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Board of commissioners and corporate governance disclosure in Sharia-compliant companies in Indonesia

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ABSTRACT

Corporate governance (CG) aims to protect the interests of stakeholders by ensuring that the company is managed properly. This study aims to examine the relationship between board of commissioners (BOC) characteristics and CG disclosure. BOC characteristics consist of board size, board independence, board meeting, educational background, and cross membership. The sample of this study was sharia compliant companies listed in Indonesia's sharia securities list registered in the year of 2017-2020. The data were analyzed using panel data regression. This study analysis 160 data from 40 companies. The results show that the level of CG disclosure is high reaching 88.89%. It may give a positive value that the companies may already have the awareness to provide adequate disclosure regarding the implementation of CG principles. The results also show that the board independence has positive effect on the CG disclosure. The finding may have impact on the regulator and users to encourage more roles of BOC in CG disclosure.

Introduction

Company is surrounded by stakeholders who have different interests. Currently, companies are expected not only to prioritize the shareholders, but also to consider the interests of stakeholders. Corporate governance (CG) plays important roles in gaining legitimacy from the stakeholders. According to IFC (2014), the governance framework will encourage companies to meet the interests of stakeholders because they realize that stakeholders contribute to the long-term success of the company. This is because stakeholder pressure can influence the company to always act ethically in its activities. There are some benefits for companies in practicing good corporate governance. Hasan et al. (2017) state that good corporate governance (GCG) will promote better business, better risk and strategic management and impact on the better competitive level. Homroy and Slechten (2019) state that governance practices can affect organizational performance and ethical actions.

CG has five principles that consist of transparency, responsibility, accountability, independence and fairness. Those principles are expected to be implemented to support the achievement of the company's performance. However, the effective implementation of GCG is depends on the commitment of the boards. In Indonesia, Law No. 40 of 2007 concerning Limited Liability Company recognizes three organs of CG namely general meeting of shareholders, board of director and board of commissioners. Indonesia adopts a two-tier board structure showing that every company usually has the board of directors (BOD) and board of commissioners (BOC). BOC is the organ of the company in charge of supervising and giving advice to the board of directors. Board of directors has obligation to manage the companies' activity while the board of commissioners controls the performance of BOD. Both of the boards have the responsibility to maintain the continuity of company's business in the long term. CG organs are considered to be able to encourage better GCG implementation (Dienes & Velte, 2016; Khaireddine et al., 2019).

There are several contributions expected from this study, first, this study uses CG disclosure in sharia compliant companies (SCC). The development of sharia compliant companies provides the alternative investment for Muslim investors in Indonesia. Elgattani and Hussainey (2020) state that CG in Islamic organizations is very unique and important because of Islamic principles that should be implemented in those organizations. They state three components of CG are essential in Islamic organization namely accountability, transparency and adequate disclosure. Second, this study uses the characteristics of BOC as an independent variable. Indonesia adopts a two-board system where there is a difference in function between the board that manages the company (board of directors) and the board of commissioners who are in charge of overseeing the performance of the board of directors. Third, this study uses the item of CG disclosure from good governance of Islamic business (GGIB), which

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is a CG guidance specifically intended for Islamic business entities. Thus, SCC can be measured by disclosure that is intended for Islamic entities.

Literature Review

Legitimacy Theory

Legitimacy theory is one theory that is often used to explain why companies disclose information (Khaireddine et al., 2019). According to Suchman (1995), legitimacy provides several benefits for the company, such as increasing stability of organizational activities and affecting how society acts toward and understands the company. Suchman (1995) also states that the organization can influence the process of legitimacy although it depends on how management controls it. Because the company is surrounded by many stakeholders, management must be able to manage activities so that the activities are desirable, proper and appropriate in accordance with the conditions faced (Suchman, 1995). The company tries to gain legitimacy by not carrying out activities that are contradictory to the values that exist in its environment.

Corporate social responsibility (CSR) disclosure is one way for companies to gain legitimacy because these activities provide benefits to the community (Yaya et al., 2018). CSR disclosure can be used to reduce the legitimacy gap through strengthening the internal governance structure (Khan et al., 2013).

