# Sharia Companies' Islamic Social Reporting Practice and Its Determining Factors in Indonesia

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**Abstract.** In line with the massive development of Sharia principles-based companies, Sharia companies' Islamic social reporting practice, or ISR, has also been developed. This business ethic is a modification of corporate social responsibility (CSR). It is adjusted with Sharia or Islamic principles. The research, then, aims to know the extent of ISR practice and having been performed by Sharia companies and its determining factors in Indonesia. Some identified factors were the firm's size, profitability (ROA), and leverage (DAR). In detail, the research's sampling was 423 companies registered in the Indonesian Islamic Index (ISSI) for 2017 – 2019 (3 years). Then, the sample was purposively taken, using the Slovin formulation. There were 81 samples or 243 companies for 3 years of observation.The analysis method used in the research was content analysis to measure ISR practice and Structural Equation Modelling-Partial Least Square (SEM-PLS) in determining its impact. As the result, the finding shows that Sharia companies' ISR practice was medium, totally. In detail, based on its theme, a high level of ISR practice was related to environment and corporate governance. A medium level of ISR practice was employment and public, and a low level of ISR practice was funding, investment, and product and service. Additionally, the firm's size had a positive impact, but leverage had a negative impact. While profitability had not impacted ISR.

**Keywords:** Islamic Social Reporting, Firm's Size, Profitability, Leverage, Sharia Companies

## 1 Introduction

Business competition, currently, does not focus on financial, but also social, such as environment, public, and so forth. It is widely known as corporate social responsibility (CSR). The increasing of social awareness results in an ethical business demand in this global era. In a company, whose shares are owned by the public, investors tend to positively react to the company performing CSR, and this becomes an investment consideration [1]. The more consistent the CSR practice performs, the more improving corporate value is, so it will increase investors' welfare and investment appeal will advance [2]. Further, CSR performed by the company shows the preference to wider stakeholders. It is a means of maintaining a relationship with stakeholders [3], and not aimed atinvestors/ shareholders only. Hence, it can guarantee a company's sustainability due to legalization [4].

Likewise, a Sharia-based company necessarily performs CSR practice. It is later known as Islamic Social Reporting (ISR), a Sharia-based social activity report. ISR is a specific framework, which is modified from CSR dan adjusted with Islamic principles. The concept of Islamic CSR, or ISR, is closely related to the application of the Sharia principle by a company

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in operating its business activity [5]. In short, ISR is a Sharia-based business ethic. Any company registered in the Islamic index is required to perform its business operation in line with Sharia principles. Corresponding to CSR, a company performing ISR consistently will achieve better feedback in the future.

ISR displays that company has social responsibility based on Islamic values. ISR, then, consists of CSR standard items, stipulated by AAOIFI (Accounting and Auditing Organization for Islamic Institutions), and supplemented by explicitly Islamic items. Various researchers have developed ISR Index. It comprises 48 items and is divided into 6 themes, such as funding and investment (6 items), product and service (3 items), employment (11 items), public (10 items), environment (5 items), and corporate governance (13 items) [6][7][8][9][10].

Further, some determining factors to improve ISR practiceare necessary taken into account. In previous research, the firm's size had a significantly positive impact on ISR [10]. A corporation is a company having more optimal resources than a small-sized company. Thus, a corporation has a large size of facility, financing, and employment, and its disclosure can be more in line with Sharia principles [7]. Khasharmeh and Desoky [1] documented that firm's size is a significant predictor ofa company's disclosure, including ISR. Additionally, the higher profitability of the company will expose a higher CSR practice (positive impact) [11]. Leverage, in the meantime, is expected to be well-managed, so fund flow will result in a greater number than the disposing number in the future [9]. However, management will reduce CSR to avoid investor's auditing when the higher leverage occurs. By the end, the impact is negative [12][13], but some findings are contradicted with the impacts of three factors on CSR [14][15][16][17][18].

Typically, CSR practice has not maximally been performed. Advanced and in-depth research is necessarily performed to determine the extent of ISR practice, particularly a public company whose shares have been indexed as an Islamic index. Being the most populated Moslem country, Indonesia has strength and opportunity in advancing Sharia economy and financial. As a result, Sharia companies are required to continuously improve ISR practice for the interest of either investors or stakeholders, widely. Therefore, the research aims to know the extent of ISR practice has been performed by Sharia companies in Indonesia and its determining factors.

