

MAQASHID SHARIA-BASED PERFORMANCE IMPROVEMENT MODEL: A CASE STUDY IN ISLAMIC BANKS IN INDONESIA

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Abstract: This study analyzes and empirically tests maqashid sharia through good corporate governance (GCG) and Islamic social reporting (ISR). The sample comprised 49 samples from sharia banking listed on the Indonesia Stock Exchange in 2012-2018. They were analyzed using the Structural Equation Model based on Partial Least Square (SEM-PLS) with SmartPLS 3.0 software. The results of this study indicate that GCG has a positive effect on ISR and maqashid sharia. ISR is also an intervening variable in the relationship between GCG and maqashid sharia. However, ISR does not affect maqashid sharia. The results of this study can be used for managers of sharia banks to maximize justice and social balance under the objectives of maqashid sharia. Meanwhile, the financial services authority (OJK) can use this study result to oversee the implementation of GCG to benefit stakeholders. For investors, it can be used as a consideration for making investment decisions. Further research can add independent variables to get a better research model. Future research also can be conducted on companies listed on the sharia stock exchange: the Jakarta Islamic Index or the Indonesia Sharia Stock Index to get an overview of maqashid sharia in other industries.

Keywords: Islamic corporate governance; Islamic social reporting; maqashid sharia

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INTRODUCTION

The Islamic banking industry in Indonesia has experienced encouraging growth in the most recent decade. The advancement of the Islamic banking industry that is faster and bigger at any rate has made a positive commitment in supporting budgetary incorporation, particularly for individuals who need money related administrations that meet Islamic standards at different levels of business, from corporate businesses to grassroots communities that have not been reached by formal financial services. Financial Services Authority (2020) comparing the development of the Islamic banking industry with conventional banking during 2012 to 2018, it found that the total assets of the conventional banking industry in 2018 amounted to IDR. 8,068 trillion, an increase of 9.22% from 2017 of IDR. 7,387 trillion. The average growth since 2012-2018 in conventional banking was 12.02%. While the total assets of the Islamic banking industry in 2018 amounted to IDR. 477 trillion, an increase of 12.50% from 2017 of IDR. 424 trillion. The average growth of Islamic banking since 2012-2018 is 18.81%. Sharia banking penetration has also increased,

if in 2014 by 4.85% it increased to 5.91% in 2018. The continued growth of the Islamic banking industry has contributed to the Indonesian economy, especially in the real sector and SMEs, where the two sectors absorb a lot of workforces so that reduce unemployment. In addition, the Islamic banking industry can drive the halal economy which is currently growing.

In Indonesia, the performance assessment of Islamic banking is regulated in Bank Indonesia Regulation No. 9/1 / PBI / 2007 concerning the Rating System for Commercial Bank Soundness Based on Sharia Principles, the assessment of Islamic banking in Indonesia is carried out by considering the CAMEL (Capital, Asset quality, Management, Earning, Liquidity) factor. The use of these ratios when applied in Islamic banking will result in a mismatch with the multidimensional objectives of Islamic banking. As a sharia institution, Islamic banking has differences with conventional banking so that it is not only required to measure performance from a financial perspective but also must be measured in terms of the achievement of sharia objectives, namely *maqashid sharia*. Previous studies have mostly measured banking performance using financial ratios including James and Joseph(2015), Belhaj and Mateus(2016), Georgantopoulos and Filos(2017), Md. Aatur Rahman and Jahurul Islam(2018), and Ayadi et al., (2019) only a few measure the banking performance with *maqashid sharia*, including Kholid and Bachtiar (2015), Arsad et al., (2020), and (Elgattani & Hussainey, 2020).

Islamic Corporate Governance (ICG) plays a significant role for achieving *maqashid sharia*. Islamic banking is needed to work as per sharia business standards and ethics by implementing corporate governance known as ICG (Farook et al., 2012). ICG is different from corporate governance which generally talks about board responsibility, legal and regulatory compliance, internal control and auditing from a fundamental perspective (Wijethunga and Ekanayake, 2015). In ICG, the administration can be coordinated by good and social values according to sharia law (Bhatti and Bhatti, 2009; Istiqomawati et al., 2020). The optimal implementation of ICG will assist Islamic banking in achieving its objectives in accordance with *maqashid sharia*, namely carrying out economic activities that are free from usury, *gharar*, and speculation.(Khan & Zahid, 2020) research results show that ICG has a positive effect on bank performance.

