

The effect of financial performance on islamic ethical identity disclosure of ASEAN sharia banks

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ABSTRACT

This research aims to analyze the influence of Risk Profile, Good Corporate Governance, Earnings and Capital (RGEC) on the disclosure of Islamic ethical identity in Sharia banks in ASEAN. The method used in this analysis is descriptive analysis and regression testing on 23 Islamic banks from 11 ASEAN countries. The research results show that non-performing financing (NPF), which measures risk profile, negatively influences the disclosure of Islamic ethical identity. In contrast, audit committee competency (KAA), as an indicator of good corporate governance, has a positive influence. Likewise, the return on assets (ROA) ratio, which measures earnings, positively influences the disclosure of Islamic ethical identity. However, as a capital indicator, the Capital Adequacy Ratio (CAR) does not have a significant influence. Based on this research, Sharia banks in ASEAN are expected to increase the optimization of their Islamic ethical identity disclosure through risk management, good corporate governance, improving financial performance, and paying attention to capital adequacy. However, this study has limitations, such as a limited sample size and high variability in the dependent variable. Therefore, further research is recommended to expand the sample, add variables, and reduce subjectivity in identifying disclosures of Islamic ethical identity.

KEYWORDS

Islamic ethical identity;
financial performance; Sharia
banks; ASEAN

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Introduction

The COVID-19 pandemic, declared an emergency by the World Health Organization (WHO), has caused severe impacts worldwide since March 2020. The virus's rapid spread through various countries has affected the health sector and penetrated the social and economic sectors, creating an unprecedented crisis (Elnahass et al., 2021). One of the sectors affected is Sharia banking, which has a strategic role in the global economy. Islamic banking, initially developed to meet the needs of Muslims, has now become generally accepted and is considered an alternative system, proliferating throughout the world (Jan et al., 2023). The role of Sharia banking is very significant in supporting investment funding needs in the business world and becoming an intermediary institution that supports the economy. However, the pandemic poses new challenges for Islamic banking, which must maintain its performance, especially in abnormal economic situations.

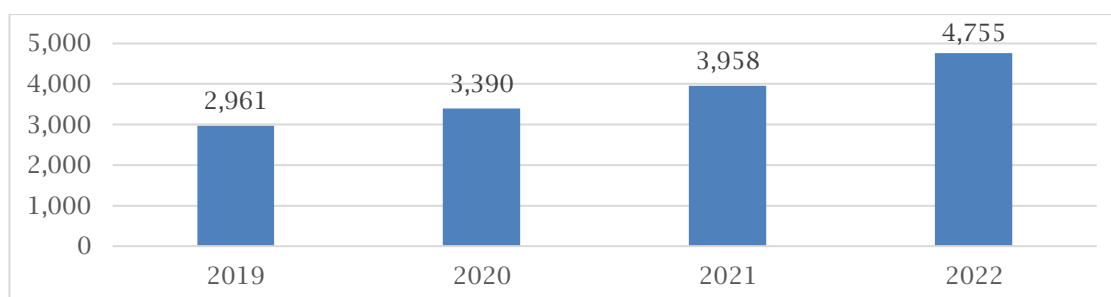


Figure 1. Islamic Finance Assets Growth (2019 - 2022, US\$ Billion)

In the face of increasingly competitive competition and greater moral demands, Islamic banking must ensure good financial performance and maintain its Islamic ethical identity. The trust of stakeholders, such as customers and the public, depends on Sharia banking's commitment to social values and Islamic justice. Even though there has been rapid growth in the Islamic finance industry, there are still challenges, such as a lack of public trust, especially

related to the non-transparency of Islamic ethical identity disclosed in annual reports. Based on the State of the Global Islamic Economy Report (2021), Sharia's total financial assets are estimated to reach USD 3.98 trillion in 2021, showing a growth of 13.9% from the previous year. However, to maintain and increase market share, Islamic banking needs to provide evidence of commitment to Islamic ethics, apart from focusing on financial growth.

Southeast Asia is an integral part of the development of global Sharia finance, and countries in ASEAN have variations in the development of Sharia banking. Malaysia, Indonesia, Bahrain, Kuwait and Saudi Arabia are the top five countries regarding sharia financial performance in 2020. Although Malaysia is leading in developing sharia banking in ASEAN, Indonesia is also actively developing this sector with a different approach. Despite the rapid growth of the Sharia financial industry, the market share of Sharia banking in Indonesia is still relatively small, only 6.65% (OJK, 2023). This may be caused by public concerns about the purity of Islamic ethics expressed by Sharia banks. Sharia banking must focus on a solid Islamic ethical identity to win public trust and increase market share.

