

## Determinants of Ethical Identity Disclosure in Islamic Banks: An Analysis of Practices in Bahrain and Malaysia

(Penentu-penentu Etika Pendedahan Identiti di Bank-bank Islam: Analisa Pelaksanaan di Bahrain dan Malaysia)

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### ABSTRACT

*Islamic banks are banks that are set up to operate within the Islamic business framework that is more equitable and based on socio-economic welfare of the society and the people. In Islamic law on commercial transactions and other related contractual activities (the framework), transparency and adequate disclosure are the fundamental determinants of a successful and peaceful relationship between the contracting parties. This is because the stakeholders of Islamic banks believed that the prescriptions of the framework would be the key determinants of the bank's Ethical Identity Disclosures (EID). This study aimed at exploring and identifying the practical determinants of EID in Islamic banks. Disclosure information in annual reports (from 2007 to 2011) of 21 Islamic banks operating in Bahrain and Malaysia was gathered and analysed using Ethical Identity Index (EII) and Multiple Regression Analysis (MRA) models. The results of EII and MRA on nine ethical disclosure dimensions consisting of 80 constructs and 4 assumed determinants of EID among Islamic banks indicated that EID of both countries is low and that independent directors do not affect the level of social disclosure. However, board size, Shari'ah supervisory Board and investment account holders can significantly influence the disclosure level in Islamic banks. Hence, we conclude that our findings are in conflict with main theories such as agency theory, however supports institutional theory.*

*Keywords: Ethical identity disclosure; determinants; Islamic Banks; Bahrain; Malaysia*

### ABSTRAK

*Kajian ini bertujuan untuk meneroka dan mengenalpasti penentu-penentu yang praktikal berkaitan Etika Pendedahan Identiti (EID) di bank-bank Islam. Laporan tahunan bagi tempoh 5 tahun (2007-2011) bagi 21 bank-bank Islam yang beroperasi di Bahrain dan Malaysia, telah dikumpulkan dan dianalisa. Kajian menggunakan Indeks Etika Pengenalan (EII) dan model Analisa Regresi Berganda (MRA). Hasil analisa EII dan MRA ke atas sembilan dimensi etika pendedahan yang terdiri daripada 80 konstruk dan 4 penentu andaian EID di kalangan bank-bank Islam menunjukkan bahawa, EID di kedua-dua negara adalah rendah dan pengarah bebas tidak memberi kesan kepada tahap pendedahan sosial. Walau bagaimanapun, saiz lembaga pengarah, lembaga penasihat syariah dan pemegang-pemegang akaun pelaburan boleh mempengaruhi tahap pendedahan dalam bank-bank Islam. Kesimpulannya penemuan kajian ini adalah bertentangan dengan teori-teori yang sedia ada seperti teori agensi dan menyokong teori institusi.*

*Kata kunci: Etika pendedahan identiti; penentu-penentu; bank-bank Islam; Bahrain; Malaysia*

### INTRODUCTION

Islamic Banks similar to conventional banks are profit-oriented organizations that aim to gain profit. However, in doing so, Islamic banks must avoid interest (*Riba*) and other non-permissible activities in Islam. Hence, they are characterised as ethical banks which are founded on the precepts of Islam and operate within the Islamic business framework. In Islamic law on commercial transactions, transparency and information disclosure are the key determinants of a successful and peaceful contractual relationship. Islamic banks therefore, have the ethical responsibility to disclose every relevant information to

all their stakeholders; either the customers, employees, regulators, shareholders or for the society at large for the purpose of making an informed decision regarding their stakes in the bank or its relationship with its business environment.

Kayed and Hassan (2011) further implied that having adequate and consistent disclosure is necessary for the Islamic banking industry to remain relatively positive and resilient. To ensure financial stability of Islamic financial system, Islamic banks need to ensure that their transparency is proper and consistent especially with regard to their ethical identity as Islamic institution. They have to ensure that their activities are in line with

*Shari'ah* principles since *Shari'ah* is the main component and the foremost salient feature in Islamic banks, which differentiate them from conventional banks. Such features include the prohibition of interest and the use of profit sharing investment. Failure to comply with the *Shari'ah* may lead to the losses to the Islamic banks themselves since they might not be able to recognize the income (IFSB 2005). The greatest losses that they need to bear is the possibility of losing their investors and Investment Account Holders, who are mostly Muslims and, who are really particular about *Shari'ah* compliance issues and the ethical identity in their dealings.

