

Human Governance Development Index of Shariah Compliant Companies in Malaysia and Indonesia

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Abstract - This research aims to form a Human governance index (HGI) using Board of Directors (BOD) attributes such as BOD job experience, BOD education background, BOD education level, BOD age, BOD gender diversity, degree of integrity, BOD training and development, and the quality of the internal control system. This research is based on a review of 70 Shariah-compliant companies' annual reports for the fiscal year ending in 2019. There are a total of 70 Shariah-compliant businesses. A representative from academia checked the measurement of this study. This study revealed that HGI is higher for Malaysia than Indonesia with 0.60 and 0.48 respectively. BOD job experience index has the highest mean for both countries, indicating that the majority of BOD has more than ten years of experience and the BOD gender diversity index has the lowest mean for both countries, indicating that the majority BOD are males. BOD education background index is almost similar between Shariah companies in Malaysia and Indonesia. BOD education level index and BOD age for Malaysia is lower than Indonesia. However, it can be seen that the integrity index is much higher for Malaysia than Indonesia, as in Malaysia it is mandatory to include the statement of internal control in the annual report, but it is not the case in Indonesia. Human governance has been proven to increase organizational performance through values, norms, and ethics implemented within the organization.

Key-Words – Human Governance, Human Governance Development Index, Shariah Compliant Company

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1 Introduction

Over the past few decades, there has been a rise in public awareness of how businesses are involved in social and environmental concerns. Companies worldwide are under increased pressure to provide information about their corporate social responsibility as the global economy grows more intertwined. [1]. Therefore, the quality of the information companies provide in their annual reports has attracted significant attention among regulators and market participants worldwide.

Emerging economies require that a company disclose one of its challenges in the annual report. [2]. Investors and creditors are more concerned with the company's social responsibility and employee information than just its liquidity, profitability, and financial health [3] in making decisions. When management makes poor decisions and changes that may impact employees' responsibilities and tasks,

they will undervalue employees' contributions, skills, or talents. It demonstrates how leaders' failure to make decisions for the company impacts their employees [4]. As a result, all organizations in the beginning years now have disclosure of corporate social responsibility (CSR) as part of their strategy plans.

Governance is an essential element in achieving higher organizational performance. Human Governance (HG) should be prioritized in management compared to other forms of governance as the implementation is related to ethical behavior in the company.

The concept of HG differs from that of Corporate Governance (CG). HG focuses on and is closely connected to employees by establishing quality values through ethics, moral conduct, and behavior to CG, which focuses on the process, policies, and other factors [5]. HG can support advantageous

relationships within the company. It can also solve Corporate Governance's failures and act as a corporate control. Previous research has also shown a positive relationship between HG to sustainability reporting [17, 13], which is in line with the global agenda that all companies should achieve Sustainable Development Goals (SDG) set by the United Nations in 2015. To increase sustainability reporting for Shariah companies, an excellent human governance structure is needed by having good board leadership, training of BOD, level, and internal quality control in place. The focus of CG is on external laws that control business activities [6]. As a result, HG must improve corporate governance in order to avoid failure, particularly in terms of humanity.

Furthermore, the development of the HG index complements the existing board governance index as established by prior literature [7]. They constructed the board governance index and found a positive association with firm operating performance. The development of the HG index by the current research has the potential to close the gap in the literature, as evidenced by the index approach's success in studies of governance performance. It more accurately reflects the total strength of a certain area of governance, such as the BOD's honesty, qualification, and training, which have an influence on the values and ethics.

HG includes the traits of value, religion, belief system, culture, and ethics, which can help improve the company's practices to achieve its objectives. A more comprehensive governance framework will be put in place due to the HG approach, as ethical conduct was initially intended to be in the realm of all professions to produce value and protect sustainability [8]. HG can also help add value to employees and maximize company value as a successful organization comes from a valuable employee with high ethics and integrity [6][9]. Hence, the main objective of this study is to develop the HG index through BOD attributes; job experience, education background, education level, age, gender diversity, level of integrity, the quantity of training attended, and quality of the internal control system. The next objective of this study is to examine the HG disclosure of Shariah-compliant companies in Malaysia based on the developed index.

