this ratio the better because it is considered the company's ability to get profits. Haniffa and Hudaib (2007) conducted a ranking test by measuring and comparing the level of the *Ethical Identity Index* (EII) on Islamic banks in the Arabian Gulf region. The results show different ratings and values for each Islamic bank in the Arabian Gulf region. Berrone *et al*, (2007) in their research showed that companies that disclose an *ethical identity* are not enough to improve the company's financial performance. While research conducted by Fauziyah and Siswantoro (2016) The results of his study indicate that there is a significant relationship between the dimensions of service product disclosure and ROA.

Ha1: *Ethical Identity Index* (EII) has a significant influence on NPM's financial performance.

3.5. Ideal Islamic Ethics Identity and Financial Performance

BOPO (Operating Expenses Operating Income) is used to measure the bank's operational costs relative to operating income. BOPO describes the operational efficiency of a bank. The smaller the BOPO value, the

better the performance and operational efficiency will be. With almost the same implications between BOPO and *Net Profit Margin* (NPM), the relationship between ethical identity dimensions and BOPO can be assumed to have the same results as the relationship between ethical identity dimensions and NPM.

Haniffa and Hudaib (2007) conducted a ranking test by measuring and comparing the level of *the Ethical Identity Index* (EII) on Islamic banks in the Arabian Gulf region. Then Zaki *et al*, (2013) examined the effect of disclosure of ethical identity on Islamic banks in Asia. The results show that only two of the eight dimensions of ethical identity affect financial performance. Meanwhile, according to Fauziyah and Siswantoro (2016), The results showed a significant relationship between the dimensions of service product disclosure and BOPO.

Ha2: *Ethical Identity Index* (EII) has a significant influence on BOPO's financial performance.

3.6. Ideal Islamic Ethics Identity and Financial Performance

The liquidity aspect is measured through the calculation of the ratio of financing to third party funds or *Financing to Debt Ratio* (FDR). FDR is the ratio between the amount of funding provided by banks and third-party funds received by banks. The FDR states how far the bank's ability to repay withdrawals of funds by depositors by relying on financing provided as a source of liquidity. (Purwanto, 2011)

The study of Chun *et al*, (2011) shows that collective organizational commitment and *Organizational Citizenship Behavior* (OCB) mediate the relationship between corporate ethics and corporate financial performance. Then Zaki *et al*, (2013) examined the effect of disclosure of ethical identity on Islamic banks in Asia. The results show that only two of the eight dimensions of ethical identity affect financial performance. But Fauziyah and Siswantoro (2016) The results showed that a significant relationship between disclosure of commitments to debtors and FDR liquidity.

Ha3: *Ethical Identity Index* (EII) has a significant influence on FDR's financial performance.

4. Discussion

4.1. Ideal Islamic Ethical Identity and Financial Performance

ratio *Net Profit Margin* (NPM) shows what percentage of net income earned from each sale. According to Harahap (2011), the greater this ratio the better because it is considered the company's ability to get profits. According to Darsono and Ashari (2012), *Net Profit Margin* (NPM) is a description of the amount of net profit that a company gets every sale made. According to Brigham and Houston (2013), *Net Profit Margin* is measuring the size of a company's net profit compared to its sales.

Bank rentability ratio analysis is the ratio used to measure the level of business efficiency and profitability achieved by the bank concerned (Kasmir, 2013). NPM defines as follows, *Net Profit Margin* is the ratio between net income (*net profit*) ie sales after deducting all *expenses* compared with sales tax included. The higher the *Net Profit Margin* (NPM), the better the operation of a company (Syamsuddin, 2014).

4.2. Ideal Islamic Ethical Identity and Financial Performance

BOPO (Operating Expense Operating Income) is used to measure the bank's operational costs relative to its operating income. BOPO describes the operational efficiency of a bank. The smaller the BOPO value, the better the performance and operational efficiency will be. With almost the same implications between BOPO ((Operating Expenses Operating Income) with *Net Profit Margin* (NPM), then the relationship between the dimensions of ethical identity and BOPO can be assumed to have the same results as the relationship between the dimensions of ethical identity and NPM.

4.3. Ideal Islamic Ethical Identity and Financial Performance

The liquidity aspect is measured through the calculation of the ratio of financing to third party funds or *Financing to Debt Ratio* (FDR). FDR is the ratio between the amount of funding provided by banks and third-party funds received by banks. The FDR states how far the bank's ability to repay withdrawals of funds by depositors by relying on financing provided as a source of liquidity (Purwanto, 2011). Among the eight dimensions of ethical identity, only the dimensions of disclosure of information on service products and the disclosure of commitments to debtors can be assumed to be related to liquidity due to information related to products and financing.

5. Conclusion

This study aims to analyze the effect of disclosure of ethical identity on the financial performance of Islamic commercial banks using financial ratios. So that this research can contribute to proving that the disclosure of a company's ethical identity influences financial performance significantly. The results of this study are expected to find any ethical identity dimensions related to the financial performance seen from *Net Profit Margin* (NPM), Operational Income Operating Expenses (BOPO) and *Financing to Debt Ratio* (FDR). Use annual reports for the period 2008-2018. To reveal that identity ethics significantly influence the financial performance of Islamic banking companies which have research restrictions only on Islamic commercial banks in Indonesia.

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