Corporate Governance (CG) and CG Disclosure

Corporate governance shows the structure and processes within the company to ensure that the company's actions are fair, transparent, accountable and responsible (IFC, 2014). CG aims to protect the interests of stakeholders by ensuring that the company is managed properly. Companies that have good CG will provide benefits to the national economy (IFC, 2014). According to PwC (2020), corporate governance holds an important key in supporting the success of the organization because it can improve its performance and increase stakeholder trust.

Sharia capital market plays a role in providing products that meet Sharia principles in the capital market. Sharia shares are one of the investment products that can be chosen by investors, especially Muslim investors. The list of sharia compliant companies in Indonesia is published in the sharia securities list twice at every year, which shows that those companies have passed the sharia screening. Sharia screening assess whether the main business activities do not conflict with Sharia principles and meeting financial ratios related to interest-based debt and non-halal income.

The society expects that the performance of sharia compliance companies (SCC) can be better than conventional one, such as corporate governance and information disclosure (Grassa & Matoussi, 2014; Othman et al., 2009). Corporate governance for Islamic institutions is expected to create a mechanism that provides justice to all stakeholders through greater transparency and accountability toward Islamic principles (Grassa & Matoussi, 2014).

Indonesia has a general guideline of CG for Islamic business entities called good governance for Islamic business (GGIB). GGIB derives the CG principles that consist of transparency, accountability, responsibility, independence and fairness. Transparency contains the elements of disclosure and the provision of adequate information which is easily accessible by stakeholders. Accountability means that Islamic business must be managed properly and measured in accordance with the interests of Islamic business practitioners while still taking into account stakeholders and society in general. Responsibility means that Islamic business practitioners must comply with the laws and regulations and the provisions of Islamic business, as well as carrying out responsibilities to society and the environment. Independence is related to how the Islamic business should be managed independently with each party may not dominate each other and cannot be interfered by any party. Fairness and equality contain elements of equality of treatment and opportunity.

Those principles are very important to be applied by the company to maintain the company's ethical behaviour. Stakeholders are very interested in the company's ethical behaviour in achieving company goals such as creating wealth, providing products and services in the market and winning the competition in the industry (Fahad & Rahman, 2020).

Board of Commissioners

Board of commissioners (BOC) is one of the CG organs in Indonesian companies applying two-board system. GGIB explains that the function of the board of commissioners is to supervise and provide advice to the board of directors and ensure that the company implements GGIB. BOC is elected through a general meeting of shareholders where its composition should encourage fast, effective and independent decision making and maintain prudent and risk awareness aspects as well as in accordance with Sharia principles. This is in line with the recommendation from PwC (2020) that one of the keys to the successful implementation of CG implementation is an effective board.

Board diversity is one of the important components in corporate governance (Salehi et al., 2017). Board diversity can be demonstrated by the diversity of nationality, education, age, expertise, industry experience and religious background (Hartmann & Carmenate, 2020). According to Hartmann and Carmenate (2020), the previous studies state that board diversity can affect a company's social performance. Diversity in the board will increase better decision making to improve company performance. This study uses board size, board meeting and board diversity variables consisting of board independence, educational background, and cross-membership of BOC. Previous studies have found a positive effect between characteristics of the board and disclosure.

Khaireddine et al. (2019) find that board independence and board meeting have positive effect on the governance, environmental and ethics disclosure. Nugraheni and Permatasari (2016) find that the size and educational background of the board of commissioners have a positive effect on the CSR disclosure in sharia compliant companies in Indonesia.

Hypothesis Development

The number of board members can affect the disclosure of the company's performance. According to Hartmann and Carmenate (2020), a large number of members will contribute to knowledge and expertise so that it affects the effectiveness of decision making. This is supported by the statement of Samaha et al. (2012) which states that large boards will increase the level of monitoring and making strategic design. Setiawan et al. (2018) state that the company's performance will be better when supported by a large number of board members. The large resources owned by a company will encourage better performance improvements and therefore greater disclosure will be published

Companies that have larger boards tend to increase disclosure quality so that more company information will be disclosed in the annual report in the practices (Samaha et al., 2012). Samaha et al. (2012) find that companies with large board sizes have a positive effect on disclosure. Moreover, Zaheer (2013) also finds that board size has a positive effect on CG disclosure on the Karachi stock exchange in Pakistan. Thus, the study derives the hypothesis:
H_1: Board size has a positive effect on CG disclosure

Board independence is a member of the board who comes from external parties of company. According to Samaha et al. (2012), outside members will encourage better quality of supervision which can have an impact on better performance and voluntary disclosure. Khaireddine et al. (2019) state that the board independence is an internal governance mechanism that can improve ethical disclosure. Meanwhile, Fahad and Rahman (2020) explains that an independence board can inspire and motivate other board members and company management to improve transparency and disclosure to protect stakeholder interests.