A number of studies demonstrate the significance of revealing the Islamic ethical character of Sharia banks with regard to their annual reports. The Ethical Identity Index (EII) technique, established by Haniffa and Hudaib (2007), is applicable when determining the ethical identity of Sharia banks. Disclosure of Islamic ethics can be evaluated based on a variety of factors, including but not limited to vision and mission statements, governance, products and services, zakat, alms, lending policies, dedication to employees, debtors, society, and the Sharia supervisory board (DPS). Additionally, some issues develop due to criticism regarding the placement of the Sharia designation, which is regarded as improper by many individuals. In order to demonstrate that Sharia banking is committed to Islamic principles and not only as a marketing tool, there needs to be a more comprehensive disclosure of Islamic ethics regarding Islamic ethics.

This study aims to evaluate the impact that Risk Profile, Good Corporate Governance, Earnings, and Capital (RGEC) have on the disclosure of Islamic ethical identity in international financial institutions in ASEAN. Within the formulation of the problem, four primary questions investigate the connection between the RGEC variable and the disclosure of Islamic ethical identity in the annual reports of Islamic banks. The purpose of this research is to conduct empirical testing of the impact that RGEC has on the revelation of Islamic ethical identity. This is to give a likely theoretical contribution, particularly in Islamic banking. In order to reap the practical benefits of this research, various stakeholders, including Sharia banking, investors, potential investors, academics, and the government, are actively involved. For sharia banking, the research findings would raise awareness about the significance of declaring their ethical identity and the financial aspects of their operations. This research has the potential to serve as a guide for investors in the process of reviewing investment decision-making policies. In the meantime, it is hoped that the research findings will serve as a reference for the government when it comes to developing rules concerning the disclosure of the ethical identity of Sharia banking.

Literature review

Grand theory

This research is based on three theories. Shariah Enterprise Theory, as the leading supporter of Sharia compliance and Islamic corporate governance, aims to achieve social and economic prosperity centered on Allah SWT as the highest stakeholder. This theory emphasizes five supporting factors, namely taking care of religion, soul, life, reason and generation, to achieve Al-Maqasid Shariah or protection of the welfare of many people (Rahman & Jusoh, 2018). Additionally, the Stakeholder Theory emphasizes that companies are not just entities for their own sake but must benefit all stakeholders, including employees, customers, shareholders and society (Ghozali & Chariri, 2016). This theory emphasizes the company's responsibility and morals towards various interested parties, underlining the need for stakeholder satisfaction to maintain good relationships. In Islamic corporate governance, investors and creditors are expected to consider profitability and ethical Islamic information in decision-making (Darma & Afandi, 2021). Meanwhile, Legitimacy Theory highlights the importance of companies ensuring that their activities and performance are acceptable to society by depicting the impression of environmental responsibility through annual reports so that they are accepted by society (Deegan, 2004).

Sharia bank

Sharia banks are financial institutions that conduct their operations by the precepts of Islam. According to Nurnasrina and Putra (2018), Sharia banks conduct business operations according to the precepts outlined in the Al-Qur'an and the Hadith. Following the provisions of Law No. 21 of 2008 about Sharia Banking, Sharia Banks are defined as financial institutions that conduct their commercial operations by Sharia principles and Islamic legislation. Sharia banks provide various services and products, including financing for various purposes, including housing, vehicles, investments, savings accounts, and Sharia checking accounts. In addition, Sharia banks provide financial products founded on the principles of Sharia, such as Sharia bonds (sukuk) and Sharia mutual funds.

Islamic Ethical Identity

Islamic ethical identity means that the company's ethical behavior in its operational activities must be based on Sharia principles and Islamic norms. Disclosure of Islamic ethical identity aims to guarantee stakeholders regarding operational activities that Islamic banks should disclose. If the value of disclosing Islamic ethical identity is still relatively low, it means that the Sharia bank still needs to implement compliance with Islamic principles fully. If Islamic banks can express their ethical identity well, stakeholders' loyalty and commitment will ultimately be higher (Hasan & Harahap, 2021). In the context of Islamic banks, Huda (2018) defines ethical identity disclosure as a collection

of information that is considered necessary based on the Islamic and Sharia business ethics framework that needs to be disclosed by Islamic banks, consisting of qualitative and quantitative information.

