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The Incremental Value of Islamic Social Reporting: Evidence from Companies Listed in Jakarta Islamic Index

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Abstract

The purpose of this study is to investigate the value relevance of Islamic social reporting disclosures in influencing the firm value. Islamic Social Reporting (ISR) is a Corporate Social Responsibility (CSR) reporting model for sharia-based institutions. Indonesia has not required ISR as a mandatory disclosure to sharia-based companies. This study was designed using causal research and analysed using multiple regression analysis. The sample of this research is companies listed in the Jakarta Islamic Index (JII) from 2014–2017. The result shows while ISR is still voluntary disclosure in Indonesia, and there are no standards for governing implementation, ISR does have incremental value in affecting firm value. The implications are significant for sharia-based companies in implementing ISR.

Keywords: Debt to Equity Ratio, Firm Size, Islamic Social Reporting, Return On Asset

1. Introduction

This study was conducted to examine the effect of incremental Islamic Social Reporting (ISR) and financial factors on firm value. In the public corporation, the company's value reflected in the share price traded on the stock exchange. So if the higher the stock price, the higher the wealth of shareholders (Mishra & Modi, 2016). Jakarta Islamic Index (JII) is one of the stock indexes in the Indonesia Stock Exchange (IDX), which calculates the share price for the type of stocks that meet the standards of Shariah. JII refers to the 30 Islamic stocks that have qualified are set by the National Sharia Board-Indonesian Ulema Council (DSN-MUI). Value companies featured in the JII in the last four years tends to decline, as seen in the chart below.

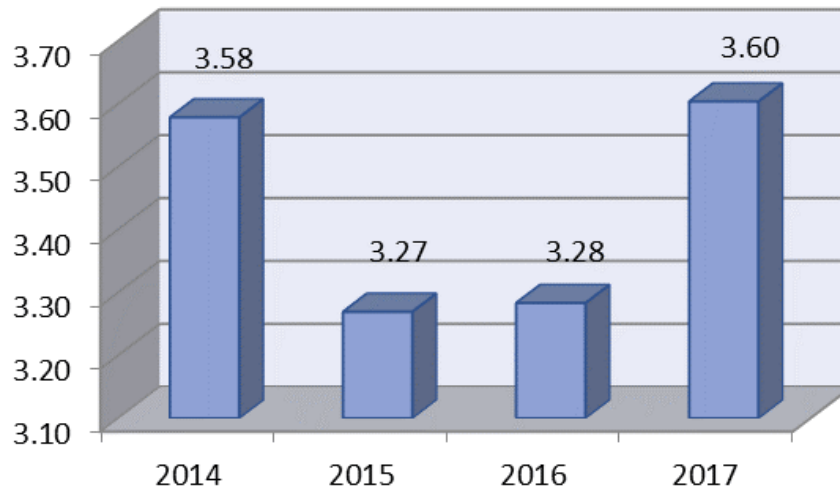


Figure 1: The trend of firm value
Source: data processed (2018)

The above data illustrates the value of the company at JII stock index from 2014 to 2017. Based on the data presented above, the relative firm value increased per year, but in 2015, the company's value declined significantly from 3.56 to 3.21. This decline was continued until 2016. It is interesting to study the factors that affect the firm value and whether the ISR contains additional information that will also affect the firm value.

Currently, the concept of CSR is not only growing in the conventional economy but also thrive on Islamic economic sectors. It's getting a lot of companies that apply the concept of Islamic in its business activity under the law and Sharia. And corporate responsibility is one aspect of the highlights to conform to the principles of Islam. Mir, Hassan, & Hassan, (2016) state that the values of Islam brought by Prophet Muhammad can serve as the basis of corporate social responsibility as well as on a conventional company. El-Halaby and Hussainey (2015) concluded that Islamic values have relevant relationships and have contributed to the concept of CSR that has been developed at this time.

The conceptual framework of ISR was first conceived by Haniffa (2002). The ISR in Islam must disclose matters related to the principles of Sharia and avoid from transactions contrary to the principles of Islamic law, while an opposite transaction with Islamic principles, such as transaction containing interest (riba), persecution (Zul), games of chance or speculation (maysir) and excessive uncertainty (gharar). And should reveal the social aspects, such as the endowment (waqf), interest-free loan(qardhul hasan), charity (sadaqah), and disclosure of worship in a corporate environment. CSR disclosure in Indonesia is still voluntary and nearly largely based on the standards disclosure contained in the Global Reporting Initiative (GRI) Index. The measurement is considered inappropriate for the sharia-based company because the company discloses information that proves the company is operating in accordance with Islamic law. Users GRI does not describe Islamic principles, such as disclosure of liberation effort from elements of usury, hazard, and uncertainty (gharar), and other illicit transactions.