Zaheer (2013) states that outsiders will be able to assess the company's performance objectively and focus on protecting the interests of shareholders. Board independence will concern on the providing information as one of the interests of stakeholders. Fahad and Rahman (2020) find that board independence increase CSR disclosure. Khaireddine et al. (2019) also find the relationship between board independence and governance disclosure. Therefore, this study derives the following hypothesis:
H_2: Board independence has a positive effect on GCG disclosure

Board meetings are a means to discuss company activities and performance. Board members with expertise and knowledge will provide input and suggestions to encourage management performance while meeting stakeholder expectations. Khaireddine et al. (2019) explain that regular meetings will strengthen supervision and ensure that managers have complied with all provisions related to every decision taken. Dienes and Velte (2016) also argue that regular meetings are a means of monitoring stakeholder interests and strengthening legitimacy.

The more BOC holds meetings, the more coordination is carried out so that every management action can be controlled, including providing adequate information for the stakeholders. Khaireddine et al. (2019) state that the board meeting has a positive effect on disclosure related to the governance aspects. Chakraborty (2018) also finds that the number of board meetings had a positive effect on CSR disclosure. Therefore, this study derives the following hypothesis:
H_3: Board meeting has a positive effect on GCG disclosure

Diversity of the board can be seen from the educational background. Educational level is very important because it can affect the level of knowledge, expertise, and cognitive abilities (Hartmann & Carmenate, 2020). Darmadi (2013) states that educational qualification reveals board's capability. Higher education will shape people to be more open minded, able to search the information, and open to different opinion (Hambrick & Mason, 1986). The higher their level of education, the higher the knowledge possessed, so that they can make more appropriate strategic decisions, including in the implementation of CG and its disclosure.

Hartmann & Carmenate (2020) find that the board education has a positive effect on the disclosure of CSR reputation. Darmadi (2013) also finds that the board education has an effect on firm performance in Indonesian companies. BOC will encourage companies to fulfill obligations to stakeholders as a form of responsibility and accountability of SCC. Nugraheni and Permatasari (2016) find that the educational background of the board of commissioners in sharia compliant companies has a positive effect. Therefore, this study derives the following hypothesis:
H_4: Educational background has a positive effect on GCG disclosure

BOC has functions to oversee the board of directors and has a role in determining the level of corporate CSR disclosure (Nugraheni & Permatasari, 2016). Therefore, BOC members should have sufficient competence to be able to carry out their responsibilities. BOC members are allowed to hold the same position in different companies. According to Rao and Tilt (2016), board member's knowledge will increase when they have experience in several companies. Nomran, Haron, & Hassan (2017) state that knowledge and experience of board members increase when discussing a lot with other members, even from different companies. According to Rahman & Bukair (2013), cross membership will influence more transparency because it becomes an information channel of business activities. Cross membership of BOC will enforce the ethical practice of business to disclose corporate information. El-Halaby and Hussainey (2016) state that cross-membership of shariah supervisory board influences positively on the sharia disclosure of Islamic banks. With the similar argument, the proposed hypothesis of this study is:
H_5: Cross membership has a positive effect on CG disclosure

Research Method

The population in this study are sharia compliant companies (SCC) listed on the Sharia Securities List for the year of 2017-2020. The purposive sampling method is used to select companies in this study that meet the following criteria: non-financial companies registered for 4 consecutive years at Sharia Securities List for the year of 2017-2020, have published annual reports and completed required variable data.

The dependent variable in this study is the disclosure of CG by Indonesian SCC. The measurement of the dependent variable refers to the items in the good governance for Islamic business (GGIB). There are five indicators of GC principles, namely transparency (12 items), accountability (6 items), responsibility (5 items), independence (4 items), and fairness (4 items). The measurement of CG index uses the content analysis method by analyzing the disclosures in the company's annual report using a dummy. If the company discloses an item in accordance with the GGIB index, it will be given a number of 1, and the number of 0 if the company does not disclose the item.