Financial performance

Financial performance reflects a company's achievements or success, which can be interpreted as the results achieved for the activities carried out (Fahmi, 2015). In terms of measuring financial performance using financial ratios, each ratio has a specific purpose, use and purpose (Kasmir, 2018). Financial performance is an achievement made by a company in a certain period that describes the company's financial condition, starting from capital adequacy, liquidity and profitability.

RGEC Model

The vast majority of global financial organizations utilise risk assessment methods as a measuring instrument to evaluate their financial performance. Assessment of the bank's health involves determining whether the bank can carry out its operating activities. In order to evaluate the performance and health of a bank, it is possible to use a variety of ways. Several modifications have been made to the performance evaluation method in Indonesia. These modifications began with the CAMEL and CAMELS methods, which are no longer being used and have been replaced with the RGEC approach (Fortrania & Oktaviana, 2015). It is stated in Bank Indonesia Regulation No.13/1/PBI/2011, refined by Financial Services Authority (OJK) Regulation No. 10/SEOJK.03/2014 concerning the General Assessment of the Health of Sharia Commercial Banks and Sharia Business Units, in its evaluation, it employs the RGEC method (risk profile, good corporate governance, earnings, and capital) by employing an evaluation on a scale ranging from 1 to 5, with an explanation of the lower points. When it is received, the bank's condition will begin to improve.

Earnings

An evaluation of a bank's health from the point of view of its profitability is referred to as earnings. Profitability is evaluated to determine whether a bank can make the most of its available capital. ROA stands for return on assets, ROE stands for return on equity, NIM stands for net interest margin, and OER stands for operational efficiency ratio. These are only some ratios that may be used to monitor a company's profitability. Both the return on assets (ROA) and the return on equity (ROE) ratios are utilized by researchers in order to evaluate a company's profitability. When it comes to profitability, a bank's features can be observed. This refers to how the bank operates in terms of earning profits and the capacity of the profits itself to increase capital and profits in the future.

Company size

According to Riyanto (2016), the term "company size" refers to a scale that is used to categorize a company's size in various ways, including the representation of the company's total assets, total revenues, share market value, and other metrics. As a result of the fact that investors use the size of a company as a benchmark in their investment plans, the firm's size becomes an essential component in the process of financial reporting. Compared to smaller organizations, large corporations have greater access to available resources and greater flexibility, allowing them to acquire capital more quickly. Maqfirah and Fadhlia (2020) state that a considerable firm size indicates that the company has enormous assets that can draw the attention of the public.

The Influence of Risk Profile on Disclosure of Islamic Ethical Identity

The risk profile is evaluated using the Non-Performing Financing (NPF) ratio, which reflects the risk of financing failure for Islamic banks. Among the types of financing that fall under the category of problematic financing are substandard, questionable, and non-performing (Asiyah, 2015). The Stakeholder Theory emphasizes the significance of Islamic banks paying attention to stakeholders' interests, which include consumers and investors. According to Mustika et al. (2021), Lambada et al. (2022), and Sonia and Khafid (2020), the National Performance Framework (NPF) is the primary emphasis since it harms financial performance, restricts bank earnings, and has an effect on involvement in social performance. The findings of the study indicate that the variable of Good Corporate Governance (GCG), which is mediated by the National Policy Forum (NPF), affects Islamic Social Reporting (ISR) Disclosure (Mustika et al., 2021).

The Influence of Good Corporate Governance on Disclosure of Islamic Ethical Identity

In order to guarantee that the company discloses all of its information, including its Islamic ethical identity, the audit committee's performance must be effective. This effectiveness may be judged by the number of members and the committee's independence. The audit committee's primary function is to ensure that financial reporting is accurate and timely. Additionally, the audit committee plays a significant role in narrowing the information gap between management and stakeholders (Yuanisa et al., 2022). The findings of the research also emphasize the fact that the frequency of audit committee meetings might be a reflection of the level of diligence that they exhibit, which in turn affects the disclosure of Islamic business practices (IBC) in firms that comply with Sharia law (Nugraheni et al., 2022).

The Influence of Return on Assets (ROA) on Disclosure of Islamic Ethical Identity

An organization's profitability can be evaluated using the Earnings variable, quantified by Return On Assets (ROA). This variable compares a company's profit to its total assets. A company's ability to generate profits for its shareholders is reflected in its return on assets (ROA). Because the costs increase proportionately to the profitability level, the organization's Islamic ethical identity is shown significantly. Although research conducted by Mais et al. (2022) indicates that profitability does not have an impact on Islamic Social Reporting (ISR), other studies, such as those conducted by Devi et al. (2021) and Affandi & Nursita (2019), have demonstrated that the disclosure of Islamic Social Reporting is influenced by different factors, including the size of the company and its financial performance, including profitability.