## 2 Literature Review

ISR practice is closely related to some theories. The following are theories related to ISR, as follows:

### 2.1 Sharia Enterprise Theory

Sharia Enterprise Theory (SET) is a theory centralizing the existence of Allah SWT and human kind as *Khalifa fil'ard* (representative in Earth). Being *khalifa*, human is entrusted *amanah* (message) to carefully manage Earth based on stipulated rules and forbidden of Allah SWT. Hence, the main responsibility of humankind is only to Allah SWT. The form of accountability to Allah SWT is established in the form of accountability to society and the environment. ISR practice is a manifestation of human responsibilities to Allah SWT [19].

### 2.2 Legitimacy Theory

This theory explains that corporate performance is related to the external environment. A company must adjust its business operation with existing standards and manuals within society [4]. Thus, social responsibility is a statement/ evidencethat a company's existence is well-accepted by its environment. Such company has assumedly provided an expected result by surrounding society [20]

### 2.3 Stakeholder Theory

Any company operating its business activity must provide benefits to stakeholdersor interesting parties. In satisfying stakeholder's interests, such as non-financial information, the disclosure of social responsibility can be one of the precise options since it relates to the impact caused company on its business activity and environment. A successful ISR disclosure and practice can be a negotiation form of such relationship [3].

### 2.4 SignalingTheory

The theory explains the incentive on how a company voluntarily disclosures to the capital market. In the capital market, voluntary disclosure is necessarily required for a company in competing successfully. Internal personnel of the company has more knowledge about the company and business opportunity than investors in the future. Thus, investors will protect themselves by proposing low offerings to the company [21]

## 3 Hypothetical Development

### 3.1 Firm's Size and ISR

A firm's size has been largely used in various researches. It is used as the main predictor ofcorporate social reports [10]. In this research, the firm's size is measured by the algorithm of the total of assets, determining the firm's size [7][22]. A large firm has a complex portfolio of activity and resources, where disclosure is more exposed and significantly affects the environment and primary stakeholders [7]. Based on stakeholder theory, disclosure liability becomes greater to satisfy stakeholder's necessities due to the increasing number of stakeholder involvement. Experts argue that the firm's size is the significant predictor of company disclosure, including Islamic-based social report, or ISR [1].

H1: A firm's size has a positive impact on ISR

### 3.2 Profitability and ISR

Profitabilityis a company's ability to obtain profit related to selling, a total of business operation, and capital [23]. The most relevant profitability with CSR is the return on asset (ROA). In the Islamic context, a company must maintain a complete disclosure, whether a company obtains profit or not [24]. A highly profitable company and conducting social report practice will obtain the trust from stakeholders and Moslem investors to invest in such company [25]. A company having higher profitability will more disclose its CSR information. Therefore, the higher profitability is, the wider CSR/ISR information is covered [26].

H2: Profitability has a positive impact on ISR

### 3.3 Leverage and ISR

The implementation of social responsibility is not only considered as a cost, but also deemed as a company's investment. A low implementation of social reports by the company will impede the company from gaining trust in external funding, such as either loans or investments [27]. However, according to agency theory, a company havinglarge leverage will consider performing social reports to avoid investors' supervisory and auditing. Such company, also, will be more concentrated on resolving any occurring issues due to loans than performing investment on social responsibility practice. In short, there is a negative relationship of leveragewith CSR/ISR disclosure [12].

H3: Leverage has a negative impact ona company's ISR

## 4 Method

The research employed the descriptive-quantitative method. Methodologically, the population of this research was companies registered in the Indonesian Islamic Index (ISSI) and issued the annual report of 2017–2019 (3 years), which was 423 companies. The sample, then, was purposively taken using proportional measurement. The Slovin formulation was used and 81 samples of the company were obtained. Thus, the total of samples was 243 companies (81 multiplied by 3 years). Data of the research was secondary data, such as the annual report collected by electronic documenting method from Indonesian Stock Exchange (BEI), and the company's official websites. Analytically, content analysis was performed to identify any reported ISR items. Score 1 was given if an item was reported, and the score of 0 was for a non-reported item. Later, the total of scores was counted, and the extent of ISR disclosure was measured, using the following formulation,

$$Disclosure\ Level = \frac{\text{Total of Disclosed ISR Scores}}{\text{Total of Maximal Scores}} \times 100\%$$

Totally or thematically, the level of ISR practice was based category referred to average score using 5 levels. The range of each level was 0.200, such as minimal score 1 was divided by 5, as seen in the following Table 1.