The independent variables are the characteristics of the board of commissioners (BOC) which include the BOC size, the board meeting, and the board diversity consisting of the board independence, educational background, and cross membership. This study also uses control variables, namely total assets and profitability. The board size shows the number of members of the board of commissioners (Setiawan et al., 2018). The board independence is measured using the proportion of independent commissioners to the total number of BOC (Khaireddine et al., 2019). The board meeting is the number of meetings held by the BOC for one year (Khaireddine et al., 2019). Educational background is measured using the proportion of BOC members who have postgraduate degrees (Darmadi, 2013). Cross membership indicates the percentage of board members who have board membership in other company (El-Halaby & Hussainey, 2016). This study uses panel data regression by choosing the most suitable method between random effect model, common effect model, and fixed effect model.

Results and Discussion

This study uses a sample of sharia compliant companies listed on the Sharia Securities List for 2017-2020. Based on the completeness of the data, there are 160 data from 40 companies that are the sample of this company. Table 1 shows the results of descriptive statistics.

Table 1. Descriptive Statistics Result

	CG	Size	Ind	Meet	Edu	Cros	Ta	Roa
Mean	88.8906	5.0875	38.9340	8.2313	42.2957	49.0540	29.4596	6.0361
Maximum	96.7700	13.0000	67.0000	30.0000	100.0000	100.0000	34.6961	49.3000
Minimum	51.6100	2.0000	17.0000	2.0000	0.0000	0.0000	25.9400	-8.2200
Std. Dev	7.5684	2.0200	8.3660	3.7032	29.4502	34.3394	1.7651	7.7295

Table 1 of descriptive statistical results show that dependent variable, namely CG disclosure, has a minimum value of 51.61, a maximum value of 96.770, and the mean value of 88.89. CG disclosure in sharia compliant companies is very high achieving 88.89%. The board size has a minimum value of 2 and a maximum value of 13 with the mean value of 5.09. The board independence has a minimum value of 17, a maximum value of 67 and the mean value of 38.93. The board meeting variable has a minimum value of 2, a maximum value of 30 and the mean value of 8.23. The variable of educational background has a minimum value of 0 and a maximum value of 100, while the mean value is 42.29. Cross membership has minimum value of 0 and maximum value of 100, while the mean value is 49.05. Regarding the control variable, company size has a minimum value of 25.94, a maximum value of 34.69, and the mean value of 29.45. The profitability has a minimum value of -8.22, a maximum value of 49.300 and the mean value of 6.04.

Table 2 shows the result of panel data regression. This study uses random effect model as the most suitable method for this study.

Table 2. Data Panel Regression

Variable	Coefficient	Std. Error	z	P > lzl
(Constant)	78.6854	16.0817	4.8900	0.0000
Size	0.2253	0.4814	0.4700	0.6400
Independence	0.1398	0.0711	1.9700	0.0490
Meeting	0.2137	0.1994	1.0700	0.2840
Education	0.0434	0.2456	1.7700	0.0770
Crossmembership	-0.0249	0.0192	-1.3000	0.1940
Company size	0.0152	0.5892	0.0300	0.9790
ROA	0.1322	0.0765	1.7300	0.0840
R-sq overall	0.0757			
prob > chi2	0.0201			

The board size variable has coefficient value of 0.2253 with a significant value of 0.6400 > alpha value (0.05) indicating that the board size has no effect on CG disclosure. Thus, the first hypothesis (H1) is rejected. This result is in accordance with research conducted by Elgattani and Hussainey (2020) and Dienes and Velte (2016) that do not find a relationship between board size and CSR disclosure but contrasted with Setiawan et al. (2018) which finds a positive effect between the board size and CSR disclosure. According to Elgattani and Hussainey (2020), the board size may have no effect when BOC members do not have an experience related to the disclosure guidance. This study uses CG disclosure from GGBI and therefore, when board member don't have an adequate understanding about GGBI, even though there are many members, no one is concerned about CG disclosure.

