An analysis on financial and social performance of Islamic banks in Indonesia

by Hasan Mukhibad

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Abstract: This study is conducted to analyse the implementation of good corporate governance (GCG), company size (Size), and financial deposit ratio (FDR) upon bank's financial and social performance. The social performance is measured using *Zakah* Performance (ZP) and *Qardul hasan* Performance (QP) variables. The financial performance is measured using return on assets (ROA) and return on equity (ROE) variable. Samples are Islamic banks in Indonesia determined based on a *purposive sampling* method. Data are analysed using multiple regression and classical assumption which include multicollinearity test. Results of the study show that the variables of Islamic Corporate Index (IDGI), Size, and FDR have significant impacts on ROA, ZP, and QP. Partially, by 10% significance level, size variable has a significant influence on ROA and ZP while IDGI variable has a significant influence on ZP and QP variable. This research suggests that Islamic banks should improve the implementation of GCG to increase bank social performance.

Keywords: IDGI; Islamic Corporate Index; *Zakah* performance; *Qardul hasan* performance.

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1   Introduction

Fraud still becomes a problem that needs to be solved in the world of business, including Islamic banks in Indonesia, such as Mandiri Syariah Bank and Jateng Syariah Bank (keuangan.kontan.co.id; Suara Merdeka, 21 November, 2011). Bank fraud may be committed by both internal and external parties. However, some bank frauds are committed by internal and external parties through the fictitious credit issued.

The above fraud cases demonstrate that shareholders' interest is not yet fully guaranteed. The management appointed by the owners to manage the company should be able to guarantee company's continuity by ensuring the company's assets and *returns*. Bank fraud is corporate assets stealing which is basically the owners' right. Fraud incidence within company indicates that the company management is still weak (poor corporate governance) (Haat et al., 2008; Khanchel, 2007). To reduce the frauds, good corporate governance (GCG) implementation may become one solution as the purpose of GCG implementation is to keep stakeholders' interests safe (Organisation For Economics Co-operation and Development, 2004; Effendi, 2009; Rezae, 2007, p.11).

Some parties (*stakeholders*) have their interests upon the company. Investors also have their interests upon their investment along with the returns. Owners concern over the capital returns and dividends. Suppliers concern over the payments of goods which are sold and their sustainability. Employees concern over to salary payments. Government concerns over tax revenues. To ensure that company is able to meet the interests of all stakeholders, the company must have a good performance.

From the above explanations, it can be concluded that the implementation of GCG is able to improve the financial performance. GCG is a system controlling the internals of company with the main purpose of managing risks significantly to meet its business objectives by securing corporate assets and increasing the value of shareholders' long-term investments (Effendi, 2009). In addition, a statement upon the implementation

of GCG may improve company performance is proven by Rehman and Mangla (2010), Heenetigala (2011), Javed and Iqbal (2006), Gaffar (2014) and Aggarwal (2013).

On the basis of the explanations above, it can be concluded that studies evaluating the implementation of GCG and its impacts on performance is still a topic that deserves to be studied. Islamic banking is used as the research object since Islamic banking uses Islamic law (Law No. 21 of 2008 in article 2) which is as operational guide transactions that harm others are forbidden, including bank fraud transactions. Bank fraud is the stealing acts which are extremely forbidden by Sharia. Islamic bank employees should make Sharia as the basis whether it is good or bad transaction. This is in line with the paradigm of Sharia concept which makes Sharia law as the basis whether it is good or bad transaction (Indonesian Accountants Association, 2008).

However, the fraud cases in Islamic banking lead to a conclusion that Sharia law has not become a major principle for banks (including bank employees) during the transactions, especially on ethics (morality). This is the reason lying under this research.

In addition, this study also analyses Islamic banks' social performance within Sharia law that the goal of a company is to have both profit oriented and social oriented. In addition to financial performance, Islamic financial institutions must also have social performance. This concept is called the concept of balance or *tawazzun*.

2 Literature reviews

2.1 Agency theory

One of the main characteristics of a great company is that there is a separation between the owners (shareholders) and the managers (management). One of the reasons for this separation is upon the great number of company shareholders resulted from the increased demands of capital the corporate requires. A great number of shareholders make the opportunity of shareholders is smaller to directly manage the company. The shareholders should appoint some parties (management) to manage the company.