**Table 1.** ISR Practice Level Determination

| Average Score | Level |
|---|---|
| 0.801 – 1 | Very hgh |
| 0.601 – 0.800 | High |
| 0.401 – 0.600 | Moderate |
| 0.201 – 0.400 | Low |
| 0 – 0.200 | Very Low |

Independent variable consisted of firm's size proxied by the algorithm of the total of company's assets in Rupiah or Ln (Total of Assets); profitability proxied by ROA (return on assets), where net profit was divided by the total of assets; and, leverage proxied by DAR (debt to assets ratio), where the total of debts was divided by the total of assets. Data analysis technique was descriptive analysis to determine the level of ISR practice and path analysis utilized PLS-SEM (Partial Least Square Structural Equation Modeling), using WarpPLS 6.0 software to determine the impact from determining factors or independent variables.

# 5 Result and Discussion

## 5.1 Result

Table 2 presents both of average score and level of ISR practice.

**Table 2.** Average Score and Level of ISR Practice

| Theme | Item | Average Score and Level of ISR Practice |
|---|---|---|
| Funding and Investment | 1. Activity contains *riba* (example: interest of charge & income) | 0.996 |
| | 2. Obscure activity (*gharar*) | 0.000 |
| | 3. *Zakat* (its total and acceptance) | 0.193 |
| | 4. A policy of delayed payment and bad debt write off | 0.000 |
| | 5. Investment (in general) | 0.975 |
| | 6. Financing project (in general) | 0.012 |
| | | 0.363 (Low) |
| Product and Service | 7. Approval of Sharia Supervisory Board for a certain product | 0.012 |
| | 8. Glossary/definition of product | 1.000 |
| | 9. Customer care | 0.000 |
| | | 0.337 (Low) |
| Employment | 10. Composition of employment | 1.000 |
| | 11. Working hour | 0.021 |
| | 12. The ratio of salary/Allowances | 1.000 |
| | 13. Remuneration | 1.000 |
| | 14. Training and education | 0.885 |
| | 15. Opportunity equity for employees/ involvement | 0.000 |
| | 16. Appreciation to employee’s performance | 0.535 |
| | 17. Work safety and health | 1.000 |
| | 18. Working environment | 0.840 |
| | 19. Praying time/religious activity | 0.037 |
| | 20. Sufficient praying room for employee | 0.148 |
| | | 0.588 (Sedang) |
| Public | 21. Donation (charity) | 1.000 |
| | 22. *Wakaf* | 0.037 |
| | 23. Loans for good (*Qard hasan*) | 0.021 |
| | 24. *Zakat*, donation, or voluntary of employees& customers | 0.000 |
| | 25. Education program (scholarship, school development, etc.) | 0.864 |

| Theme | Item | Average Score and Level of ISR Practice |
| --- | --- | --- |
| | 26. Work empowerment for graduated | 0.992 |
| | 27. Youth development | 0.012 |
| | 28. Societal welfare improvement (economy empowering) | 1.000 |
| | 29. Orphan care | 0.025 |
| | 30. Endorsing societal/health/sports activity | 1.000 |
| | | 0.495 (Medium) |
| Environment | 31. Environment conservation | 1.000 |
| | 32. Global-warming reducing program (pollution, water management, etc.) | 1.000 |
| | 33. Environmental education | 0.613 |
| | 34. Environmental certification/reward | 0.358 |
| | 35. Environmental management system | 1.000 |
| | | 0.794 (High) |
| Corporate Governance | 36. Sharia compliance status | 0.000 |
| | 37. Detail of name and profile of Board of Commissioner | 1.000 |
| | 38. Commissioner's performance (responsibility and total of meetings) | 1.000 |
| | 39. Remuneration of Board of Commissioner | 1.000 |
| | 40. Detail of name of the profile of director/management | 1.000 |
| | 41. Director's performance (responsibility and total of meetings) | 1.000 |
| | 42. Remuneration of the board of directors | 1.000 |
| | 43. Detail of name and profile of Sharia supervisory board | 0.012 |
| | 44. Performance of DPS (responsibility and total of meetings) | 0.012 |
| | 45. Remuneration of DPS | 0.012 |
| | 46. Structure of share ownership | 0.996 |
| | 47. Anti-corruption policy | 0.543 |
| | 48. Anti-money laundering policy and other deviating practices | 0.395 |
| | | 0.613 (High) |
| Total | | 0.553 (Medium) |