The influence of bank financial performance is assessed from Capital on Disclosure of Islamic Ethical Identity

The Capital Adequacy Ratio (CAR) is a measure that indicates how well banks can manage risk and how much capital they have available. When the CAR ratio is high, it indicates that the bank is stable and can deal with risk. It has been established through research conducted by Chindo and colleagues (2022) that CAR is connected to the revelation of the ethical identity of Islamic banks. When the CAR is higher, there is a more significant degree of disclosure of the Sharia ethical identity. However, according to the findings of research conducted by Kalbuana et al. (2019), profitability does not impact Islamic Social Reporting. This study's findings highlight the significance of capital and operational stability in terms of their impact on the disclosure of the ethical identity of Islamic financial institutions.

Methods

Research object

This research uses a population of Islamic banks in ASEAN from 2018 to 2022. This population includes Islamic banks in countries in the ASEAN region. To select the sample, the research used a purposive sampling technique with criteria involving Sharia Commercial Banks in ASEAN countries that have published financial reports and annual reports on the bank's official website for the 2018-2022 period. This sample consists of 11 Sharia Commercial Banks in Indonesia, 8 Sharia Banks in Malaysia, 1 Sharia Bank in Brunei Darussalam, 1 Sharia Bank in Singapore, and 1 Sharia Bank in the Philippines by predetermined criteria (Sudjana, 2016).

Operational Definition of Variables

This research uses the dependent variable of disclosure of Islamic ethical identity, measured through the total dimensions of the Islamic ethical index in the annual report, with a score of 1 for disclosed and 0 for not disclosed (Sudjana, 2016). The independent variables consist of the non-performing financing (NPF) ratio, audit committee with competency based on education and experience, return on assets (ROA) ratio, and Capital Adequacy Ratio (CAR). The NPF ratio measures the percentage of non-performing loans, the audit committee is assessed based on the chairman's competence, ROA measures the company's efficiency in generating profits, and CAR shows the bank's capital adequacy. The control variable is company size, measured by total assets (Sultana et al., 2015; Al-Musali et al., 2019; Mais et al., 2022; Kalbuana et al., 2019; Maqfirah & Fadhli, 2020).

Technical Data Analysis

The analysis in this research involved several approaches. First, the descriptive analysis describes the research results by evaluating the research variables' maximum, minimum, mean and standard deviation values. Then, regression analysis is carried out to understand the influence between variables. The Coefficient of Determination Test (R²) measures the model's ability to explain the variance of the dependent variable, with an R² value close to 1 indicating good model ability. The F statistical test is used to assess the suitability of the regression model, where rejection of the null hypothesis indicates a good model. Finally, the t-statistical test evaluates how the independent variable explains the dependent variable (Ghozali, 2017).

Results

Research Sample

Based on the analysis of sample collection, it is known that the Southeast Asia region currently consists of 11 countries; from all these countries, the researcher found 23 Islamic banks from 6 countries as research samples. The Sharia Banks in the sample include 11 Sharia Commercial Banks in Indonesia, 8 Sharia Banks in Malaysia, 1 Sharia Bank in Brunei Darussalam, 1 Sharia Bank in Singapore and 1 Sharia Bank in the Philippines.

Descriptive analysis

Description of the Islamic Ethical Identity Index

This study modifies eight dimensions from Haniffa & Hudaib (2007) to examine ASEAN Islamic banks' disclosure of Islamic ethical identity. Vision and Mission Statement, BOD and Top Management, Product, Zakah,

Charity and Benevolent Loans, Employees, Debtors, Community, and Shari'ah Supervisory Board. The average disclosure of Islamic ethical identity is 0.604, indicating modest disclosure. Sharia banks in ASEAN reflect their Islamic ethical identity differently in their Vision and Mission Statements (VMS). Islamic banks support Sharia but prioritize consumers and stakeholders without stating so in their vision and goal.

The BOD and Top Management aspects highlight the board of directors and top management's profile and performance by a high average. New products and non-halal income risks are poorly disclosed in the Product dimension (PRD). The Zakah, charity, and benevolent loans (ZCL) dimension also discloses social and environmental concerns. The Employees Dimension (EMP) extensively discloses staff appreciation, training, and Sharia policies. Lending rules and written-off debts are disclosed extensively in the Debtors (DEB) dimension. The Community Dimension (CMY) discloses moderate support for social activities and job creation. Finally, the Shari'ah Supervisory Board (SSB) dimension reveals low product fault and repair solution disclosure, requiring additional clarity in the yearly report.