To achieve *maqashid sharia*, Islamic banking is also required to report social activities as a form of Islamic banking responsibility towards its social environment or commonly known as Islamic Social Reporting (ISR). Haniffa (2002) revealed that there are impediments in conventional social reporting, thus she proposes a reasonable system for ISR in accordance with sharia provisions which contributes on decision-making for Muslims, as well as assists organizations with satisfying social commitments to society while providing spiritual satisfaction for their investors. (Khalil & O'sullivan, 2017) research found that ISR has an effect on bank performance.

Based on several previous studies (Khalil & O'sullivan, 2017) on the effect of profitability, size, leverage on ISR; (Khan & Zahid, 2020), the influence of sharia and corporate governance on profitability; (Elgattani & Hussainey, 2020), the effect of corporate governance on profitability; the influence of corporate governance and ISR on *maqashid sharia* (Atiqoh and Yusro, 2018) and the effect of GCG on ISR (Sari and Helmayunita, 2019), it is possible to design a new research model and conduct empirical testing. This

study used a better model than the previous research by Atiqoh and Yusro (2018). This study also examined ISR as an intervening variable for the relationship between ICG and sharia. ICG can encourage Islamic banks to fulfill social responsibilities according to sharia principles (ISR). It encourages Islamic banks to realize justice and balance for the community following the goals of sharia maqashid. Besides that, this research also develops ICG measuring instruments from (Aslam & Haron, 2020) and Setyawan and Permatasari (2018) so as to produce a better ICG instrument.

LITERATURE REVIEW

This research is based on two theories, namely Stakeholder Theory and Legitimacy Theory. Stakeholder theory explains that the company acts not only for the benefit of the company itself but must also provide benefits for stakeholders (Freeman & McVea, 1984). Stakeholders relate to the concept of corporate social responsibility which is the survival of the company by the stakeholders (Gray et al., 1995). Corporate responsibility is not only limited to maximizing profits but must pay attention to the community, suppliers, or customers as part of the company's operations. As with shareholders, stakeholders also have rights to the actions taken by company management.

Gray et al., (1996) explained that Legitimacy Theory is a management system that is oriented towards taking sides with society, individual government, and community groups. Organizations or companies are part of the community so that they pay attention to the social norms of the community so that the compatibility between the company, and the community. Herrera (2016) stated that legitimacy is important for companies because the community's legitimacy to the company is a strategic factor for the company's future development, especially in relation to efforts to position itself as part of the company in the community. Good acceptance in the community will make it easier for the company to manage, which in turn can guarantee the survival of the company so that it can make the company grow.

Islamic Corporate Governance (ICG) and Maqashid Sharia Performance (MSP)

The application of ICG refers to business ethics and the principles of Islamic economics and finance, including those related to zakat, prohibition of usury, and prohibition of speculation (Setyowati et al., 2019). ICG encourages the formation of a professional management work pattern and is in accordance with the maqashid sharia (Bukhari et al., 2013).

The optimal implementation of ICG can be known in the existence of transactions that are carried out fairly, such as distributing zakat which is the implementation of the principle of justice in the Islamic economic system and carrying out banking activities, especially investments that are free of usury (Mansour and Bhatti, 2018). The more optimal the application of ICG, the more it will help the company achieve its goals in accordance with the maqashid sharia (Apriani et al., 2020). This is similar with the research of by Yadiat et al., (2017), (Istiqomawati et al., 2020), Kusuma & Rosadi (2018), and Darwanto & Chariri (2019) who found that ICG has a positive and significant effect on MSI.

H₁: ICG has a significant positive effect on maqashid sharia

Islamic Social Reporting (ISR) and Maqashid Sharia Performance (MSP)

ISR is one of the demands of stakeholders so that banks not only operate for the interests of shareholders, but must also pay attention to and prioritize the interests of stakeholders in their business practices (Meutia & Febrianti, 2017). One form of the responsibility of Islamic banks is carrying out social responsibility and efforts to improve the welfare of the people (Abu Bakar and Md Yusof, 2015). The ISR program is carried out to create benefit for Islamic banks with fair transactions without harming any party and products that are free of usury (Shandy Utama, 2019). With the implementation of this ISR, the purpose of operating a sharia entity is not only to seek profit but also to create social welfare, economic justice and public benefit in accordance with the maqhasid sharia (Soediro and Meutia, 2018; Tri Cahya et al., 2019). This is in line with research conducted by Yadiat et al., (2017) and Atiqah and Rahma (2018) which state that ISR has a positive and significant effect on maqashid sharia.