Profitability is the ratio used to measure a company's ability to generate profits from other normal activities (C. Doktoralina and Apollo, 2019). Leverage is a financial ratio used to measure how much the company is financed by debt and ability to repay the finance, both long term, and short term. Profitability is important because companies generally aim to make a profit, while the debt has a good or bad influence for the company (Kartikasari and Merianti, 2016).

Research on the factors that affect the value of the company has been carried out by previous researchers but still shows the inconsistency of results. Suffah and Riduwan, (2016) state profitability, leverage, and dividend policy have a positive effect on corporate value, while the size of the company does not affect the value of the company. Novari & Lestari, (2016) disclose the size of the company and significant positive effect on firm value, leverage does not significantly influence the company's value, and profitability and significant positive effect on firm

value. While Suwardika and Mustanda (2017) prove the profitability leverage and positive effect on the value of companies, growth companies have a negative relationship.

Sartono (2001) suggested that the company have attention to the environmental impact of their operational activities. The purpose environmental impact of to the notice is companies will not face difficulties on the products because "boycott actions" by the community (as a form of protest) which then have an impact on decreasing the value of the company. The CSR is also a phenomenon and strategies used by companies to accommodate the needs of their stakeholders. The government supports the liability of companies doing business in the area or activities associated with the natural resources to carry out their responsibilities to the environment. The government support was stated in Law Number 40 of 2007 concerning Limited Liability Companies article 74. Therefore, this study is essential to strengthen the confidence of stakeholders on the importance of ISR disclosure for institutions whose activities are based on sharia to enhance shareholder value further.

2. Literature Review and Hypotheses

2.1 Theoretical Studies

Stakeholder theory said that the company is not the only entity that operates for its own account but must provide benefits to stakeholders (shareholders, creditors, customers, suppliers, analysts, and others). Thus the company's presence is strongly influenced by the support provided by the stakeholders to the company (Chariri & Ghozali, 2007). Stakeholder strategy not only financially, but also in social performance carried out by the company. The ISR is a strategy undertaken by the company in the disclosure of the company's activities to satisfy the desires of stakeholders

Dowling & Pfeffer, (1975) revealed that legitimacy is an important thing for the organization, the limits outlined in the social norms and values, as well as a reaction to these restrictions, encourage the importance of organizational behaviour analysis by looking at the environment. The theory of legitimacy in the general form provides an important view of the practice of corporate social disclosure.

In the financial theory of capital markets, stock prices in the market referred to the concept of enterprise value (Naufal, 2014). Dianawati & Fuadati (2016) describe Firm Value (Rated companies) are willing to pay the price which prospective investors if the company will be sold. Meanwhile, according to Ramadan (2015), the value of the company is aimed at stock price. Then if the higher price of the stock market, the higher the wealth of shareholders.

One approach to measuring the value of the company is Price to Book Value (PBV) ratio. The PBV describes how much the market values the book value of a company's stock. The higher the PBV ratio, the market believes in the prospect of the company. The PBV also shows how far a company is able to create company value relative to the amount of capital invested. In companies whose business is running well, generally this ratio reaches above one, this shows that the stock market value is greater than the value of the book. The formula used to measure the PBV is as follows:

$$PBV = \frac{\text{Market price per share}}{\text{Book value per share}}$$

2.1 Profitability

The profitability ratio consists of two types of ratios that show profitability in relation to sales and ratios that show profitability in relation to investment. Together, this ratio will show the overall operational effectiveness of the company (Van Horne and Wachowicz, 2013). According to Hermanto & Agung (2015) is a profitability ratio that measures the effectiveness of management shown by the profit generated in sales and investment companies. Return on Assets (ROA). This ratio measures the rate of return from the sale or all of the existing assets. ROA selected because it describes the efficiency of the funds used in the company and is commonly used to view the performance of profitability. ROA is also sometimes referred to as Return on Investment (ROI). C. M. Doktoralina, Anggraini, Safira, & Melzatia (2018) states that companies with high ROA tend not to disclose

sustainability reports. Previous research conducted by Suffah and Riduwan (2016) stated that profitability has a positive direction toward company value. The study identified that the higher the value of profitability, the higher the value of the company.

H₁: Profitability is positively correlated with firm value

2.2 Leverage

Debt to Equity Ratio is the ratio used to assess the debt for equity. This ratio is chosen because it is useful to know the amount of funds provided the borrower (creditors) with the owner of the company and is commonly used to highlight the performance of the company. Loan funds are intended for long-term debt and current debt. The research conducted by Suffah and Riduwan (2016) shows that capital structure (leverage) has a positive effect on firm value, this is caused by the use of company assets which are largely financed with debt effectively. The effective use of debt will generate profits, which will ultimately have an impact on the value of the company.