Shariah-compliant companies provide an interesting avenue to analyse the HG disclosure of a company. Besides ensuring the activities and financing comply with the Shariah law and principles, Shariah-compliant companies are also expected to uphold their ethics and values in their overall operation.

Islam strongly emphasizes social justice in dealing with a human.

This paper will discuss the HG governance practices of Shariah Compliant Companies of two emerging economies, Malaysia and Indonesia. Indonesia established the Shariah-based capital market in 2003, while Malaysia's official list of Shariah-approved securities was approved in 1997. Both countries are actively promoting the Shariah-based capital market as investors have a growing interest in this market.

Due to this reason, this current study is motivated to examine the extent to which Shariah-compliant companies are expected to practice their Islamic image and disclose the HG information in their annual reports.

The paper begins with an elaboration on what human governance is and the elements of Human Governance. It will then explain the theory used in Human Governance. Research methods and findings will be discussed and will conclude with recommendation for this study.

2 Literature Review

In an organization, people are essential. Human behavior is governed by internal, inside-out, and value-based convictions. HG plays a key role in enhancing employees' morals and conduct. It addresses values, religion, belief systems, culture, and ethics in order to foster a supportive culture that yields moral principles and high ethical standards [8]. All workers should act in a way that is positive, genuine, and devoid of toxicity, as encouraged by HG. Exemplary leadership, integrity, training and development, a good internal control policy, spirituality, culture, and recruiting and selection may all be used to gauge an organization's HG [5]. An organization will gain more moral if it practices good HG [6].

2.1 Job Experience

Job experience is any past, present, or future professional or personal events that may influence a person's decision-making. [10]. BOD's experiences may influence how effectively they monitor and advise the organization and deal with business challenges [11].

2.2 Education Background

Education background can be defined as the field in which a subject's most advanced degree was awarded; formal or informal [12]. Previous studies argued that education background should be an

essential determinant in evaluating BOD qualification as the consequences of the education background will affect accounting values, practices, and corporate accountability [13][14][15].

2.3 Education Level

Board's education level can be used as a measurement of HG. HG can be measured through CEO's attributes such as age, tenure (job experience), and gender diversity [16][17]. Higher education, such as a doctoral degree (Ph.D.), provides a more profound knowledge, broader analysis, and a unique perspective on problem-solving for the organization [18].

2.4 Age

HG can be measured through CEO age by expressing the age of an executive adjusted by year to identify the influences of HG on a firm's leverage decision through secondary data collected from Bursa Malaysia [16]. Age has a significant positive relationship with the environmental corporate social responsibility disclosure and computed the square age term of directors by multiplying mean age by itself [19].

2.5 Gender Diversity

Gender, age, education, experience as a director, and skill boost CSR performance [16][20][21]. [22] and management commentary disclosure or sustainability disclosure is positively impacted by the number of female BOD members [23].

2.6 Level of Integrity

Three separate categories of Malaysian public sector organizations—state level, state statutory body, and federal statutory body—can be used to gauge the level of integrity. The ethical commitment was measured by looking at six (6) dimensions: corporate moral values, action to promote ethics, ethics committee, whistle-blowing policy, code of ethics, and sustainability practices [24].

2.7 Training and Development

It was suggested that training and development should enhance employees' human values, specifically integrity, moral conduct, and ethics [5]. It is found that training is associated positively with firm performance [25]. This result agrees with a study conducted [26], which also found that a practical training and development program will increase job proficiency in the organization through a positive employee with a high value of integrity. Thus, the more training programs attended by BOD,

the higher the value of integrity and job proficiency in the organization will lead to better performance.