H₂: ISR has a significant positive effect on maqashid sharia

Islamic Social Reporting (ISR) and Islamic Corporate Governance (ICG)

ICG is corporate governance within the scope of sharia to create sustainable economic value for management and stakeholders (Muneeza and Hassan, 2014). Islamic banking, which has the main business objective of obtaining the pleasure of Allah SWT by obeying the Holy Qur'an, has an obligation to comply with a set of Islamic laws (Indrawaty and Wardayati, 2016); Wijethunga and Ekanayake, 2015). The application of ICG will make companies more open in conveying useful information as a type of responsibility for stakeholders and the environment and furthermore society (Sahut andSwitzer, 2013;Stuebs andSun, 2015; Zubeltzu-Jaka et al., 2018). This is in accordance with research conducted by Indrawaty and Wardayati (2016) and Budi et al., (2019) which states that ICG has a positive and significant effect on ISR.

H₃: ICG has a significant positive effect on ISR

Based on the several hypotheses above, an empirical research model can be formed as shown in Figure 1.

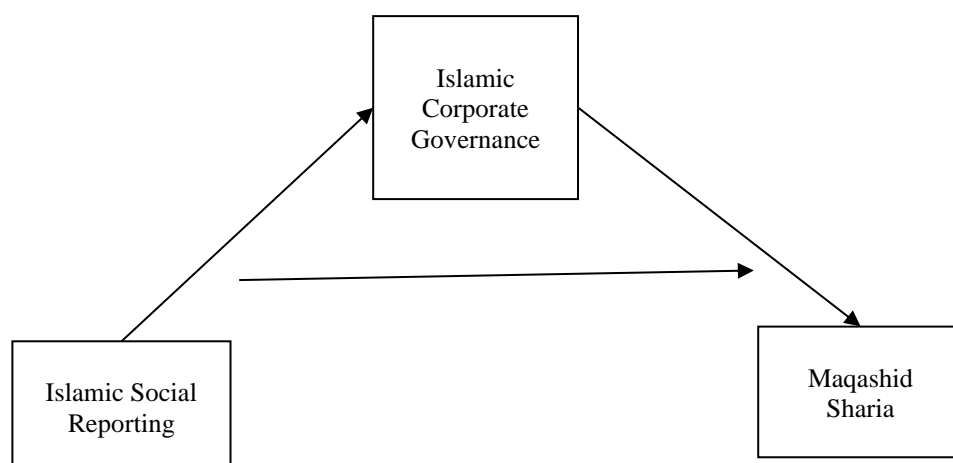


Figure 1: Empirical Model

Operational Definition and Measurement of Variables Islamic Corporate Governance

Islamic Corporate Governance (ICG) is a governance that is fundamental to moral and social values based on Islamic law (Bhatti & Bhatti, 2009). The ICG measurement instrument was developed based on the instruments by (Apriani et al., 2020) and Setyawan & Permatasai (2018). The instrument consists of 74 indicators covering two main categories, namely Sharia Governance (SG) and General Governance (GG). Sharia Governance consists of three themes: the Sharia Supervisory Board, Sharia Internal Compliance Unit, and the Internal Sharia Audit Unit. Meanwhile, General Governance consists of five themes: the Board of Directors, Board of Committees, Internal Control and External Audit, and Risk Management.

$$ICG = \frac{\text{Number of Sub-Items to be disclosed}}{\text{Maximum number of scores (74)}} \times 100\%$$

Islamic Social Reporting (ISR)

According to AAOIFI (Accounting and Auditing Organization for Islamic Financial Reporting), Islamic Social Reporting (ISR) is all agendas carried out by Islamic financial institutions to fulfill religious, economic, legal, ethical, and discretionary responsibilities as intermediary financial institutions both for individual and institution. ISR is measured by the instrument used by (Haniffa, 2002) and Othman et al (2009). The theme of the ISR Index disclosure consists of 40 indicators divided into five: the theme of funding and investment, the theme of products and services, the theme of employees, the theme of society, the theme of the environment and corporate governance.

$$ISR = \frac{\text{Number of Sub-Items disclosed}}{\text{Maximum number of scores (40)}} \times 100\%$$

Maqashid Sharia

Maqashid Sharia is the implementation of sharia that prosper life on earth, maintain order in it, always maintain the stability of the benefit of nature with human responsibility to create a healthy environment, act fairly and take various actions that can benefit all layers of the inhabitants of the earth (FKI Ahla Shuffah 103, 2013). Measurement of maqashid sharia refers to Mohammed and Razak (2008). The disclosure of maqashid sharia consists of 10 indicators covered in 3 themes, namely individual education, creating justice, and the public interest. The stage for measuring the maqashid sharia performance is carried out by assessing each performance ratio of the 60 maqashid Sharia indicators then determining the rank of the Islamic bank based on the Performance Indicator (IK).