Alternatively, the banks' abilities in maintaining its capital at sufficient level, as well as ability in realising rates of return equal to the assumed investment risk is a measurement to both shareholders and Investment Account Holders (Mohd Ariffin, Archer & Abdel Karim 2009). These criteria are important for their evaluation and confidence in making decision. Lack of such confidence may stop any Muslim from having a business deal with the Islamic banks. In order to prevent the possibility of such incidence, proper disclosure is needed in Islamic banks' financial report, which is prepared according to the standard that is applicable to the Islamic banks. As such, studies of assessing the strength of communicated ethical identity of Islamic banks are important since Islamic banks are accountable not only to the society but also to God. Besides, transparency in Islamic banks' ethical identity is essential to the society as it is one of the approaches in achieving ethical and social activities of Islamic banks. For example, matters pertaining to Islamic banks' products, financing activities and community activities.

Due to the extensive and progressive approach on Islamic banking and finance, the Kingdom of Bahrain is chosen for this study as it is known as the hub of Islamic banking worldwide and it represents the best practice of Islamic banks (Hidayat & Abduh 2012). Bahrain established its first Islamic banks, Bahrain Islamic Bank, in the year 1979 and currently having 26 Islamic banks, which comprise of six retail Islamic banks and twenty (20) wholesale Islamic banks registered under Central Bank of Bahrain (Central Bank of Bahrain 2012). Similarly, Malaysia has also observed progressive and robust development in Islamic banking since 1986 in order to serve the needs of Malaysian economy as well as enhance the sustainable and economic growth of Malaysia (Bank Negara Malaysia 2012). Therefore, by comparing the ethical identity disclosure of Malaysian Islamic banks with Bahrain Islamic bank, Malaysian Islamic banks' position could be identified when compared to the pioneer of Islamic banking. Examining the level of ethical disclosure among Islamic Banks in Malaysia and Bahrain can fulfil the gap from previous studies where the focus had been more towards corporate social responsibility disclosure.

This research paper is therefore set to explore the concept, practices and determinants of corporate ethical disclosure in Islamic banks by examining and analysing the practices of 5 Islamic banks operating in Bahrain and

16 Islamic banks operating in Malaysia as a collective sample representing the industry practice. According to the principles of Islamic law on commercial transactions and other related contractual activities, transparency and adequate disclosure is the fundamental determinant of a successful and peaceful business relationship between the contracting parties. However, there is no sufficient evidence in terms of literature to indicate what are the determinants or factors that can influence transparency and adequate social disclosure in Islamic banks that operate in today's business environment. Hence, this study also examines the determinants of the level of ethical identity disclosures (board size, board independence, *Shari'ah* Supervisory Board and Investment Account Holders).

The remainder of this paper is organised as follows. The next section reviews on relevant literature and hypothesis development. The third section discusses on sampling methodology, data collection and data analysis, followed by discussion on the research findings in the fourth section. Finally, the paper ends with summary and conclusion of the research.

#### REVIEW OF PREVIOUS STUDIES AND HYPOTHESES DEVELOPMENT

Empirically, this study used corporate governance characteristics as a determinant in assessing the factors affecting the ethical disclosure of the Islamic banks. Specifically, the board composition, which comprises three perspectives, namely, board size (Said et al. 2009), board independence (Khan 2010; Bhasin, Makarov & Orazalin 2012) and *Shari'ah* Supervisory Board, as well as Investment Account Holders (Farook, Hassan & Lanis 2011) are used to assess the ethical identity disclosure of Islamic banks, thus relating each variable to the theoretical assumptions.

#### BOARD SIZE

The board of directors is one of the important elements in corporate governance and is responsible in supervising and overseeing the organisation as to ensure that it is being properly managed by the management. According to Jensen (1993), the larger the number of board members, the more ineffective the communication and coordination of the board and the more likely it is controlled by the CEO. This argument is supported by the agency theory, which proposes that large board can be costly to the organization due to increase in the potential conflict and operational complexity among board members, which lead to poor decision making (Lipton & Lorsch 1992; Jensen 1993). Ning, Davidson and Wang (2010) suggested that an increase in board size would likely cause an increase in agency problems, which would contribute to internal conflict as well as the free-riding problem among the directors. Said et al. (2009) also acknowledged that ineffective communication and inefficiency in decision-

making would lead to low quality disclosure in financial reporting since the board members are not able to perform their roles efficiently.