Management basically is the representative of owners to manage the company or in other words, management is trusted by the owner to manage the company. Upon the authority delegated by the owners, the management may have salary, allowances, fees, etc. Thus, it is reasonable that management takes the favourable policies for the owners.

The concept of agency theory is a concept in which management in this case called as an agent in managing the company, who concerns more on self-interest and ignore the owners' interests or in this case is as a principle. Agency theory arises due to a conflict of agencies in which agents are directly involved in the management of company and have more information than the principles that are not directly involved in the management of company. The existence of asymmetric information between the agents and the principles may increase the chances of agents concerning on their own interests.

The assumption coming from agency theory is that each party is the economic rational society, where materials are the dominant considerations. This assumption is not appropriate if implemented in Islamic financial institutions. Under Sharia law, the primary consideration is worship that working is one form of human devotion to God. The material resulted from working is God's prerogative right to give prosperity to all

human beings. Thus, some parties consider that the concept of agency theory is not appropriate to use in the study of Sharia economics.

However, the empirical facts mention that fraud does not only occur in conventional financial institutions. Fraud also occurs in Islamic financial institutions (Islamic banks). These empirical facts prove that agency theory still occur in Islamic financial institutions triggered by some Islamic banks which regulations are based on agency conflicts, such as the concept of GCG in Islamic banks. Bank Indonesia Regulation No. 11/33/PBI/2009 on the Implementation of GCG in Islamic banks and Sharia business units states that the purpose of GCG implementation in Islamic banks, one of which, is to protect the stakeholders' interests. Thus, several studies on Islamic financial institutions are still using agency theory in building a research model.

2.2   Good corporate governance

GCG according to Wikipedia is a set of processes, customs, policies, rules and institutions that affect the directions, management and controls of a company or corporation. Corporate governance also includes the relationships among the stakeholders (stakeholders) involved in the company's management. A broader definition is included in Bank Indonesia Regulation No. 11/33/2009 which states that GCG is a Bank's management implementing the principles of transparency, accountability, responsibility, professional and fairness.

- To support the GCG implementation in Islamic banks, Bank Indonesia Regulation No. 11/33/2009 on the Implementation of GCG for Islamic banks and Sharia business units, there are some disclosures: GCG implementation for Islamic banks (BUS) that at least must be realised in:
    - the implementation of duties and responsibilities of the Board of Commissioners and Board of Directors
    - the completion and implementation of duties and functions of committees running BUS internal controls
    - the duties and responsibilities of the Sharia Supervisory Board
    - the application of compliance function, internal and external audit
    - the maximum limit of fund distributions
    - the transparency of BUS financial and non-financial conditions.
- GCG implementation in Sharia business units at least should be realised in:
    - the implementation of duties and responsibilities of UUS Director
    - the duties and responsibilities of Sharia Supervisory Boards
    - funds distribution to main financing and fund storage customers by the main depositors
    - the transparency of UUS financial and non-financial conditions.

2.3 Financial and social performance

One of Islamic transaction principles is *tawazun*, in which each transaction performed by the bank must have two dimensions, that is, the present welfare (in the world) and the future prosperity (hereafter), physical and spiritual and financial and social performance. Related to social performance in Islamic banks, Lestari (2013) reveals that CSR concept emphasises on operations based on Islamic law. Even Kamla et al. (2006) argues that environment is the centre of Islamic lessons. Islamic concepts or principles mentioned in al-quran or hadith of the prophet Muhammad such as monotheism, caliphates, ummah, justice, charity, wisdom and obedience have the implications on the relationship between humans and their environment (Kamla et al., 2006). Even Hassan and Latiff (2009) state that for Islamic financial institutions, CSR expenditure is viewed as an advantage not a cost.

In addition to social performance which is based on *tawazun* principle, Islamic banks must also have a good financial performance. Bank financial performance is the result of mandate given by the owners to the management. Similarly, in conventional concept, the Islamic bank financial performance is needed to assess the efficiency of bank performance.

