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Implementing Islamic Corporate Governance (ICG) And Islamic Social Reporting (ISR) In Islamic Financial Institution (IFI)

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Abstract

Today CSR also growing in Islamic Financial Institution (IFI). This study aims to explain ICG relations with the ISR on its Islamic banking in Indonesia based on the study of literature and research results on similar theme. Various studies have been conducted to assess the effectiveness and determinants of ICG in Indonesia. Determinant of ICG, among others existence and composition of the membership of the Shariah Supervisory Board, the size and composition of the Board of Commissioners, Board of Commissioners frequency, size and composition of the audit committee, and the number of audit committee meetings.

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1. Introduction

Lately, CSR is not only growing in the conventional economy, but also on the Islamic economics, namely the Islamic bank as one of the Islamic Financial Institution (IFI). Shariah-based industries are experiencing rapid development is the banking industry. Based on data from Statistics Islamic Banking (Bank Indonesia, 2012) stated that the number of Islamic Banks in 2006 amounted to 3 (three) banks 349 offices. Meanwhile, until the end of 2012

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the number of Islamic banks which experienced significant increase is 11 (eleven) banks higher than in 2006 with 1745 offices.

It shows that the growth of Islamic banks in Indonesia is quite rapid. According to surveys conducted and reported in Global Islamic Finance Report (CIMB Islamic, 2012) Indonesia ranked the seventh in the development of Islamic banking in the world (Wardayati and Wulandari, 2014). Islamic banking firm as a service company whose one of the success depends on the trust of customers would have to implement corporate governance and CSR which is in accordance with the principles of Islamic teachings. In Islamic principles, God Almighty is also one the company's stakeholders.

Various studies with Islamic Corporate Governance and Islamic Social Reporting topic have been carried out. Maali, *et al.* (2006), which used samples from 29 Islamic banks in Muslim countries, showed that only eleven banks (38%) that express its social responsibility in accordance with the standards set by AAOIFI. Results of this study indicated that 62% of Islamic banks do not disclose their social responsibility as expected.

The research of Wardayati and Wulandari (2014) who did comparison of CSR between Indonesia and Malaysia with content analysis explains that there is no Islamic bank in Indonesia and Malaysia implementing social responsibility perfectly or achieve score of 100% based ISR index model. Several factors causing is the limit understanding of the concept of Islamic Social Reporting in the Islamic banking industry in Indonesia and Malaysia. Another factor is due to the development of ISR indexes in Indonesia and Malaysia are still slow, because the index ISR is new and is still not widely known by the Sharia Company. Generally, disclosure standards which are often used by companies in the world is the index of the Global Reporting Initiative (GRI). Moreover, as there are no more detailed regulations regarding the ISR and ISR indexes, the disclosures made by Islamic banks are still less specific.

Maali *et al.* (2006) also found that social issues are not priority for the majority of Islamic banks in CSR reporting. This may reflect the fact that most Islamic banks operating in developing countries, where social concerns, especially environmental issues, are considered as less important (Belal, 2000 in Maali, 2006).

Based on the background above, this study aims to explain the relationship between Islamic Corporate Governance and Islamic Social Reporting (ISR) on Islamic banking in Indonesia. This study used qualitative approach with the method of literature review, such as book and journal or article with the topic ICG and ISR research.

2. Literature Review

2.1. Islamic Social Reporting (ISR)

In the context of Islam, social responsibility of individuals mentioned in the Quran and Sunnah also applied to the company. In line with this concept, the main goal of Islamic business is to obtain the pleasure of God (Allah SWT) by obeying the Quran and Sunnah. Islam considers work or business as a form of worship to Allah SWT. Business aim for making profit is recognized, but this aim must be achieved in sharia ways (Maali *et al.*, 2006). ISR Index is an extension of the conventional reporting framework which does not only contains material aspects, moral, or social, but also reveals some matters relating to Islamic principles such as zakat, compliance status on sharia, and the transaction is free from elements of *riba* and *gharar* as well as social aspects such as *sodaqoh*, *waqof*, *qordul hasan*, until the disclosure of worship in the corporate environment. There are six themes in the ISR index (Othman, *et.al*, 2010), namely: (a) Investment and Finance, (b) Products and Services, (c) Employee, (d) Social, (e) environment, and (f) Organizational Governance.

2.2. The Theory of Legitimacy

Theory of legitimacy is one of the theories that underline the CSR disclosure. Davis (1973) in Wood (1991) states that "society gives legitimacy and authority on business" In the long-term business that do not use power in a way that is deemed responsible by the community, will tend to lose these powers".

There are some works need to be done in managing the company's legitimacy to be effective (Dowling and Pfeffer, in Hadi, 2011):

- a) Doing Identification, communication and dialogue with the public.
- b) Communicating social values, environmental, and building the perception of the company.
- c) Doing strategy of legitimacy and disclosures regarding to CSR.

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