However, Clemente and Labat (2009) claimed that large board size would increase the monitoring capabilities of the board. Due to a significant relationship between the organization and their stakeholders, they tend to increase their disclosure level and release more information, as suggested by the stakeholder theory. In a study by Akhtaruddin, Hossain, Hossain and Yao (2009), they found that board size is a significant predictor of the voluntary disclosure in Malaysian listed firms, as they found that large board size produced a greater level of voluntary disclosure. Moreover, in Rouf (2011), who studied how corporate characteristics and governance attributes would affect the voluntary disclosure in Bangladeshi firms, found there is a significantly positive relationship between board size and voluntarily disclosure. In a study concerning the impact of corporate governance on social and environmental information disclosure in Malaysian banks by Htay, Abd Rashid, Adnan and Mydin Meera (2012), it was found that board size has a positive significant impact on the social and environmental information disclosure. This is because large board size seems to produce a better effect on the disclosure in the banking sector. Thus, based on the stakeholder theory, this study expects that there is a positive relationship between board size and disclosure level, which leads to the hypothesis which states:

H<sub>1a</sub> There is a positive significant relationship between board size and ethical identity disclosure.

#### BOARD INDEPENDENCE

In Jensen and Meckling (1976), according to the agency theory, boards need to be observed and supervised by another party because of the nature of their opportunistic behaviour. As the decision experts, independent directors are suitable to take the role of monitoring and controlling the management performance since they have to be professional and have a positive influence over the director's decision (Fama & Jensen 1983; Hermalin & Weisbach 1988). Lim, Matolcsy and Chow (2007) found that independent directors would influence the disclosure level of firms concerning corporate information, as they play a role in the decision making process at the board level. On the other hand, Ho and Wong (2001) found no significant association between board independence and disclosure due to the low level of compliance in Chinese firms even with the presence of independent directors. This is also supported by the findings of Mohd Ghazali and Weetman (2006) who found that board independence has no significant relationship with voluntary disclosure as the existence of independent directors on the board of directors could not influence the voluntary disclosure of Malaysian listed companies.

The findings from Mohd Ghazali (2007) showed that board independence is significantly positive towards the

disclosure level of the organization, which is consistent with the suggestion by the agency theory that claims that involvement from the board of directors is necessary in order to monitor any self-interest activities by managers. In addition, this theory suggests that a high proportion of independent directors will be able to monitor any self-interest action by the management; and, thus, may encourage the management to disclose more information (Williams, Duncan, Ginter & Shewchuk 2006). This is consistent with the study by Bhasin et al. (2012) who examined the voluntary disclosure determinants in the banking sector of Kazakhstan, and found that board composition has a positive significant impact on the voluntary disclosure by Kazakhstan banks. This is supported by the findings by Htay, Ab. Rashid, Adnan and Mydin Meera (2011) who found that independent directors are one of the significant factors affecting the voluntary disclosure in Malaysian listed banks as they can provide more sources of information to the dependent directors. Consequently, based on the stakeholder and agency theory, this study expects that Malaysian and Bahrain Islamic banks tend to disclose more information on ethical identity with the presence of independent directors as board members:

H<sub>1b</sub> There is a positive significant relationship between board independence and ethical identity disclosure

#### SHARI'AH SUPERVISORY BOARD

This study includes the *Shari'ah* Supervisory Board, as the board is one of the corporate elements in Islamic banks, and is considered as crucial to the level of disclosure in Islamic banks. The *Shari'ah* Supervisory Board is a unique element in the governance of Islamic banks. In Scott (2005), he explained that the institutional theory is a kind of social structure that has been set up as an authoritative guideline, which consists of schemes, norms and routine, to structure the social behaviour. Based on this theory, Farook et al. (2011) and Khan et al. (2015) mentioned that the *Shari'ah* Supervisory Board institution plays a vital role in ensuring that the activities of Islamic banks harmonize with *Shari'ah* ethics and principles. As the institution that governs Islamic banks, the *Shari'ah* board is responsible for guiding and controlling the behaviour of organizations so that the interests of society can be protected. Karim (1990) stressed in his paper that the authority of the *Shari'ah* Supervisory Board is equal to other conventional auditors since they need to 'investigate' whether the Islamic banks adhere to Islamic ethics and *Shari'ah* principles. According to Farook et al. (2011), the nature of *Shari'ah* compliance is not only based on the assurance of compliance through the *Shari'ah* Supervisory Board report but also on the greater involvement in social activities as well as the social disclosure. Thus, it is expected that the existence of the *Shari'ah* Supervisory Board in the governance of Islamic bank would lead to greater disclosure level of the Islamic bank itself.