2.4 Previous studies

Several studies related to the influence upon the implementation of GCG on financial performance has been conducted by Javed and Iqbal (2006) which examines a company registered in Karachi stock exchange find that there is a positive and significant influence of GCG implementation quality to the corporate performance. Similar results are also found by Aggarwal (2013) in his research that uses 20 samples of companies listed in CNX Nifty 50 Index shows that there is a significant relationship between corporate governance and company's financial performance. The similarity of both studies above is upon the measurement of GCG variable using GCG index, while their difference is on the financial performance operational variable. Javed and Iqbal use Tobin's Q model in measuring the financial performance while Aggarwal (2013) uses ROA, ROE, return on capital employed (ROCE) and profit before tax (PBX) variable. Mrad (2015) uses one of those indicators to measure the implementation of GCG and finds that the ownership structure negatively influences company's economic performance. The results of this study differ from Putra and Simanungkalit (2014) who found that GCG implementation has no direct influence on the measured performance of the firm value.

On the other hand, Ayuso and Argandona (2007) who use the compositions of the board of directors find that there is a significant relationship between the composition of the board of directors on financial performance and CSR. Heenetigala (2011) in his study in Sri Lanka finds a positive relationship between the separation of leadership, the composition of directors, and the board of committee on performance as measured by Tobin's Q models. In addition, Heenetigala (2011) also finds that there is no relationship between CSR and performance.

Results of the previous studies show that there is a correlation between GCG and CSR. Harjoto and Jo (2011) in his research find that CSR selection is influenced by the characteristics of company. The characteristics of company are proxied

by the independent board and the institutional ownership that basically the proxy is a part of GCG. Meanwhile, Supriyono et al. (2015) suggest that the implementation of GCG influence the corporate social disclosure.

The influence of GCG implementation to financial performance of Islamic banks is also studied by Gaffar (2014) that in his study of Islamic banks in Pakistan, he finds a significant difference between corporate governance and profitability. Corporate governance is measured from the ethics while corporate social responsibility (CSR) and profitability are measured by the amount of return on assets (ROA) and return on equity (ROE). Rehman and Mangla (2010) examine GCG, financial performance of Islamic banks and compare them with the conventional banks. Rehma and Mangla (2010) find that there is no significant relationship either between ROE and GCG or ROA and GCG. In addition, the results also show that there is a significant difference between GCG influence upon the performance of Islamic and conventional banks.

3   Research methods

The population in this research is 11 Islamic banks in Indonesia. The samples are taken by using a purposive sampling in which samples are selected based on the following criteria:

*   the banks provide information on financial statements (Financial Position statement, Income Statement, Zakat Funding Statement and Benevolent Funding report) consecutively in 2011, 2012 and 2013

*   the banks provide reports on GCG of 2011, 2012, and 2013 consecutively.

By using above criteria, there only eight Islamic banks are qualified as samples for this study.

This study is conducted to test the influence of GCG implementation upon bank's financial performance and upon the social performance that the variables and the measurement used in this study are as follows:

*   GCG implementation is measured based on Islamic GCG Disclosure Index due to the score disclosure from all disclosures mentioned in Regulation No. 11/33/PBI/2009. Score determination is conducted based on the following rules:

    Value 0   No description or explanation.

    Value 1   There is an explanation or description, but it is incomplete.

    Value 2   There is a complete explanation followed by pictures, tables, diagrams that qualitatively and quantitatively present the explanation.

    Islamic Disclosure of GCG Index (IGDI) is measured based on the following formula: IGDI = (total score)/(total of the maximum score).

*   Company size (Size) is calculated based on the amount of assets net book value recorded on the balance sheet.

- Financial deposit ratio (FDR) is calculated based on the following formula:
  FDR = (total financing)/(total deposits collected).

- Financial performance is calculated based on two measurements:

  Return on Assets (ROA) is measured with the formula of:

- ROA = (Net income)/(Total assets).

  Return on Equity (ROE) is measured with the formula of:

  ROE = (Net income)/(Total equity).

- Financial performance is calculated based on two measurements:

  Zakah Performance (ZP) is measured with the formula of:

  ZP = (Total revenue of Zakat funds)/(Total assets).

  Benevolent fund performance (QP) is measured with the formula of:

  QP = (Total revenue of virtue funds)/(Total assets).