From Table 2 above, the total of scores averagely related to ISR practice is 0.553, categorized as medium level. It shows that companies, on average, only reported 55.3% or 26 ISR items. Environment and corporate governance-themed ISR practice included in the high level, by the score of 0.794 (38 items) and 0.613 (29 items), respectively. In the following section, ISR practice about employment and public was in the medium level, by the score of 0.588 (28 items) and 0.495 (23 items), respectively. While, the last position was reporting on funding, investment, and product and service. These themes were in the low level, by the score of 0.363 (17 items) and 0.337 (16 items), respectively.

The model testing using WarpPLS 7.0 demonstrates that Goodness of fit (GoF) had a large value, which was 0.503. It means that model used in the research has been sufficient and ideal. Further, the value of Average VIF (AVIF) and Average Full Collinearity VIF (AFVIF) was 1.102 and 1.29, respectively. The value showed the fit result due to under the stipulated requirements, as of ≤5. The value of SPR, then, was 0.750, where it could be accepted since the value was ≥0.7. Based on such value, it can be comprehended that 75% of lines were in the independent model of the Simpson paradox.Though the RSCR value had0.962, almost reaching the ideal number at 1, RSCR was stated as fit due to it was ≥0.9. Based on the RSCR value, it can be seen that the role and positive R-squared build 96,2% minimally from the total of roles and absolute R-squared in this model. Subsequently, SSR value as of 1.000 was stated fit due it was ≥0.7. It indicates that 100% of lines were in the independent model of statistical emphasizing. The value of R-Squared,about 0.75, 0.50, and 0.25 in each variable of latent endogen within the structural model, can be depicted as substantial, moderate, and weak [28]. In this finding, the R-squared value of Islamic Social Reporting (ISR) was 0.050. This value means that the ability of independent variable, consisting of firm's size (SIZE), profitability (ROA),and leverage (DAR), in explaining dynamic of the dependent variable was 5%, categorized as weak. While, the rest, 95%, was described by other factors, which were beyond the analyzed model. Based on the result of model testing, the research's model, then, was acceptable.

Next, the structural model of the research's findings and hypothetical testing result

According to the result of the hypothetical, path-coefficient value of each variable and decisions on whether hypotheses are accepted or not are as follows:

a) Path-coefficient value on firm's size (SIZE) to Islamic Social Reporting (ISR) was 0.265,bythe p-value of<0.001, or significant. The first hypothesis (H1) was accepted. It can be stated that the firm's size (SIZE) had a positive and significant impact on ISR.
b) Path-coefficient value on profitability (ROA) to Islamic Social Reporting (ISR) was 0.003,by thep-value of 0.480>0.005, or non-significant. The second hypothesis (H2) was rejected. It can be said that ROA had not impacted ISR.
c) Path-coefficient value on leverage (LEV) to Islamic Social Reporting (ISR) was -0.142, by the p-value of 0.012<0.005, or significant. The third hypothesis (H3) was accepted. It can be argued that LEV had a negative and significant impact onISR.

## 5.2 Discussion

The analysis result displays that ISR practice performed by companies was medium, averagely. It, then, can be stated that ISR practice had not been maximally performed by companies registered in ISSI. If seen from each of the themes, however, companies had already performed ISR practice on either environment and corporate governance. Both themes were at a high level. A high reporting of the environment cannot be partially put aside from firm and strict environmental regulations. Also, corporate governance reporting has been regulated by laws.

While the reporting on employment and public was at a medium level, companies registered in ISSI had not maximally demonstrated their social responsibility to employees and society. In detail, an item of employment theme, such as "opportunity equity for employees/involvement", and one item on the public theme, such as "*zakat*, donation, or voluntary of employees and customers" were not reported (average score of 0.000). Finally, it can be said that companies, mostly, did not concern with funding, investment, and product and service since both themes were at a low level. Particularly, the reporting was not conducted on both items of “obscure activity (*gharar*)” and “delayed payment policy and bad debt write-off”. It becomes a serious concern because companies listed on the Indonesian Sharia Index should strictly apply Sharia principles, including the prohibition of obscurity (*gharar*). Whereas, the item of “customer care”, also not reported in the theme of product and service describes that companies had not duly taken preference on customer’s interest, representing Islamic values.