Farook et al. (2011) also stated that the higher the number of the members of the *Shari'ah* Supervisory Board, the greater the disclosure level of Islamic banks since the ability of the *Shari'ah* Supervisory Board to monitor the Islamic banks governance also increases. Their study, which examines the *Shari'ah* Supervisory Board as one of the factors that may influence the corporate social responsibility disclosure in Islamic banks, found that the *Shari'ah* Supervisory Board is the most significant factor that affects the level of corporate social disclosure. Similarly, Abdul Rahman and Awadh Bukair (2013) found that the combination of *Shari'ah* Supervisory Board attributes has a significant positive influence on corporate social responsibility (CSR) disclosure among Islamic Banks of Gulf Co-Operation Council Countries. In examining *Shari'ah* disclosures among Malaysian and Indonesian Islamic Banks, Wan Abdullah et al. (2013) found that the extent of disclosure on *Shari'ah* Supervisory Board is associated with the cross-membership with other *Shari'ah* Supervisory Board and the expertise of *Shari'ah* Supervisory Board members in accounting, banking, economics or finance.

As suggested by institutional theory, the *Shari'ah* Supervisory institution plays an important role in influencing the level of disclosure of Islamic banks, as they are a part of the *Shari'ah* governance, which governs the *Shari'ah* matters in Islamic banks. Hence, applying institutional theory, this study proposes that disclosure is positively related to the *Shari'ah* Supervisory Board of Islamic banks, which can be formulated in the following hypothesis:

H<sub>1c</sub> There is a positive significant relationship between the *Shari'ah* Supervisory Board and ethical identity disclosure.

#### INVESTMENT ACCOUNT HOLDERS

Farook et al. (2011) argued that Muslim investors would prefer to make an investment as investment account holders rather than invest their funds as shareholders. This is because they are usually interested in the services offered by Islamic banks compared to the share ownership of that particular bank. However, Archer and Karim (1998) argued with regard to agency theory, the form of profit sharing loss contract used by Islamic banks in managing and mobilizing the investment account holder's fund might lead to agency problems. Since Islamic banks act as the agent of the shareholders as well as for the Investment Account Holders, this relationship would increase the possibility of having a conflict of interest in dealing with the investment account holders' funds (Archer et al. 1998). Pertaining to the Islamic banks risk, *Shari'ah* compliance is one of the important elements in Islamic banks. Therefore, the investment account holders might face the risk of non-compliance with *Shari'ah*, which may contribute to the agency problem in Islamic banks

when the banks fail to meet the obligation of *Shari'ah* principles (Bank Negara Malaysia 2010). Therefore, in order to solve these agency problems, adequate disclosure of reporting information, especially information with regard to the *Shari'ah* compliance, might reduce the occurrence of agency problem among the investment account holders since they have enough information to assess the risk (Karim 2001).

Karim (1990) also stated that in the context of the *Shari'ah* Supervisory Board report, if Islamic banks are going to publish a negative report, the group of investment account holders would begin to doubt the management's commitment towards *Shari'ah* and they may start to avoid dealing with that particular Islamic bank. As the investment account holders are more interested in the *Shari'ah* compliance issues in the Islamic banks, the presence of investment account holders could have greater influence concerning the extent of disclosure. Further, in a study by Farook et al. (2011), which examines investment account holders as one of the factors that may influence corporate social responsibility disclosure in Islamic banks, found that investment account holders are among the significant factors that affect the level of corporate social disclosure. This is consistent with the stakeholder theory that claims the responsibility of Islamic banks towards the investment account holders. As investment account holders are the backbone in the operation of Islamic banks, the banks should strive to meet and maintain the expectation of the investment account holders through ethical identity disclosure. Thus, the final proposition on the relationship between the investment account holder and ethical identity disclosure level could be hypothesised as below:

H<sub>2</sub> There is a positive significant relationship between investment account holders and ethical identity disclosure.

#### RESEARCH METHODOLOGY

The sample size of this study consists of 16 Malaysian Islamic banks and 5 retail Islamic banks operating in the Kingdom of Bahrain, totalling 21 Islamic banks. The main source of data for this study is the corporate social disclosure information published in the annual reports of the banks for the period of 5 consecutive years from 2007 to 2011. The study used content analysis to identify the items for measuring the corporate social disclosure practices of Islamic banks. The items and categories for the research instrument chosen take into account the disclosure requirement by the Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI, 1997) as used in similar studies by Haniffa and Hudaib (2007), and Zubairu et al. (2011). Data collected was analysed using Ethical Identity Index (EII) comprising of nine dimensions of disclosure namely; vision and mission statement, board of directors and top management, product,

zakat, charity and benevolent loan, employees, debtors, community, environment and *Shari'ah* Supervisory Board. The possible total score obtained by each bank amounts to 80 points.