2.8 Quality of Internal Control

The internal control system was measured using six (6) dimensions. They are the internal control structure, a distinct dimension section of internal control, the execution of internal control, the function of internal control, the aim of internal control, and the content of internal control disclosure [27]. Chinese listed non-financial enterprises' internal control system quality was 63.67% [28]. The level of the internal control system was measured with a questionnaire. The result showed that the status of the internal control system of the selected companies in Somalia is high, with an overall mean of 2.85 [29]. The average internal control system of companies listed in Bursa Malaysia was 4.196 [30]. From the studies, risk assessment is the highest rated item of the internal control system, followed by control activities, monitoring, control environment, and information and communication. The mean of the quality internal control system of Malaysian Public Hospitals was 2.96 by measuring service quality and patient satisfaction [31].

3 Resource-Based Theory

Each company has a vast range of resources and skills at its disposal. Three different categories of resources exist: 1) Physical capital resources include things like buildings, machinery, and equipment; 2) Human capital resources include things like education and experience; and 3) Organizational capital resources include things like formal structures [3]. Financial, physical, human, technical, and organizational resources can all be categorized. The cornerstone of strategy is made up of resources and capabilities, and internal resources and capabilities serve as the main compass for a firm's strategy [32]. Human capital, social capital (i.e., connections and exchanges between internal and external parties), and organizational capital (i.e., procedures, technology, databases) make up an organization's resources [33].

Resources for the company include both material and intangible assets that might offer it a competitive edge. Physical assets, which are tangible assets like real estate, machinery, and other tangibles like cash and equipment, are examples of tangible resources. The expertise and abilities of

employees, a company's reputation, and a firm's culture are examples of intangible assets and resources. In this study, HG components are regarded as intangible assets that give an advantage over competitors. This theory focuses on the idea that internal resources might help a company maintain a competitive edge by assisting it in fending off threats from rivals and other external market factors [34]. Being more accountable and transparent by sharing relevant information about the organization's operations might provide you a competitive edge.

4 Research Method

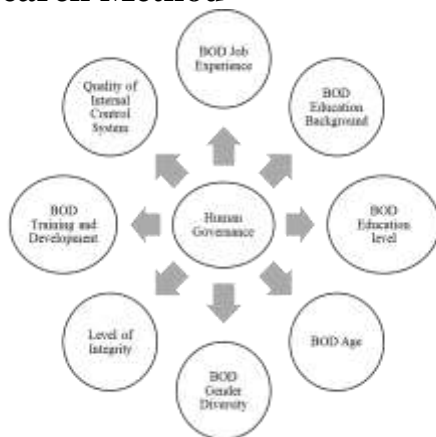


Fig. 1: Conceptual Model

The creation of an HG index is the study's primary goal. Based on prior research, the HG Index was developed. It consists of 8 sub-indices: (i) the BOD job experience index; (ii) the BOD educational background index; (iii) the BOD educational level index; (iv) the BOD age index; (v) the BOD gender diversity index; (vi) the level of integrity index; (vii) the amount of training the BOD attended; and (viii) the quality of the internal control system index. These indices were taken, accordingly, from a variety of sources [16][22][24][27][35].

The index score for the BOD work experience assessment was 1 if the experience was greater than ten (10) years, and 0 otherwise. A score of one is equal to 100%, while a score of zero is equal to 0%. The entire score is divided by the total BOD number to determine the job experience index.

Business gets a score of 1 on the BOD education background index, whereas non-business gets a score of 0. For a score of 1, 100% is given, and for a score of 0, 0% is given. The overall score is divided by the total BOD number to get the education background index.

A score of 0 indicates a degree or less, 1 indicates a degree, 2 indicates a professional certification, 3

indicates a master's, and 4 indicates a Ph.D. A score of 4 receives a 100% assignment, a score of 3 receives a 75% assignment, a score of 2 receives a 25% assignment, and a score of 0 receives a 0% assignment. The entire score is divided by the total BOD number to determine the education level index.