Description of independent variables

This study evaluates ASEAN Islamic banks' financial health using independent factors such as Risk Profile (NPF), Good Corporate Governance (audit committee competency), Earnings (ROA), and Capital (CAR). NPF study shows that Sharia bank credit portfolios average "Healthy" under Bank Indonesia Regulations, indicating adequate credit risk management. Most of the audit committee's high competency shows Islamic banks' commitment to excellent corporate governance. According to ROA analysis, Islamic banks average a "healthy" return on assets and efficiently generate profits. On the other hand, Capital (CAR) exceeds fundamental capital limits.

The findings show robust financial health, but differences between banks highlight the need for cautious risk management and strategic planning based on their particular characteristics. As a control variable, company size (SIZE) shows ASEAN Islamic banks' operational scale diversity. In conclusion, ASEAN Islamic banks perform well financially and follow sound governance practices. To ensure the future viability and resilience of the Islamic banking sector, each institution's challenges must be considered.

Classic assumption test

The One-Sample Kolmogorov-Smirnov test reveals that research data is usually distributed because the p-value is more significant than 0.05. The multicollinearity test with tolerance values and variance inflation factor followed. The calculation results reveal that NPF, KAA, ROA, CAR, and SIZE have tolerance values above 0.10 and VIFs below 10, indicating no multicollinearity. The heteroscedasticity test demonstrates no residual variance non-uniformity in the regression model, as shown by randomly distributed scatterplots. The Durbin-Watson autocorrelation test yields $D_w = 2.18$, between the crucial range of 1.784 and 2.216, suggesting no autocorrelation issues in the regression model. Therefore, this research data fits the basic assumptions of linear regression analysis and can be used to evaluate the results.

Coefficient of determination test and feasibility of the model

According to the coefficient of determination (R^2) of 0.347, financial performance variables with a risk approach (Risk-Based Bank Rating)—Risk Profile, Good Corporate Governance, Earnings, and Capital (RGEC) factors—explain 34.7% of the variation in ASEAN Islamic banks' disclosure of Islamic ethical identity. About 65.3% of the variation is explained by factors not studied. The model feasibility test using F statistics indicates a low significance value (p -value < 0.05), indicating a feasible and significant regression model. Thus, this model adequately describes the association between financial performance and Islamic ethical identity disclosure in ASEAN Islamic banks, supporting its use in this research.

Hypothesis test

Based on the results of hypothesis testing using the t-statistical test on variables that proxy the financial performance of Islamic banks using a risk approach (Risk-Based Bank Rating), it was found that the non-performing financing (NPF) variable has a significant negative influence on the disclosure of Islamic ethical identity. On the other hand, audit committee competency (KAA) and return on assets (ROA) ratio significantly influence this disclosure. However, the Capital Adequacy Ratio (CAR) variable cannot be confirmed as a significant influence on the disclosure of Islamic ethical identity.

Table 1. t-test result

Variable	Coefficients	t-value	t-table	sig	Conclusion
(Constant)	0,495	4,424	1,658	0,000	
NPF	-0,368	-3,970	1,658	0,000	Ha supported
KAA	0,175	1,998	1,658	0,042	Ha supported
ROA	0,189	2,079	1,658	0,040	Ha supported
CAR	-0,088	-1,092	1,658	0,277	Ha not supported
SIZE	0,081	0,854	1,658	0,395	Ha not supported

Discussion

Risk Profile towards Islamic Ethical Identity Disclosure

The study's findings indicate that the Risk Profile, as assessed by non-performing financing (NPF), has a detrimental impact on the disclosure of Islamic ethical identity in Islamic banks located in ASEAN. A non-performing loan (NPF) is a type of financing that has yet to reach the target that the bank has set for itself. The success of the implementation of NPF affects the financial performance of the bank. The conclusions of this study are consistent with those of other studies, such as Sonia and Khafid's (2020) investigation, which discovered that liquidity and leverage had a negative and significant impact on the disclosure of sustainability reports. Stakeholder theory is another theoretical underpinning that demonstrates that problematic finance, one of which is non-performing financing (NPF), is the primary concern of stakeholders within the decision-making process. These stakeholders include investors and customers. A low net profit factor (NPF) may allow Islamic banks to place a greater emphasis on expressing their Islamic ethical identity. In contrast, a high NPF may decrease the amount of cash available for activities of this nature.