Conceptually, there are three types of variables in this study namely; independent, dependent and control variables. The independent variables are:

1. Board size measured according to the number of directors on the board (Akhtaruddin et al. 2009),
2. Board independence measured by looking at the percentage of independent directors to the total number of directors (Chau & Gray 2010; Huafang & Jianguo 2007),
3. *Shari'ah* Supervisory Board measured by looking at the number of members on the *Shari'ah* Supervisory Board (Farook et al. 2011) and
4. Investment Account Holders (IAH) measured by dividing the IAH funds to the paid up capital in shareholders' equity (Farook et al. 2011).

Ethical Identity Disclosure (EID) is the dependent variable. While bank size is measured based on the logarithm of total assets of the banks at the end of the reporting year (Fungacova & Weill 2009), banks' profitability measured through the return on equity (ROE) of the Islamic banks (Berger & Black 2011) and country, measured using dummy values (0 Malaysia, 1 Bahrain) are the control variables. The usage of country as a control variable was similarly used in study by Bashir (2001).

Two analytical models namely; Ethical Identity Index (EII) Multiple Regression Analysis (MRA) will be used in determining the disclosure level of corporate social disclosure and identifying the factors that determine corporate ethical identity in Islamic banks respectively. Similar to the studies by Haniffa and Hudaib (2007), Zubairu, Sakariyau, and Dauda (2011) EII is computed as follows:

Model 1:

$$EII_j = \frac{\sum X_{ij}}{n_j}$$

Where EII<sub>j</sub> = Ethical Identity Index

X<sub>ij</sub> = 1 if *i*th construct is disclosed, 0 if *i*th construct is not disclosed

n<sub>j</sub> = Number of constructs to be disclosed by banks

The MRA equation is as below:

MRA Equation:

$$CSD = \beta_0 + \beta_1 BSIZE + \beta_2 BINDE + \beta_3 SSB + \beta_4 IAH + \beta_5 SIZE + \beta_6 PROFIT + \beta_7 COUN + \epsilon$$

Where:

- EID = Corporate Social Disclosure
- BSIZE = Board's size
- BINDE = Board's independence
- SSB = *Shari'ah* Supervisory Board
- IAH = Investment Account Holder
- SIZE = Banks' size
- PROFIT = Banks' profit
- B<sub>i</sub>* = Parameter to be estimated
- i* = 1, 2, 3, 4, 5, 6, 7
- ε = Error term

## RESULTS ANALYSIS AND DISCUSSIONS

### ANALYSIS OF EID PRACTICES

Table 1 presents the ethical identity disclosure (EID) index for nine dimensions for both the Malaysian and Bahrain Islamic banks. It shows that the overall disclosure for ethical identity for both countries is only 51.7%, which suggests that there is low level of disclosure for both countries. Further, it can be seen that the disclosure of Bahrain Islamic banks is significantly higher (56.4%) than that of the Malaysian Islamic banks (47%). However, even though the level of disclosure of the Bahrain banks is greater than that of the Malaysian banks, it is still low as both countries only disclosed about 50% of the disclosure requirements. The Table also illustrates that

TABLE 1. Ethical identity disclosure index

Ethical Identity Index	Malaysia	Bahrain	Total Mean	Sig.
Vision and mission statement	47.1%	56%	51.6%	0.001
BOD and top management	62%	76.6%	69.3%	0.000
Product	36.8%	53.6%	45.2%	0.000
<i>Zakāt</i> , charity and benevolent loans	30.1%	49.8%	39.9%	0.000
Employees	62.5%	75%	68.8%	0.000
Debtors	84.4%	71%	77.7%	0.000
Community	38.3%	76.7%	57.5%	0.000
Environment	13.2%	0%	6.6%	0.005
<i>Shari'ah</i> Supervisory Board	49%	48.7%	48.8%	0.914
Total	47%	56.4%	51.7%	0.000

Source: Research Data Analysis

the most communicated dimension by both banks is the debtors' dimension (77.7%) followed by board of directors and top management dimension (69.3%). While the least communicated dimension is the environmental dimension with 6.6% of disclosure. This implies that neither country prioritises environmental issues, which, perhaps, is because they considered that environmental issues are not influenced by their operations.

The results further indicated that the Malaysian and Bahrain Islamic banks need to improve their disclosure on vision and mission statement, product, *Zakāt*, charity and benevolent loans, community, environment and *Shari'ah* Supervisory Board dimension, since the level of disclosure for these dimensions is either below or around 50%.