A score of 0 is assigned for those under the age of 39, 1 for those between the ages of 40 and 49, 2 for those between the ages of 50 and 59, and 3 for those over 60. A score of 3 is given a 100%, a score of 2 is given a 67%, a score of 1 is given a 33%, and a score of 0 is given a 0%. By dividing the overall score by the total BOD number, age is determined.

Females receive a score of 1 and men receive a score of 0 for the BOD gender diversity metric. For a score of 1, 100% is given, and for a score of 0, 0% is given. The entire score is divided by the total BOD number to get the gender diversity index.

The degree of integrity index refers to the disclosure of (i) corporate ethical ideals (1 item), (ii) activities done to promote ethics (3 items), (iii) code of ethics (2 items), existence of an ethics committee (2 items), and whistleblowing policy (comprise of 2 items). Each item receives a score of 1 if it is disclosed and a value of 0 if not. There are 10 things in all. By dividing the total number of disclosed items by the 10 things that should have been disclosed, one may get the degree of integrity index.

The number of training sessions the Board of Directors attended during the year is shown by the amount of training index. If the Board participates in training and development more than five (5) times, they will receive a 1; otherwise, they will receive a 0. For a score of 1, 100% is given, and for a score of 0, 0%. The overall score is divided by the total BOD number to determine the size of the Training index.

The disclosure of the internal control system is referred to by the internal control system quality index. The control system's quality is assessed using 21 different factors. By dividing the total number of revealed items by the 21 things that should have been declared, the quality of the internal control system index is calculated.

A pre-test analysis of the developed index has been conducted with academics that have experience working on corporate social responsibility, corporate governance, and sustainability reporting practices. This is to ensure that the design of the HG index is reliable and valid.

The study's second objective is to examine how corporations disclose HG based on the developed index. This study employs content analysis, a technique that has been widely employed in

research on voluntary disclosure. It is a research strategy used to ascertain the presence of specific concepts or terms within the text that are relevant to the study's aims. Content analysis is a methodological approach for categorizing the symbolic contents generated by all forms of recorded communication [36]. It enables the analysis of yearly reports to be conducted methodically, repeatably, and uniformly [37]. Secondary information from publicly accessible yearly reports and relevant websites is used in this study. Companies that adhere to Shariah and are listed on Bursa Malaysia make up the study's population. There are 696 businesses identified as adhering to Shariah as of November 2019. (Security Commission of Malaysia, 2019). This research focuses on businesses who have regularly filed annual reports between 2016 and 2019 and have been listed on Bursa Malaysia. Fig.1 shows the conceptual model.

5 Result and Analysis

The descriptive data for the HG indices utilized in the analysis are shown in Table 1. HG was made up of 8 indices: i. BOD job experience index, ii. BOD educational background index, iii. BOD educational level index, iv. BOD age index, v. BOD gender diversity index, vii. level of integrity index, viii. quality of internal control system index. Furthermore, the result reflects that Malaysia has a higher HG index compared to Indonesia with a value of 0.60 and 0.48 respectively. The result also shows a big gap between the training indicators in the two countries of 0.7 which is considered very high as other indicators are not that far different. Therefore, Indonesian companies need to focus on improving the training index to gain a higher human governance index within the company. In addition, the quality of internal control for Indonesian companies is 0.47 as compared to Malaysia companies which has 0.70. This might be due to the fact that in Malaysia the statement of internal control is mandatory but not in Indonesia. The finding of the study is consistent with the previous study [28].

Out of the eight indices, the highest mean is BOD job experience for both countries. It contributed most to the Human Governance Index, where Malaysia shows a mean of 0.93 and Indonesia a mean of 0.90.

The Age index for Malaysia is 0.70 compared to Indonesia 0.79, which indicates both countries have BOD who are more mature.