H₂: Leverage is positively correlated with firm value

2.3 Islamic Social Reporting (ISR)

Haniffa, (2002) explained that if the ISR will be needed by the Muslim community with the aim to reveal accountability to God and the wider community in order to obtain information that helps them meet their spiritual needs. In this study, the authors used an index ISR developed by (Othman and Thani, 2010). There are six themes of disclosure, in which five other themes is the theme expressed by Haniffa (2002), and the other theme is the theme developed by (Othman and Thani, 2010).

Disclosure of ISR is Financing and Investment Themes; Themes Products/Services; Employees Scene; Society Scene; Environmental themes and the theme of corporate governance. ISR index in this study was determined by the method of content analysis at the company's annual report. ISR indices used in this study only about 42 items, due to differences in regulations between research (Othman and Thani, 2010) conducted in Malaysia and Indonesia. So the biggest score is 42, and the smallest is 0 for each company in each year. Islamic Social Reporting Indexed of Companies (ISRI) great value if it achieves 100% disclosure.

$$ISRI_j = \frac{\sum X_{ij}}{n}$$

Information:

ISRI_j = Islamic Social Reporting Indexed of Companies j

$\sum X_{ij}$ = number of items/indicators expressed firm j

n = Total items/indicators disclosures (42 items)

Haniffa (2002) states how important ISR disclosure is to show corporate accountability to the public. Muslim stakeholders expect to get information as a facility provided by the company to them in decision making. ISR disclosure aims to build a good corporate image in the community. Previous research conducted by Cahya, Nuruddin, and Ikhsan (2017) states that the disclosure of ISR has a positive and significant effect on firm value. Iskandar and Efitia (2016) prove that CSR disclosure has a positive effect on firm value. Through ISR disclosure, the public will give a positive appreciation along with the increase in the company's stock price.

H₃: ISR is positively correlated with firm value

2.4 Firm Size

Research conducted by Novari and Lestari (2016) states that company size has a significant influence on firm value. Inchausti (1997) found that large companies may have potential conflicts between management and the stakeholders.

H₄: Firm size is positively correlated with firm value

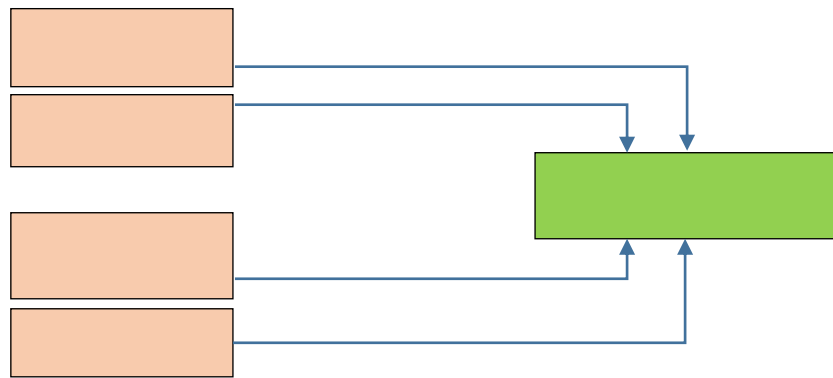


Figure 1. Research Model

3. Method

This study will test the incremental value of ISR after testing the information content of the general performance ratios and company size. First, the study will examine the correlation of each profitability, Leverage, firm size, and ISR to find out how each variable influences investor decisions reflected in the value of the company. Then to test the value of the information content, the ISR will be compared with the information content of the previous three variables.

This study uses two testing methods. First, do the correlation test, then the second test compares the R^2 value of each regression model to see the level of information content contained in each variable. The research model was formed as follows:

$$\text{Regression model 1: } PBV = a + b_1ROA + b_2DER + e$$

$$\text{Regression Model 2: } PBV = a + b_1ROA + b_2DER + b_3SIZE + e$$

$$\text{Regression Model 3: } PBV = a + b_1ROA + b_2DER + b_3SIZE + b_4ISR + e$$

Before the two test methods were carried out, the classical assumption test was carried out in this study consisting of a normality test, multicollinearity test, heteroscedasticity test, and autocorrelation test as a regression test requirement.

4. Results and Discussion

4.1 Descriptive Statistics

Table 1: Descriptive Statistics

	N Statistic	Minimum Statistic	Maximum Statistic	Mean Statistic	Std. Deviation Statistic
PBV	52	.377	82.451	7.50394	16.8451
ROA	52	.010	.439	.11115	.092605
Leverage	52	.022	2.655	.78225	.745842
Size		15.980	19.500	17.46952	.968617
ISR	52	.581	.0860	.68198	.075145

Source: Data Processed

Table 1, shows the average value of PBV is 7.503 which means that the market price of the company's share was 7.5 times higher from the book value of the share, the sample company has a high share value. The average value of ROA was 11.11% shows the ability of the company to generate profits of 11.11% of the total assets it has. The average DER was 78.23%, indicating that corporate financing from loans was 78.23% of total equity. While the average value of the ISR of the sample companies is 0.67825 or equal to 68.19% of the 43 items of the disclosure, this means that the average company sample reveals as many as 29 ISR disclosure items. This amount represents more than half of the disclosure items disclosed by the sample companies.