Population, Sampling and Analysis Techniques

The population of this study is a sharia banking company registered with Bank Indonesia (BI) during 2016 - 2018 with a propulsive sampling technique and a sample of 49 people was obtained. Furthermore, analysis using Structural Equation Modelling with *Partial Least Square* (SEM-PLS) based by using SmartPLS 3.0 software was carried out to

test the research hypothesis. There are 2 models, namely:

$$\eta_1 = \gamma_1 \xi_1 + \zeta_1$$

$$\eta_2 = \beta_1 \eta_1 + \gamma_2 \xi_1 + \zeta_2$$

in which:

- η_1 : Islamic Social Reporting
- η_2 : Maqosid Sharia
- $\gamma_1 - \gamma_3$: Coefficient
- ξ_1 : Islamic Corporate Governance
- $\zeta_1 - \zeta_2$: Residual Value

RESULTS AND DISCUSSION

Descriptive Statistic Analysis

This research used descriptive statistical analysis in order to decide the depiction of each research variable (Nurfitriana and Fachrurrozie, 2018). The analysis used in this study includes the minimum, maximum, average and standard deviation values. The results of the descriptive statistical test are explained in Table 1 below:

Table 1. Data Description

	N	Minimum	Maximum	Mean	Std. Deviation
ICG	49	0,838	0,946	0,899	0,0292
ISR	49	0,600	0,800	0,723	0,083
MSP	49	0,129	0,428	0,226	0,083

Source: Processed data in 2020

The results of data processing in table 1 show that the ICG variable has a minimum value of 0.838 that occurs at Bank BCA Sharia and a maximum value of 0.946 occurs at Bank Muamalat. The mean value of 0.899 is greater than the standard deviation value indicating low data distribution. The Size variable has a minimum value of 27.218 that occurs in Maybank Sharia Bank and a maximum value of 32.995 occurs in Bank Panin Sharia. The mean value of 30,234 is higher than the standard deviation value of 1.462, indicating a low data distribution. The ISR variable has a minimum value of 0.600 that occurred at Bank BCA Sharia in 2012 and 2013. While the maximum value of 0.800 occurred in Bank BCA Sharia in 2017-2018, Bank Mandiri Sharia in 2015-2018, Bank Mega Sharia in 2018, Bank Muamalat in 2015-2018, Bank BNI Sharia 2015-2018, Bank BRI Sharia in 2015-2018, and Bank Panin Sharia in 2015-2016. The mean value of 0.730 is greater than the standard deviation value of 0.083 indicating low data distribution. Maqashid Sharia variable has a minimum value of 0.129 which occurs in Bank Panin Sharia. Meanwhile, the maximum value of 0.428 occurs at Bank BRI Sharia. The average value of 0.226 is greater than the standard deviation value of 0.083 indicating low data distribution.

Measurement Model Evaluation

Outer Model

Convergent Validity

Convergent Validity aims to determine the correlation between indicators and their

construction. The indicator is valid if it has a correlation value > 0.70 .

Table 2. Outer Loading and Average Variance Extracted (AVE)

	Islamic Governance	Corporate	Islamic Reporting	Social	Maqashid Sharia Performance
ICG	1,00				
ISR			1,00		
MSP					1,00
AVE	1,00		1,00		1,00

Source : Processed secondary data, 2020

Based on the outer loading output results, the outer loadings value of each variable has shown above 0.70. It proves that each variable has a good convergent validity value; thus, the convergent validity requirements are fulfilled.