#### DESCRIPTIVE STATISTICAL ANALYSIS

Table 2 shows that, on average, most of the Islamic banks in Malaysia and Bahrain employed about seven to eight members as the members of the board of directors, which is an optimal number for the board, as having more than that would interfere with the group dynamics (Jensen 1993). As for the board's independence (BINDE), the mean is 50.14%, which means that half of the board of directors

in Islamic banks consist of independent directors. This indicates that the banks have met the corporate governance requirements for Islamic banks. For *Shari'ah* Supervisory Board (SSB), the results indicate that most *Shari'ah* Supervisory Boards in Islamic banks consist of four members. This shows that both countries have complied with the regulators' requirement. Finally, the mean for investment account holders of 1626.69% implies that most of the investment account holders in Islamic banks are about sixteen times more than the paid up capital of the Islamic banks.

#### CORRELATION ANALYSIS

Table 3 below indicated there is a negative significant correlation between the board size and investment account holders where  $r$  is -0.377 at 1% significance level. This medium relationship indicates that a larger board size would reduce the investment account holders. Table 3 also illustrates that there is a positive significant correlation between board independence and investment account holders, which has a medium strength of relationship, as  $r$  is 0.304 at 1% significance. This shows that a large proportion of independent directors would increase the number of investment account holders.

TABLE 2. Descriptive statistics of ethical identity disclosure determinants

Determinants	Malaysian Islamic Banks		Bahrain Islamic Banks		Total	
	Mean	Std. Deviation	Mean	Std. Deviation	Mean	Sig
BSIZE (No of member)	7.53	1.646	8.68	1.773	7.8	0.003
BINDE (%)	50.63%	0.133788	48.56%	0.223694	50.14%	0.571
SSB (No of member)	4.20	1.152	4.04	0.935	4.16	0.529
IAH (%)	2001.67%	31.838083	426.73%	3.635097	1626.69%	0.016

Source: Research Data Analysis

Notes: EID is Ethical Identity Disclosure.

BSIZE is Board Size

BINDE is Board Independence.

SSB is Shari'ah Supervisory Board.

IAH is Investment Account Holder.

TABLE 3. Pearson correlation coefficient

	BSIZE	BINDE	SSB	IAH	SIZE	PROFIT	COUN
BSIZE	1						
BINDE	-0.023	1					
SSB	0.002	0.031	1				
IAH	-0.377**	0.304**	-0.033	1			
SIZE	-0.275**	0.240*	0.336**	0.439**	1		
PROFIT	0.126	0.096	0.019	0.007	-0.137	1	
COUN	0.284**	-0.056	-0.062	-0.236*	-0.809**	0.171	1

Source: Research Data Analysis

Notes: \*\* Correlation is significant at the 1% level (2-tailed).

\* Correlation is significant at the 5% level (2-tailed).

EID is Ethical Identity Disclosure.

BSIZE is Board Size

BINDE is Board Independence.

SSB is Shari'ah Supervisory Board.

IAH is Investment Account Holder.

## MULTIVARIATE ANALYSIS

Before running the multiple linear regression analysis, we tested the data for normality and multicollinearity. The Kolmogorov-Smirnov test indicates that the data is not normally distributed. However, according to Pallant (2010), it is common for large sample size to be abnormally distributed, through which the data violates the assumption of normality; however, it will not cause any serious problem. In addition, according to the Central Limit Theorem, when the sample size is large, more than 30 per group, the sampling distribution will take a normal distribution shape, regardless of the population shape from which the sample is drawn (Field 2009).

Table 4 tabulates the results for the Multiple Linear Regression analysis that examines the determinants for EID. The Durbin-Watson value shows 1.710. This implies that there is no presence of auto-correlation, thereby indicating data independence between the independent variable and EID.

TABLE 4. Multiple linear regression analysis: Determinants of ethical identity

Model	Coefficients	t-value	p-value
(Constant)		-2.855 ***	0.005
BSize	0.196	2.509 **	0.014
Bindep	0.025	0.333	0.740
SSB	0.284	3.320 ***	0.001
IAH	0.235	2.397 ***	0.008
Size	0.609	3.667 ***	0.000
Profit	-0.054	-0.748	0.456
Coun	0.897	6.326 ***	0.000
R <sup>2</sup>		0.529	
Adjusted R <sup>2</sup>		0.495	
F-value		15.541	
p-value		0.000	
Durbin-Watson		1.710	
N		105	

Notes: \*\*\* P-value is significant at the 0.01 level

\*\* P-value is significant at the 0.05 level

Dependent variable - EID is Ethical Identity Disclosure.