On the basis of each variable of data measurement above, it shows that independent variable of X1, X2, X3 and Y1, Y2, Y3 and Y4 have a ratio data. Thus, one appropriate analytical tool is the regression analysis. The purpose of this study is not only to examine the relationship between variables, but also to prove whether X2 and X3 are the moderator variable. Thus, to perform test moderated regression analysis test model (MRA) is used (Ghazali, 2013, p.229).

Classic assumption test includes multicollinearity, autokolerasi, heteroscedastisitas and normality test. Hypothesis testing uses a multiple regression with four equations as follows:

$$\text{ROA} = b_0 + b_1 \text{IGDI} + b_1 \text{SIZE} + b_1 \text{FDR} + \text{E} \qquad \text{Model 1}$$

$$\text{ROE} = b_0 + b_1 \text{IGDI} + b_1 \text{SIZE} + b_1 \text{FDR} + \text{E} \qquad \text{Model 2}$$

$$\text{ZK} = b_0 + b_1 \text{IGDI} + b_1 \text{SIZE} + b_1 \text{FDR} + \text{E} \qquad \text{Model 3}$$

$$\text{QP} = b_0 + b_1 \text{IGDI} + b_1 \text{SIZE} + b_1 \text{FDR} + \text{E} \qquad \text{Model 4}$$

Hypothesis testing is conducted by looking at the significance level of relationship between the independent variables and the dependent variable either partially or simultaneously. H_a is accepted if the level of significance is less than 0.10. H_a will be rejected (H_0 is accepted) if the significance level is more than 0.10.

4 Results and discussions

4.1 Variable description

Variable description is conducted to know the average value of all variables used in this study, including the maximum value, minimum and standard deviation of each variable used. Here is the description values of all variables used in this study (Table 1).

Table 1   Variable description

	N	Minimum	Maximum	Mean	Std. Deviation
			Statistics description		
GCG	24	22.00	45.00	37.2917	7.65835
SIZE	24	6.42E11	6.40E13	1.7408E13	2.02748E13
FDR	24	46.08	102.70	85.5883	14.12787
ROA	24	−0.59	6.93	1.5696	1.39952
ROE	24	−3.26	57.98	14.3604	13.54214
ZAKAH	24	0.00	0.07	0.0294	0.02398
QHARDUL HASAN	24	0.00	0.04	0.0103	0.01098
Valid N (listwise)	24				

Source: (Processed) Secondary Data, 2015

4.2   The results of hypothesis test

Classical assumption test covers autocorrelation, heteroscedasticity, normality and multicollinearity. The presence of multicollinearity may be seen from the value of tolerance or variance inflation factor (VIF). If the limit of tolerance value is below 0.10 or above 10 VIF, there will be a problem of multicollinearity. It means that if the tolerance value is under 0.10 or of VIF is more than 10, there will be multicollinearity. Here are the test results of multicollinearity.

On the basis of Table 2, it shows that all independent variables in model 1, 2, 3 and 4 have VIF value less than 10. This indicates that all models which are developed are free from multicollinearity. The second classical assumption test is the autocorrelation test which is conducted using Durbin–Watson value (d) to know whether there is autocorrelation or not. If $d < dl$, it means that there is a positive autocorrelation. If $d > (4 − dl)$, it means that there is negative autocorrelation. If $du < d < (4 − dl)$, it means that there is no autocorrelation. If $dl < d < du$ or $(4 − du)$, it means that it cannot be concluded. Here are the autocorrelation test results using SPSS.

Table 3 shows that the values of Durbin–Watson are 1.683, 2.222, 1.610 and 2.293. By using three independent variables and 24 data, it results in the value of $dl = 1.101$ and the value of $du = 1.656$. The value of DW is greater than du but less than $4 − du$ $(4 − dw)$. This indicates that there is no autocorrelation upon all four models which are developed.

The next test is heteroscedasticity test. Method used to determine the presence or absence of heteroscedasticity is by looking at the distribution of scatterplot images. The results of Scatterplot images upon the fourth model show a spreading image with not specific patterns. This indicates that there is no heteroscedasticity appears in the fourth model which is developed.

The last results of classical assumptions test is obtained from the normality test which is conducted using a non-parametric statistical test of Kolmogorov–Smirnov (KS). Here are K–S test results upon the fourth variable which is developed.

Table 4 shows that all models have a significance value of 0.005. This indicates that all models have normal residual data.