Discriminant Validity

Discriminant validity (validity test) measures how far a construct with its indicators differs from other constructs. The value of discriminant validity can be seen through cross-loading. If the AVE square or diagonal values are greater than the correlation value between constructs, it meets the discriminant validity. The results of discriminant validity are explained in table 3:

Table 3. Discriminant Validity

	Islamic Governance	Corporate	Islamic Reporting	Social	Maqashid Sharia
ICG	1,000		0,334		0,110
ISR	0,334		1,000		0,289
Maqashid Sharia Performance	0,110		0,289		1,000

Source : Processed secondary data 2020

From table 3, the ICG cross-loading value is 1,000 with an ISR value of 0.334 and maqashid sharia of 0.110. The ISR cross-loading value is 1,000 with an ICG value of 0.334 and maqashid sharia 0.289. The cross-loading value of maqashid sharia is 1,000 with an ICG of 0.110 and an ISR of 0.289. In conclusion, each construct with its indicators has a higher cross-loadings value than the other constructs. It means latent constructs can be predicted better by each indicator compared to indicators from other constructs.

Composite Reliability

Composite reliability is a reliability test used to assess the reliability of a construct. The construct is reliable if the value of composite reliability and Cronbach's alpha are > 0.70 .

Table 4. Composite Reliability

	Composite Reliability	Cronbach's alpha
ICG	1,000	1,000
ISR	1,000	1,000
Maqashid Sharia	1,000	1,000

Table 4 shows that each construct has composite reliability and Cronbach's alpha value of more than 0.70, which is 1.00. It means each latent construct has good reliability because it has met the requirements of the composite reliability test and Cronbach's alpha.

Inner Model Test Results Structural Model

Inner model analysis tests the relationship or correlation between latent constructs. The inner analysis is justified from the following indicators.

Coefficient of Determination (R²)

The R² test finds out which exogenous variables influence and can explain endogenous variables. If R² closes to 1, the exogenous variables can explain endogenous variables well. The results of R² is described in table 5:

Table 5. R-Square and Adjusted R-Square

	R Square	R Square Adjusted
Islamic Social Reporting	0,111	0,097
Maqashid Sharia	0,084	0,053

Source : Processed secondary data 2020

Based on the data processing results in Table 5, the R Square Adjusted value in model 1, the Islamic Social Reporting variable, is 0.097 or 9.7%. It means that the Islamic Social Reporting variable can be explained by the Islamic Corporate Governance for 9.7%, whereas other variables explain the 90.3%. In model 2, the R Square Adjusted value for the maqashid sharia variable shows a value of 0.053 or 5.3%. It implies that the maqashid sharia variable can be explained by the variables of Islamic corporate governance and Islamic social reporting as much as 5.3% while 94.7.

Hypothesis Test Result

Table 6. Research Result

	Original Sample (O)	P Value	Result	Conclusion
Islamic Corporate Governance → Islamic Social Reporting	0,334	0,002	Positive Significant	Hypothesis 1 Accepted
Islamic Corporate Governance → Maqashid Sharia	0,016	0,902	Positive Insignifican t	Hypothesis 2 Accepted
Islamic Socai Reporting → Maqashid Sharia	0,284	0,023	Positive Significant	Hypothesis 3 Accepted

Source : Processed secondary data 2020

Effect of ICG on ISR

Based on statistical data analysis, ICG has a positive and significant effect on ISR. The implementation of ICG will make banks more transparent, accountable, responsible, impartial, and pay attention to the interests of all stakeholders. Social responsibility

reporting is an implementation of the principles in corporate governance that a company is not only responsible to its shareholders but also to its stakeholders. Thus, the better the implementation of ICG, the better it will encourage Islamic banking to carry out and report on its social activities. The results of this study are in accordance with research conducted by Indrawaty & Wardayati (2016) and Budi et al., (2019) which found that the application of ICG has a positive and significant effect on ISR. However, the results of this study are not in line with the research of (Rahma & Bukair, 2015) which found that ICG had no effect on ISR.

Effect of ICG on Maqashid Sharia

ICG has a positive and insignificant effect on maqashid sharia. ICG cannot fully guarantee that the banking sector has carried out its operations in accordance with maqashid sharia that proposes the public benefit. The application of maqashid sharia in Islamic Commercial Banks sampled in this study is still low, namely for the first purpose (educating individuals) and the third objective (*maslahah*). The following is the average result of the implementation of maqashid sharia in Islamic Commercial Banks in 2012-2018:

Table 7. The average result of the implementation of *maqahid sharia*

Objective 1 (educating individuals)	Scholarships	10,54%
	Research	0,01%
	Training	0,78%
	Promotion	1,49%
Total Objective 1		12,82%
Objective 1 (uphold justice)	Fair returns	4,63%
	Distribution function	22,91%
	Free of usury product	58,57%
Total Objective 2		86,11%
Objective 3 (Public benefit/<i>maslahah</i>)	Profit ratio	0,46%
	Personal income	0,61%
	Real sector investment	0,00%
Total Objective 3		1,07%
Total		100,00%

Based on the results of table 7, it can be concluded that the sharia commercial banks sampled in this study have met the principles of sharia, this can be known from the percentage of free of usury products and high distribution function. However, banks are still low in their efforts to enforce maqashid sharia in achieving goal 1, namely educating individuals. This means that the bank's efforts to increase Human Resources (SDI) are still low. In addition, banks are still low in their efforts to enforce maqashid sharia in achieving the third goal, namely public benefit/*maslahah*. This is due to negative profits, low zakat, and very low real sector investment. Thus, the implementation of ICG alone is not fully said to be able to create the general benefit if it is not balanced with activities that are useful and able to create social welfare. The results of this study are similar with the study of Atiqah & Rahma (2018) found that ICG has no effect on maqashid sharia. However, this research is different with

the research by Yadiat et al., (2017), (Istiqomawati et al., 2020), Kusuma & Rosadi (2018), and Darwanto & Chariri (2019) which found that ICG has a positive and significant effect on maqashid sharia.

Effect of ISR on Maqashid Sharia

ISR has a positive and significant effect on maqashid sharia. In the perspective of sharia, ISR is a form of social responsibility reporting where it is not only a form of corporate reporting on social and environmental issues but also a form of corporate responsibility towards Allah SWT. Thus, the entity plays a role in social problems that are community development, for example providing scholarships, empowering the economy of the poor, and building facilities for health and so forth. Thus, with the existence of social responsibility, banks not only operate to maximize their profits but are also able to increase concern for the environment including concern for the community. The results of this study are in line with Yadiat et al., (2017) and Atiqah & Rahma (2018) who concluded that ICG has a positive and significant effect on maqashid sharia.

Table 8. Specific Indirect Effect

		Original Sampel (O)	Sample Mean (M)	Standard Deviasi (STDEV)	T Statistics (O/STDEV)	P Value
Islamic Governance Social Reporting Sharia	Corporate → Islamic	0,095	0,092	0,048	1,979	0,048

Source: Data processed in 2020

Indirect Effect of ICG, ISR on Maqashid Sharia

Based on table 8, it shows that ISR mediates the effect of ICG on maqashid sharia. The purpose of implementing ICG is for banks to carry out their operational activities in accordance with Islamic principles and laws. A good ICG reflects that all elements of a sharia bank are running in accordance with applicable laws and procedures and compliance with sharia principles. Descriptive statistics show that the mean value of ICG is high, that is 0.899. ISR is a form of implementation of ICG, the mean value of ISR is also high, that is 0.723. With ICG, it encourages banks to implement and report ISR as a form of responsibility to stakeholders. Islamic Corporate Governance implementation can encourage sharia banks to fulfil their social responsibilities following sharia principles (Islamic Social Reporting). It encourages sharia banks to seek profit and realizes justice and balance in society based on the objectives of maqashid sharia..

CONCLUSION, IMPLICATION AND LIMITATION

According to the results of data investigation and discussion, it can be presumed that ICG has a positive and significant effect on ISR. Namun ICG tidak mempunyai efek terhadap maqosid sharia. Furthermore, ISR can mediate the effect of ICG on maqashid sharia. The results of this study contribute to (1) sharia bank managers. They can use the results of this research to improve maqashid sharia by maximizing the implementation of

GCG and conducting ISR to create justice and balance in accordance with the objectives of establishing sharia banks. (2) Regulators, especially OJK, supervise the implementation of GCG as more than just a formality to provide benefits for sharia banks and stakeholders. (3) Investors can choose to invest in sharia banks that carry out maqashid sharia well to avoid losing investments.

However, this study has several weaknesses: (1) The number of samples is only 49 due to the small number of sharia banks in Indonesia. Subsequent research can expand the sample to other industries, for example, companies listed on ISSI or JII. (2) Adjusted R square value in model 1 is only 9.7%, and the second model is only 5.3%. It indicates that the variables determined 92.3% of model 1 and 94.7% of model 2 is determined by variables outside the model. Further research can add other variables, including profitability, size and leverage.

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