Independent variables - BSize (Board Size), Bindep (Board Independence), SSB (Shari'ah Supervisory Board) & IAH (Investment Account Holder)

Control variables - Size (Banks' Size), Profit (Banks' Profit) & Coun (Country)

Table 4 highlights that there is a positive significant relationship between board size (BSize) and EID of Islamic banks, in which the t-value is 2.509 at 5% significance level; thus accepting hypothesis H<sub>1a</sub>. Our findings is supported by Akhtaruddin et al. (2009), Rouf (2011) and Htay et al. (2012) who found a positive relationship between board size and voluntary disclosure, which suggests that a large board will ensure more EID compared to a smaller board. Our findings are also consistent with the stakeholder theory, which claims that the Islamic banks tend to increase their disclosure level and release more information concerning their operations and activities due

to the significant relationship between Islamic banks and their stakeholders. Therefore, having a large number of board members would increase the level of disclosure in Islamic banks, which helps the board to satisfy the needs of the stakeholders as also claimed by Clemente and Labat (2009). This result implies that board size is one of the important determinants of EID in Bahrain and Malaysian Islamic banks as it plays a significant role in influencing the disclosure of the ethical identity by the banks. The existing size of 7 and 9 board members in Malaysian and Bahrain Islamic banks respectively are considered large enough to influence dynamic decision making. Further observation indicates that most of the Islamic banks in Malaysia and Bahrain that have a high-level of disclosure are those banks with large board size.

However, as indicated in Table 4, hypothesis H<sub>1b</sub> is rejected as the results show there is no significant relationship between the proportion of independent members on the board of directors and EID. This finding is in contrast with agency theory that suggests that to influence decision making as well as monitor and control the opportunistic behaviour of management and other board members, independent directors need to be among the board members. This is because, besides incentives, effective monitoring is one of the mechanisms that was proposed to minimise the agency problem that occurs in organisations by Jensen and Meckling (1976). However, the results corroborate the findings of Mohd Ghazali and Weetman (2006), and Khodadadi, Khazami and Aflatooni (2010), as the authors found no significant relationship between board independence and voluntary disclosure in Malaysia and Iranian listed firms. This is supported by other findings from Haniffa and Cooke (2002), as they found that the proportion of independent directors could not influence the level of disclosure due to the ineffective monitoring role by the directors. Hence, the issue that needs to be addressed in the findings of this study concerns the independence of independent directors as well as their monitoring effectiveness, as most of them are appointed and paid by the bank's chairman or CEOs, their influences are limited. The data collected also show that the proportion of independent directors is similar for most of the banks, and that even banks with the highest and lowest disclosure level are a bit different in terms of their proportion of independent directors.

Similar to the studies by Farook et al. (2011), the regression results in Table 4 further indicate that there is a significant positive relationship between the Shari'ah Supervisory Board and ethical identity disclosure in Malaysian and Bahrain Islamic banks and the relationship; thus hypothesis H<sub>1c</sub> is accepted. This finding is consistent with the institutional theory that suggests that to ensure the organisation is successful in achieving its goals and objectives, the organisations' corporate governance mechanism must be effective. The institutions' Shari'ah Supervisory Board is responsible for guiding and controlling the conduct and performance of the Islamic banks to ensure that the interests of society are

protected. Thus, the existence of the *Shari'ah* Supervisory Board members may result in greater governance and monitoring, and, consequently, greater compliance with *Shari'ah* principles by the Islamic banks. Increasing the level of integrity of the *Shari'ah* Supervisory Board may increase the level of confidence of Muslim society, especially Muslim investors towards the Islamic financial institution.

Similar to the study by Farook et al. (2011), further analysis in this study shows that investment account holders (IAH) have a significant positive relationship with ethical identity disclosure in Malaysian and Bahrain Islamic banks; thus, hypothesis H<sub>2</sub> is accepted. This finding is consistent with the stakeholder theory, whereby having greater monitoring by the investment account holders as one of the stakeholders is needed in the Islamic banks to ensure that the investment account holders are managed and mobilised appropriately by the banks. As the Islamic banks need to act as the agent to the investment account holders as well as to the shareholder, the conflict of interest or agency problem would arise. Therefore, the presence of monitoring from investment account holders may reduce the agency problem, and, thus, influence the management of Islamic banks pertaining to the compliance and disclosure issues (Archer et al. 1998). The investment account holders' influence may apply more pressure on the management of Islamic banks to disclose more information as required by the regulators. Thus, by disclosing the ethical identity information, it may establish a connection with the Muslim investor.