4.2 Classic Assumption Test

After a normality test, the results show that the data is not normally distributed, then the data is transformed into the Log. After the data is transformed, the data has been normally distributed. Based on the results of the classic assumption test, the data proved to fulfill the free assumption of multicollinearity and heteroscedasticity, but positive autocorrelation was found for all regression models.

4.3 Correlation between Operational Variables

Table 2 shows that ROA, DER, and ISR are positively correlated with PBV. Based on the correlation test results, it is proven that H_1 is accepted, for DER and ISR information (H_2 and H_4) the correlation is positive but not significant, so H_2 and H_4 are not accepted. This study is not consistent with the results of Pratama and Wiksuana, (2016); Suffah and Riduwan, (2016); Suwardika and Mustanda, (2017) which states that leverage has a significant effect on firm value. However, the results of this study are consistent with the results of the Novari and Lestari (2016) study. And according to the Jakarta Islamic interest-based total debt index compared to total equity, not more than 82% (interest-based debt compared to total equity, not more than 45%: 55%). So that companies in carrying out their activities rely more on their own capital than debt. ISR does not significantly correlate with firm value because ISR disclosure is still voluntary, and there is no prescribed disclosure standard.

Table 2: Pearson Correlation

		PBV	ROA	DER	SIZE	ISR
PBV	Pearson Correlation	1	.832**	.246	-.283*	.245
	Sig. (2-tailed)		.000	.079	.042	.080
ROA	Pearson Correlation	.832**	1	-.013	-.277*	.135
	Sig. (2-tailed)	.000		.927	.047	.339
DER	Pearson Correlation	.246	-.013	1	.171	.203
	Sig. (2-tailed)	.079	.927		.226	.148
SIZE	Pearson Correlation	-.283*	-.277*	.171	1	.241
	Sig. (2-tailed)	.042	.047	.226		.085
ISR	Pearson Correlation	.245	.135	.203	.241	1
	Sig. (2-tailed)	.080	.339	.148	.085	

Source: Data Processed

Meanwhile, firm size is negatively correlated with firm value, so H_3 is not accepted. This shows that the larger the size of the company, the smaller the value of the company. Risk-averse Investors see large companies tend to have more complex problems than small companies; therefore, conservative investors prefer to invest in small companies to avoid higher investment risks. The results of this study are not consistent with prior research, Pratiwi, Yudiaatmaja, and Suwendra, (2016); Suwardika and Mustanda, (2017) stated that company size has a positive and significant effect on firm value.

4.4 Regression Test with Comparison of R^2 values

In order to test the information content of the variables ROA, DER, SIZE, and ISR, a regression test is performed by comparing the value of R^2 from the three previously formed regression models. R^2 is a measure to find out how much the ability of the independent variable to explain the dependent variable. The greater the R^2 , the greater the influence of the independent variables on the dependent variable.

Regression model 1: $PBV = a + b_1ROA + b_2DER + e$

Regression Model 2: $PBV = a + b_1ROA + b_2DER + b_3SIZE + e$

Regression Model 3: $PBV = a + b_1ROA + b_2DER + b_3SIZE + b_4ISR + e$.

Table 3: ISR Information Content Test Results

	Model 1	Model 2	Model 3
F stat	76.754	53.083	41.953
Sig.	.000	.000	.000
R square	.758	.768	.781
Adjusted R square	.748	.754	.763

Source: Data Processed

The research model can be said to be good at predicting company value, and this can be seen from the significance value of 0.000. From table 3, it can be seen in regression model 1 that the contribution of the effect of ROA and DER on PBV together is 74.8%. From the results of this test, it can also be proven that there is an increase in the value of R^2 seen from the adjusted R^2 in the regression model 2 of 0.6% to 75.4% after the SIZE variable is entered. Based on the results of the adjusted R^2 test value in the regression model 3, the value increases again by 0.9% to 76.3%. Then hypothesis 4 can be accepted, meaning ISR is able to provide value-added financial statement information content that will affect the value of the company, even though the increase in value is very small.

5. Conclusion and Suggestion

The results of the study based on regression tests into three models prove that Islamic Social Reporting has incremental value information content when ISR becomes part of financial reporting. In other words, the results of the study indicate the value relevance of Islamic Social Reporting disclosure as part of financial reporting. The future research can then use a comparative method to compare the incremental value of ISR between sharia-based companies and public companies or replace the analysis unit on a larger scale, such as the Indonesian Syariah Stock Index (ISSI).

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