The result of hypothetical testing demonstrates that the firm’s size had a positive impact onISR. In short, it can be stated that the larger size of companies listed on the Indonesian Islamic Index (ISSI), the more detailed the disclosure of social responsibility via ISR. Varied resources provided freedom for companies to perform social activities, including Islamic aspect and ISR disclosing. This action was performed to satisfy their responsibility to Allah SWT (sharia enterprise theory), obtain legalization from the public (legitimacy theory), fulfill their stakeholders’ necessity (stakeholder theory), and show positive signal to (signaling theory). It proves that a large-sized company can reveal a broader disclosure in line with Islamic principlesdue such company has financing, facility, and more complex human resources [7]. Additionally, the larger the firm’s size, the more information costs [29]. This result is in the same vein as the research’s findings of [10][18][14][26][12], postulating that firm’s size has a positive relationship with social responsibility. Also, Hussain et al. [10] analyzed the role of ISR.

Moreover, profitability had not impacted ISR. It evidences that companies’ fluctuated profit did not impact on company’s management to disclose a wider social responsibility of companies. This result was following Islamic views that the company conducting disclosure of its social responsibility is not only based on profit and loss, but also a social responsibility to Allah SWT. Shortly, this finding supported sharia enterprise theory. Presumably, companies listed on ISSI had reserved their profit for other purposes. Fund allocated for social responsibility was not taken from profit, but it had initially allocated. The motivation was also in line with other theories, such as legitimacy theory, stakeholder theory, and signaling theory. Such theories argued that the company’s action is to obtain legalization to satisfy stakeholders’ necessities and give positive signals to investors [6][19]. Although the result was in contrast with the previous findings, showing a positive relationship [10][26][30], it supported other previous researches, stating that profitability has not impacted social responsibility [14][15][31].

Meanwhile, leverage had a negative impact on ISR. This finding means that leverage depicting the company’s debt had an inversely proportional relationship with ISR. Disclosing costs would accompany the policy of information disclosure related to social responsibility, so it would reduce income/revenue. It, then, is in line with agency theory, arguing that a company having large leverage would consider disclosure of social information to avoid investors’ supervisory and auditing. Moreover, social responsibility was a long-term investment, so a company having higher leverage would probably focus on short-term investment to mitigate any risks occurring from resource usage, which was derived from such loans. Similarly, this finding corresponds with previous research stating the existence of a negative relationship [12].

## 6 Conclusion and Implication

According to the research's findings, it can be concluded that ISR practice performed by Sharia companies, registered in ISSI,was medium. In detail, the findings demonstrate that based on its theme, a higher level of ISR practice was the environment and corporate governance. A medium level of ISR practice was employment and public, and a lower level of ISR practice was funding, investment, and product and service. Furthermore, some determining factors of ISR practice are that the firm's size had a positive impact, but leverage had a negative effect. Whereas, profitability had not impacted ISR.

The implication of this research is that management is necessary to improve ISR practice on a medium level, themed on employment and public. Also, the theme should concern on a lower level, such as funding, investment, and product and service, mainly on items not having been reported. The existence of a positive impact on the firm's size to ISR makes the company to necessary improve its company's size. It aims to improve ISR practice providing a huge advantage for stakeholders.In the meantime, leverage or debt should be necessary reduced, so that company can focus on performing its social responsibility and reporting via ISR.

### 6.1 Scope of limitation and Suggestion

The research limits on items of Islamic Social Reporting (ISRI), still commonly used, and more focuses on Sharia financial institutions, such as Sharia banks. It is seen from the specific items, such as Sharia Supervisory Board, which only exists in Sharia bank. Subsequently, a suggestion that can be proposed to regulatory parties, such as the government, OJK, and other related institutions, must promptly make and decide formulation and legalize ISR regulation related to supervisory, reward mechanism, or certification and punishment. It aims to extend ISR disclosure and practice responsibly and maximally. For following researchers intentionally analyzing ISR in the non-banking company, it is suggested to modify ISR items to adjust with the condition of such non-banking company.

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