#### CONCLUSION

From the ethical identity index model, we can see that the overall disclosure level in both countries is 51.6%, which suggests a low level of disclosure by both countries, since they only disclose 50% of their total expected disclosure. In addition, the overall disclosure shows that the disclosure level of Bahrain Islamic banks is significantly higher (56.4%) than Malaysian Islamic banks (47.1%). The results further indicate that the information in the vision and mission statement; product; *Zakat*, charity and benevolent loans; community; environment; and *Shari'ah* Supervisory Board dimensions need to be emphasised by the regulators as well as the Islamic banks as they are among the least communicated activities by both banks. This needs to be emphasised by both the management and the regulators of Islamic banks because if these dimensions are not adequately disclosed, it could have a severe impact on the image of Islamic banks as ethical and Islamic financial institutions. The management of Islamic financial institutions have the upmost duty to improve their disclosure level to provide a deeper assurance to the stakeholders on the institutions' *Shari'ah* compliance in all aspects of their products, instruments, operations and practices. Moving towards a more transparent disclosure would also require more proactive involvement of

regulators as the results in this study have shown that the respective institutions will only abide with the minimum requirement as provided by the regulators.

Further analysis suggests that independent directors of Islamic banks in both Malaysia and Bahrain cannot really influence the management when it comes to ethical identity disclosures regardless of their number. Meanwhile, the *Shari'ah* Supervisory Board members are found to be the most significant factor that could influence the level of ethical identity disclosure in Islamic banks. This is consistent with the idea suggested by the institutional theory in which the *Shari'ah* Supervisory Board is one of the significant means of governance in Islamic banks to supervise and control the Islamic banks' activities and performance and ensure that they conform to the *Shari'ah* principles (Farook et al. 2011). Thus, the current findings show that the *Shari'ah* Supervisory Board plays a critical role in influencing the level of ethical identity disclosure in Islamic banks as they could govern the Islamic banks effectively with their expertise. Furthermore, the result of this study implies that investment account holders are among the monitoring mechanisms that can be used to enhance disclosure level and transparency among Islamic banks. This is in line with stakeholder theory, as investment account holders could be a good monitoring tool in observing the activities of Islamic banks. After all, their huge amount of deposits can serve as a control mechanism to force the Islamic banks to comply with *Shari'ah* and other ethical requirement. Since Muslim investors are more likely to invest their funds in *Shari'ah*-compliant investments, Islamic banks need to carefully manage their operations and ensure that everything is in accordance with *Shari'ah* law.

Finally, this study also found that the size of the board has a significant influence on the level of ethical identity disclosure in Islamic banks. This is consistent with the stakeholder theory and findings of Clemente and Labat (2009), which claimed that the larger the board size, the greater the level of disclosure in Islamic banks; thus more stakeholders' needs as well as expectations could be fulfilled by the Islamic banks. However, there are many aspects of this study that could be explored in future research. As this study used secondary data in examining the level of disclosure in Islamic banks, future research may consider using other methodological approaches, other forms of media as well as improving the research instruments by adding any other aspects that could be used in examining the ethical identity disclosure in Islamic banks. Future studies could also consider comparing the determinants for both countries and identify which determinants would be more important under different Islamic governance settings.

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## APPENDIX A

## List of Sampled Islamic Banks in Malaysia and Bahrain

Islamic Banks in Malaysia		Islamic Banks in Bahrain	
No.	Bank Name	No.	Bank Name
1	Affin Islamic Bank Berhad	1	Al Baraka Islamic Bank B.S.C.
2	Al Rajhi Banking & Investment Co. Berhad		
3	Alliance Islamic Bank Berhad	2	Al-Salam Bank -Bahrain B.S.C.
4	AmIslamic Bank Berhad		
5	Asian Finance Bank Berhad	3	Bahrain Islamic Bank B.S.C.
6	Bank Islam Malaysia Berhad		
7	Bank Mu'amalat Malaysia Berhad	4	Khaleeji Commercial Bank B.S.C.
8	CIMB Islamic Bank Berhad		
9	Hong Leong Islamic Bank Berhad	5	Kuwait Finance House (Bahrain) B.S.C. ©
10	HSBC Amanah Malaysia Berhad		
11	Kuwait Finance House (Malaysia) Berhad		
12	Maybank Islamic Berhad		
13	OCBC Al-Amin Bank Berhad		
14	Public Islamic Bank Berhad		
15	RHB Islamic Bank Berhad		
16	Standard Chartered Saadiq Berhad		

Source: Bank Negara Malaysia and Central Bank of Bahrain