For both countries, it can be seen that the majority of BOD are males.

The level of integrity index for Malaysia is 0.47 (47%) whereas for Indonesia is 0.38 (38%), it can be said that activities to promote ethics, existence of code of ethics and ethic committee, are below average compared to previous study [38]. Moreover, it referred to the importance of honesty and accurate reporting as fundamental values for the effectiveness of integrity rules. These are becoming essential factors of the companies to disclose more to maintain their reputation and trust among the customers [39].

Fig 2 shows the level of integrity of the companies. If the company has a score of 0%-20% of integrity level, the company might disclose only 1 to 2 items. While if the company score from 80%-100%, it shows that it has disclosed eight (8) or all the integrity items. The result shows that 41 (58%) companies in Malaysia have disclosed 4-6 items of integrity, and 29 (41%) companies in Indonesia have only disclosed up to 4 items. None of the companies from both countries disclosed all the items in this study.

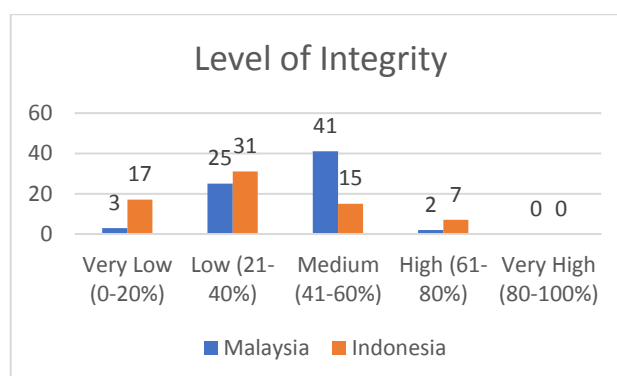


Fig. 2: Human Governance Index for Level of Integrity

The Educational Background index both of Malaysia and Indonesia have similar level of 0.58 and 0.59 consecutively, while the Educational Level index for Malaysia is 0.4, compare to Indonesia 0.46 which give indication that Indonesia Shariah companies emphasis the important of education level, while previous study showed there is no significant relationship between BOD educational background and performance [40].

Fig 3 shows the frequency number of training that the BOD has attended. Most BOD have attended less than five (5) training sessions for both countries. There are 60 (85.7%) BODS from

Malaysia, while 59 (84.3%) BODS from Indonesia have less training.

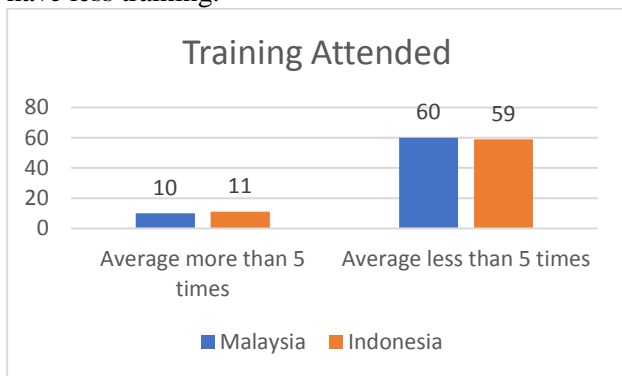


Fig. 3: Human Governance Index for Training

Fig 4 shows the number of items in the internal control policy that the company has disclosed. If the company scores 0% - 20%, it disclosed only 1-4 internal control items. While if the company score is 80% - 100%, the company disclosed 18 or all the items for the internal control policy. The findings show that 31 Malaysian companies mostly score 61% to 80% for internal control policy. In comparison, 26 Indonesian companies mostly score 41% - 60% for this internal control. On average, the internal control index for Malaysia is 0.70 better than Indonesia 0.47.