The board independence has coefficient value of 0.1398 with a significant value of 0.0490 < alpha value (0.05) which indicates that the board independence influences positively on CG disclosure. Thus, the second hypothesis (H2) is accepted. This result supports Khaireddine et al. (2019) which states that the board independence has a positive influence on governance disclosure. Khaireddine et al. (2019) argues that outside members will tend to engage in CG compliance and practices. BOC has important function to ensure the transparency and disclosure of the company's financial statements and strive for fair treatment of minority shareholders and other stakeholders. The mean value of the board independence is 38.93 that is already higher than the regulatory requirement which requires at least 30% of BOC members consisting of board independence when there are more than two members of BOC. The composition of the board independence in the BOC will influence the controlling power of the board (Fahad & Rahman, 2020).

The board meeting has coefficient value of 0.2137 with a significant value of 0.2840 > alpha value (0.05) so that this variable does not influence CG disclosure. Thus, the third hypothesis is rejected. Elgattani and Hussainey (2020) state that the board meeting has no effect on the governance disclosure of Islamic banks. According to Elgattani and Hussainey (2020), when the board members lack understanding or experience in CG guidance, then the CG disclosure will not be discussed in the meeting so that the board meeting will not affect the CG disclosure. Dienes and Velte (2016) also find that the frequency of meetings of supervisory boards in Germany does not influence CSR reporting. The board members may give certain topics in each meeting so when CG disclosure is not on the agenda, the number of BOC meetings will not affect CG disclosure.

Educational background variable has coefficient value of 0.0434 with a significant value of 0.0770 > alpha value (0.05) so that this variable has no effect on CG disclosure. The fourth hypothesis (H4) is rejected. These results support the research of Nugraheni (2018) which states that the educational background of SSB has no effect on the social performance of Indonesian Islamic banks. According to Nugraheni (2018), the ability of the board to carry out its functions is also supported by expertise related to business management. When the postgraduate educational background is not much related to business knowledge, some aspects such as disclosure may not be the focus of the BOC. This result does not support the research of Darmadi (2013) which finds that educational background of top managers can influence management actions but supports Hartmann & Carmenate (2020) which find that educational diversity influences CSR reputation.

Cross membership has coefficient value of -0.0249 with a significant value of 0.1940 > alpha value (0.05), so that this variable has no effect on CG disclosure. Thus, the sixth hypothesis (H6) is rejected. This study supports Nugraheni (2018) which does not find a relationship between cross membership of sharia supervisory board and social performance in Indonesian Islamic banks. According to Nugraheni (2018), cross membership adds to the busyness of the board members, so that the level of supervision of the company may not be maximal, including in supporting disclosure. Therefore, this variable does not influence CG disclosure. This result is not in line with El-Halaby and Hussainey (2016) which finds that large cross membership of sharia supervisory board will disclose more sharia disclosure.

Regarding the control variable, company size as measured by total assets has a coefficient value of 0.0152 and a significant value of 0.9790 >0.05, which means that company size does not influence CG disclosure. Regarding the profitability, the coefficient value is 0.1322 with a sig. value of 0.0840 > 0.05 which indicates that the profitability has no effect on CG disclosure. This is in accordance with the research of El-Halaby and Hussainey (2016) which states that profitability has no effect on disclosure. Haniffa (2002) states that profit should have no effect on disclosure because the company should remain open to the public regardless of the profits.

Conclusion

Corporate governance (CG) aims to protect the interests of stakeholders by ensuring that the company is managed properly. This study aims to examine the relationship between the board of commissioners (BOC) characteristics and CG disclosure. The results demonstrate that the board independence has positive effect to the CG disclosure, while the rest the variables do not influence CG disclosure.

Islamic business organizations are generally expected to have greater transparency than other general organizations. Their activities must not conflict with sharia principles so that transparency and disclosure of information will increase the stakeholder's trust. This study finds that the level of CG disclosure of sharia compliant companies is very high, that can be seen from the mean value of CG disclosure. However, only the board independence as one of the BOC characteristics used in this study that affects to the disclosure. It should encourage the users and regulators to improve the role of the BOC in suggesting the management to provide adequate disclosure regarding the implementation of CG principles in their company. Nevertheless, the BOC still has to carry out its supervisory function to ensure that CG is still implemented and the interests of stakeholders are protected by the company.

The limitation of this study is that it only uses one organ of CG mechanism namely the board of commissioners. The use of other organs such as the board of directors or other committees can be added to see if they have the same or different results. The BOC characteristics also can be added with other variables such as expertise and nationality of members to complement the characteristics of the BOC.

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