Good Corporate Governance towards Islamic Ethical Identity Disclosure

It has been demonstrated through the findings of this research that Good Corporate Governance (GCG) has a favourable impact on the disclosure of Islamic ethical identity in Islamic banks located in ASEAN. (Nugraheni et al., 2022) The GCG elements are evaluated while considering the governance framework, emphasizing audit committee variables. Ridwan and Mayapada (2022) state that the audit committee, a component of the corporate governance framework, is responsible for ensuring that the integrity of financial reporting is maintained and that the organization complies with corporate governance and any applicable rules. The findings of this study are consistent with the findings of research conducted by Devi et al. (2021), which demonstrates that the effectiveness of supervision over the company's financial reporting is positively correlated with the number of audit committee members available. These findings are supported by Nugraheni et al. (2022), who demonstrate that the frequency of audit committee meetings has a beneficial influence on the disclosure of Islamic business conduct (IBC). The effectiveness of the audit committee's performance and vigilance in assuring the integrity and regularity of financial reporting is a significant factor that influences the level of corporate disclosure, including the company's Islamic ethical identity.

Earnings towards Islamic Ethical Identity Disclosure

The calculation findings indicate that the Earnings element, and more specifically, Return on Assets (ROA), favours the disclosure of Islamic ethical identity in Islamic banks located in ASEAN. This hypothesis, which states that "earning has a positive effect on the disclosure of Islamic ethical identity," can be verified. Return on assets (ROA) is a measure of earning capacity that describes the profit Islamic banks make from each rupiah of assets they use. An increase in the return on assets (ROA) indicates a more effective utilization of assets and a more significant profit margin, both indicative of substantial financial success. Islamic financial institutions that have achieved a high level of financial performance have more significant resources available to invest in social initiatives, such as revealing Islamic ethical identity. According to a study conducted by Lambada et al. (2022), which reveals that high profitability encourages managers to disclose more thorough information to convince investors, this finding agrees with that research.

Capital Against towards Islamic Ethical Identity Disclosure

The calculation results indicate that capital parameters, particularly the Capital Adequacy Ratio (CAR), do not favourably influence the disclosure of Islamic ethical identity in Islamic banks in ASEAN. "Bank financial performance assessed by Capital has a positive effect on the disclosure of Islamic ethical identity" is a theory not supported by the evidence. The CAR, which measures a bank's ability to cover a loss in assets due to asset risk, is evaluated as part of the capital assessment process. This research demonstrates that high capital sufficiency does not affect the disclosure of Islamic ethical identity, even though Bank Indonesia establishes a minimum capital requirement of 8%. It is consistent with the findings of research conducted by Siswanti (2018), which demonstrates that the company's financial performance does not influence the disclosure of Islamic Social Reporting. According to Al-Sartawi (2020), disclosure cannot affect the capital that banks collect through CAR. This is because banks concentrate more on their operational activities and the services they provide to their shareholders and business clients.

Conclusion

This research aims to analyze the influence of financial performance on the disclosure of Islamic ethical identity in Sharia Banks in ASEAN. The research results show that risk profile, as measured by non-performing financing (NPF), negatively influences the disclosure of Islamic ethical identity. On the other hand, good corporate governance, as measured by audit committee competency (KAA), positively influences the disclosure of Islamic ethical identity. Likewise, earnings, as measured by the return on assets (ROA) ratio, positively influence the disclosure of Islamic ethical identity. However, the capital factor, as measured by the Capital Adequacy Ratio (CAR), does not significantly influence the disclosure of Islamic ethical identity. However, this research has several limitations, such as the limited number of samples and the high variability of the dependent variable, which the independent variables cannot fully explain. Therefore, further research is recommended to expand the sample size, add variables, and reduce subjectivity in identifying the disclosure of the Islamic ethical identity index.

In line with these limitations, future research should expand the sample size, include additional variables, and reduce subjectivity in identifying an Islamic ethical identity disclosure index. Additionally, the study recommends involving a more comprehensive range of Sharia-compliant companies beyond banking institutions and extending the observation period for a more comprehensive understanding of the dynamics involved. The findings of this research contribute to the understanding of the interaction between financial performance and the disclosure of Islamic ethical identity in the context of Islamic banking in ASEAN, providing valuable insights for academics and practitioners in this field.

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