Table 2   Test results of multicollinearity

	Model 1		*Model 2*		*Model 3*		*Model 4*	
	Collinearity statistics		*Collinearity statistics*		*Collinearity statistics*		*Collinearity statistics*	
Model	*Tolerance*	*VIF*	*Tolerance*	*VIF*	*Tolerance*	*VIF*	*Tolerance*	*VIF*
(Constant)								
IDGI	0.781	1.280	0.781	1.280	0.781	1.280	0.781	1.280
SIZE	0.777	1.287	0.777	1.287	0.777	1.287	0.777	1.287
FDR	0.773	1.293	0.773	1.293	0.773	1.293	0.773	1.293

Table 3   Autocorrelation test results

	Model 1	*Model 2*	*Model 3*	*Model 4*
Model	*Durbin-Watson*	*Durbin-Watson*	*Durbin-Watson*	*Durbin-Watson*
1	1.683	2.222	1.610	2.293

Table 4   Kolmogorov-Smirnov test results

		Model 1	*Model 2*	*Model 3*	*Model 4*
		Unstandardised residue	*Unstandardised residue*	*Unstandardised residue*	*Unstandardised residue*
N		24	24	24	24
Normal parameters of a,b	Mean	0.0000000	0.0000000	0.0000000	0.0000000
	Std. deviation	1.15977226	11.85857222	0.01796343	0.00935640
Most extreme differences	Absolute	0.217	0.228	0.124	0.177
	Positive	0.217	0.228	0.124	0.177
	Negative	−0.147	−0.164	−0.087	−0.095
Kolmogorov-Smirnov Z		1.063	1.117	0.608	0.869
Asymp. Sig. (2-tailed)		0.208	0.165	0.854	0.437

4.3   Hypothesis test

Hypothesis test is conducted by partial and simultaneous testing upon all models. Here are the partial test results of model 1.

On the basis of Table 5, it shows that by using 5% significance level, ROA variable only influences FDR. Variable Islamic Corporate Index (IDGI) and size have no significant influence on ROA.

Table 6 shows that 5% significance level of all independent variables (IGDI, Size and FDR) has no significant influence on ROA. However, at 10% significance level, the size variable has a significant influence on ROA.

Table 7 shows that 5% significance level of all independent variables (IGDI, Size and FDR) has no significant influence on ZP variable. However, at 10% significance level, IDGI variable has a significant influence on ZP variable.

Table 8 shows that 5% significance level of all independent variables (IGDI, Size and FDR) has no significant influence on QP variable. However, at 10% significance level, IDGI variable has a significant influence on QP variable.

Table 5   The test results of model 1

Model		Unstandardised coefficients		Standardised coefficients			
		B	*Std. Error*	*Beta*	*T*	*Sig.*	*Conclusion*
1	(Constant)	5.019	1.860		2.699	0.014	
	IDGI	0.045	0.038	0.248	1.182	0.251	Reject Ha
	SIZE	0.000	0.000	0.180	0.855	0.403	Reject Ha
	FDR	−0.063	0.021	−0.632	−2.997	0.007	Reject Ho

Dependent variable: ROA.

Table 6   The test results of model 2

Model		Unstandardised coefficients		Standardised coefficients			
		B	*Std. Error*	*Beta*	*T*	*Sig.*	*Conclusion*
2	(Constant)	3.752	19.017		0.197	0.846	
	IDGI	0.346	0.392	0.196	0.884	0.387	Reject Ha
	SIZE	0.000	0.000	0.408	1.837	0.081	Reject Ha
	FDR	−0.082	0.213	−0.086	−0.386	0.704	Reject Ha

Dependent variable: ROE.

Table 7   The test results of model 3

Model		Unstandardised coefficients		Standardised coefficients			
		B	*Std. Error*	*Beta*	*T*	*Sig.*	*Conclusion*
3	(Constant)	−0.050	0.029		−1.734	0.098	
	IDGI	0.002	0.001	.537	2.835	0.010	Reject Ha
	SIZE	0.000	0.000	.159	0.834	0.414	Reject Ha
	FDR	0.000	0.000	.091	0.480	0.637	Reject Ha

Dependent variable: ZP.

Simultaneous hypothesis test results

Results of these tests are conducted to prove whether all independent variables in each model have a significant influence on the dependent variable. Here is the summary of simultaneous hypothesis test results.