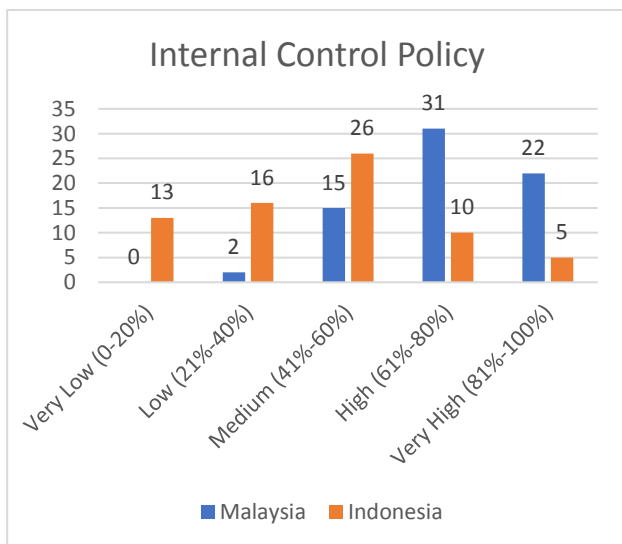


Fig. 4: Human Governance Index for Internal Control Policy

Table 1 shows the descriptive statistics for the HG indices of both Malaysia and Indonesia.

Table 1. Descriptive Statistics

	Malaysia N=70			Indonesia N=70		
	Min	Max	Mean	Min	Max	Mean
Job Experience	0.50	1.00	0.93	0.25	1.00	0.90
Education Background	0.10	1.00	0.58	-	1.00	0.59
Education Level	0.10	0.68	0.41	0.08	1.00	0.46
BOD Age	0.28	1.00	0.70	0.17	1.00	0.79
BOD Gender	-	0.50	0.17	-	0.75	0.11
Integrity	0.10	0.70	0.47	-	0.80	0.38
BOD Training & Development	-	1.00	0.86	-	1.00	0.16
Internal Control	0.33	0.95	0.70	-	0.95	0.47
HGI			0.60			0.48

6 Conclusion

Eight human governance indices have been created as a result of this study: the BOD job experience index, the BOD educational background index, the BOD educational level index, the BOD age index, the BOD gender diversity index, the level of integrity index, the amount of training the BOD attended, and the quality of the internal control system index. The study found that, HG index for Malaysia is higher (0.60) as compared to Indonesia (0.48). The high HG index for Malaysia is contributed by job experience (0.93) and training (0.86), which are much higher than Indonesia. The mean of age for BOD in Indonesia (0.79), educational background (0.59), and education level (0.46) is much higher than Malaysia. Majority of BOD for both countries are males.

This study has its limitations, just like any other study. Only the manufacturing industry is examined and only one year period (2019) is covered. Future studies may include more industries and examine changes over time in other sectors. Although within the acceptable sample size for this study, future studies could expand the sample to increase statistical capacity.

This study is an attempt to measure HG using secondary data. Future studies can study the relationship of HG to other variables, such as fraud, governance, sustainability reporting, organization's performance, and employee satisfaction, as HG has been proven to increase the organization's performance through values, norms, and ethics

implemented within the organization. Future studies can use primary data such as interviews and questionnaires to validate the constructed index. In addition, other explanatory variables, such as the behavioral issues of the Board of Directors, might play a significant role.

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Contribution of Individual Authors to the Creation of a Scientific Article (Ghostwriting Policy)

Idris Gautama So, Professor in Management Science, has the role of consolidating writing and being a correspondence author.

Hasnah Haron; Professor and expert in Shariah business and coordinating the information process on Malaysia's Shariah companies matters and ensuring quality research related to Shariah issues.

Anderes Gui, an Expert in information management, ensures secondary data availability and data alignment from Malaysia and Indonesia to ensure the quality of this research.

Elfindah Princes; Expert in research management, she has contributed to extracting references and data processing to ensure the quality of this research.

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Conflict of Interest

The authors have no conflicts of interest to declare that are relevant to the content of this article.

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