Table 9 shows that 10% significance level of IDGI, Size and FDR variable simultaneously has a significant influence on ROA, ZP and QP.

Table 8 The test results of model 4

Model		Unstandardised coefficients		Standardised coefficients	T	Sig.	Conclusion
		B	Std. Error	Beta			
4	(Constant)	0.048	0.015		3.206	0.004	
	IDGI	−0.001	0.000	−0.446	−2.067	0.052	Reject Ha
	SIZE	0.000	0.000	0.277	1.283	0.214	Reject Ha
	FDR	0.000	0.000	−0.249	−1.149	0.264	Reject Ha

Dependent variable: QP.

Table 9 Simultaneous test results of all model (IDGI, SIZE and FDR toward ROA, ROE, ZP and QH)

	Model	Model 1	Model 2	Model 3	Model 4
Model summary of all model	R	0.560	0.483	0.662	0.523
	R Square	0.313	0.233	0.439	0.274
	Adjusted R Square	0.210	0.118	0.355	0.165
	Std. error of the estimate	1.24372	12.71690	0.01926	0.01003

	Model 1		Model 2		Model 3		Model 4	
l	F	Sig.	F	Sig.	F	Sig.	F	Sig.
Regression	3.041	0.053	2.027	0.142	5.214	0.008	2.512	0.088
Residual								
Total								
Conclusion	Reject Ho at 10% Significantion		Reject Ha at 10% Significantion		Reject Ho at 10% Significantion		Reject Ho at 10% Significantion	

4.4 Discussions

Model 1 states that there is a significant relationship of IDGI, Size, and FDR with ROA that simultaneously results in a model accepted with a significance level of 10%. The relationship of these variables is 31.3%. However, these are not supported by the partially research findings. Partially, IDGI and FDR variable have no significant relationship with ROA, while size variable has a significant relationship with ROA.

The measurement of financial performance using ROE has different results if compared to those of the first model. The results show that simultaneously, IDGI, Size and FDR variable has no significant influence on ROE. The partial test results upon the second model show that there is a significant relationship between FDR and ROE variable, while IDGI and size variable do not have a significant influence on ROE.

The test results of the first and second models result in different findings if compared with those of the previous studies. GCG implementation does not have a significant influence on the financial performance. These findings weaken the results of previous studies of Javed and Iqbal (2006) and Aggarwal (2013). The difference is probably due to the use of IDGI implementation upon the disclosure of GCG. Disclosure of GCG

implementation upon the GCG report may not be fully used as the basis for GCG implementation.

On the other hand, the third and fourth models testing revealing the influence of IGDI, Size and FDR on social performance also results in different findings with previous studies. Results of this study simultaneously show that IGDI, Size and FDR have a significant influence on *Zakah* and QP. It means that the greater the IGDI, Size and FDR of a bank the more *Zakah* and *Qardul hasan* funds are collected. The contribution amount of IGDI, size and FDR variable on ZP is 43.9% while on QP is 27.5%.

The results of this study partially show that at 10% significance level, only IGDI variable which has a significant relationship to *Zakah* and QP variable. The size and FDR variable do not have a significant relationship to *Zakah* and QP variable. The rejection upon the alternative hypothesis is presumably caused by the raising fund of *Zakah* and *Qardul hasan* bank from outside of the company that the assets increase and FDR bank may not necessarily be followed by the increase of *Zakah* and *Qardul hasan* funds collected. In addition, there is a possibility that bank operations related to the management of *Zakah* and *Qardul hasan* funds still will be banks' minor operation (has not become the major operation yet, such as the management of banks' productive fund).

5   Conclusion

On the basis of results of the study, it shows that simultaneously, GCG implementation, corporate size and FDR have a significant influence on ROA, ZP and QP. However, the findings only show partial implementation of GCG variable which has a significant influence on the performance *Zakah* and QP. In addition, the corporate size variable has a significant influence on ROA. FDR variable has a significant influence on ROE.

This study suggests that Islamic banks should improve the implementation of GCG to increase *Zakah* and QP. Further research is expected to increase the number of data analysis using other variables related to the implementation of GCG.

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An analysis on financial and social performance of Islamic banks in Indonesia