Comparative Analysis of CSR Disclosure and Its Impact on Islamic Banks Financial Performance

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Abstract
Corporate Social Responsibility (CSR) is one of indicators reflecting not only a firm financial performance but also their connection to the stakeholders. This study will analyse the CSR disclosure between two Islamic Banks in MENA Countries; Boubyan Bank from Kuwait and Ithmaar Bank, a Bahrain origin. By employing a mixed qualitative-quantitative method, the paper will contrast both financial reports for 5 consecutive years (2011-2015), and utilise CAMEL rating, as the indicators for financial performance. Furthermore, the data will be analysed intensely using Belal, et al (2015) CSR index. For the non-financial performance, a deeper analysis of the Chairman’s statement will be conducted through text analysis software (DICTION and LIWC). The result showed a consistent output, between financial and non-financial performance, for both banks. Boubyan Bank performed better in terms of financial state, and in addition, avoided impression management procedure. In contrast, Ithmaar Bank indicated the opposite result.

Keywords: Corporate Social Responsibility; Financial Performance; CAMEL Rating

1. Introduction

Human-beings as the God’s vicegerent on earth have a responsibility to protect the nature and the living things covered by the environment. This obligation is embedded in daily management activities as they turn into homoeconomicus in fulfilling their need in order to reach prosperity. In accounting and economics perspective, the phenomenon materialized as the result of deforestation, carbon emission, pollution and climate change are the responsibility of an entity involved in those environmental area.¹

Corporate Social Responsibility (CSR) has become the first priority in business and competition that indicates a relation and impact between organization’s activities to the society and surroundings (Mustafa et al, 2012). Under the Sharia perspective, it is a mandatory for a company, bank in this case, to perform well, followed by a responsible disclose on their CSR report. Hence, it is important to analyse whether the banks operated under Sharia are upfront in their activities towards the environment and completely fulfil their obligation based on Sharia compliance.

Meanwhile, accountability has a broader meaning for Islamic Financial Institutions (IFIs), since IFIs need to disclose their activities horizontally, to the board of director and management, and vertically to the Creator, under the Islamic principles and Sharia regulation. Thus, full disclosure is urgently needed to share financial, social performance, and environmental assessment and information to the stakeholders and specific Islamic Bank’s clientele, namely Investment Account Holders (IAHs), as well as future investment and risk management prevention and other business decisions. Since it has a unique structure and product, IFIs need to fulfil two types of disclosure: universal, which is applied to all banking industry, and particular, a reporting subjected to the sharia compliance issues.2

The Islamic banking principles obligate the product providers, in this case Islamic Banks, to fulfil not only the financial disclosure of their annually work period, but also full non-financial disclosure of Corporate Social Responsibility, Sharia Compliance, Environmental and Corporate Governance.3 This paper aims to make a comparison between two Islamic Banks, Ithmaar Bank from Bahrain, and Boubyan Bank from Kuwait, related to their financial and non-financial disclosure of their annual report, websites and other reliable sources.

**Research Gap**

Although there are numbers of literature about how CSR disclosure reflecting on bank’s financial performance, there is only a single literature that used content analysist as a measurement to determine the score of CSR. More importantly, in most previous research, CSR disclosure reporting is mixed with Corporate Governance and Ethical disclosure as the determinants. However, this paper will only concern in the disclosure of CSR and the impact of bank’s financial performance.

**Focus and Purpose**

This paper will analyse the CSR disclosure between two Islamic Banks; Ithmaar Bank from Bahrain, and Boubyan Bank from Kuwait, for 5 consecutive years starting from 2011 until the recent years, through their annual reports, and thus comparing the result to the slope of their financial performance, using CAMEL ratios and profitability as the financial indicator.

The analysis will be undertaken to evaluate several CSR disclosures, such as: environmental disclosure, social sustainability disclosure, and economic sustainability disclosure.

**2. Research Methodology**

**Strategy, Sample and Data Collection**

The most crucial step in undertaking any kind of research or observation is to pair the methodology to the research questions.4 Although the CSR disclosure is generally measured using qualitative method, but in this case, using Belal et al index, the measurement is translated into binary code, marked 1 for disclose items and 0 for the

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contrary, using content analysist. Thus, this paper will use both, quantitative and qualitative approach, since it is perfectly match to numerical measurement to examine relationship or cause and the effect of phenomena.

Furthermore, this research will use purposive sampling, as the data is subjective to Ithmaar Bank and Boubyan Bank. To conduct a comprehensive research, annual reports from both banks for 5 consecutive years (2011-2015) will be analysed intensely using Belal et al CSR index. Additionally, financial ratios and profit throughout the years will be generated via BankScope database, from Durham University Library. And finally, to obtain a deeper analysist, the paper will also analyse the Chairman Statement and contrast it to the profitability using the text analyser software.

3. Result and Analysis
3.1 Financial Performance

1. CAMEL Analysis
Recognized as one of the first pioneer of Islamic Bank in Bahrain, Ithmaar Bank, established in 1984, indicates a struggling effort to performing well year by year. On the contrary, Boubyan Bank, one of Kuwaiti Islamic Leading Institution, ranked 9 in the country Islamic Bank’s Industry. To conduct a deeper analysis related to overall bank performance, this essay will utilise CAMEL rating system that covers capital adequacy, asset quality, management quality, earnings ability and liquidity to evaluate bank’s robustness and quality. The supervisory information that analysed through CAMEL approach is an effective way to determine the bank’s current condition with further insight since its combine managerial and financial performance assessment. The table describing the information of CAMEL rating of both banks are presented in the first table of Appendix 1, collected from Bankscope database.

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<tr>
<td>Total Capital Ratio</td>
<td>12.81</td>
<td>12.11</td>
<td>12.77</td>
<td>12.64</td>
<td>12.88</td>
<td>12.64</td>
<td>17.04</td>
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<td>24.39</td>
<td>25.06</td>
<td>20.39</td>
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<td>Assets Quality</td>
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<td>Loan Loss Prov / Net Int</td>
<td>414.85</td>
<td>-367.25</td>
<td>-264.67</td>
<td>-351.60</td>
<td>-128.24</td>
<td>-305.32</td>
<td>12.03</td>
<td>16.72</td>
<td>28.15</td>
<td>30.34</td>
<td>26.17</td>
<td>22.68</td>
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<td>Cost to Income Ratio</td>
<td>71.31</td>
<td>87.93</td>
<td>98.19</td>
<td>85.38</td>
<td>120.56</td>
<td>92.67</td>
<td>43.15</td>
<td>45.48</td>
<td>45.67</td>
<td>47.12</td>
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<td>Earnings Ability</td>
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<tr>
<td>Net Interest Margin</td>
<td>-0.34</td>
<td>0.00</td>
<td>-0.02</td>
<td>-0.19</td>
<td>-0.30</td>
<td>-0.17</td>
<td>3.36</td>
<td>3.22</td>
<td>3.47</td>
<td>3.51</td>
<td>3.23</td>
<td>3.36</td>
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<tr>
<td>Return on Avg Equity (ROAE)</td>
<td>-6.95</td>
<td>-1.18</td>
<td>-10.15</td>
<td>-5.23</td>
<td>-7.27</td>
<td>-0.62</td>
<td>11.32</td>
<td>4.83</td>
<td>9.99</td>
<td>3.77</td>
<td>3.24</td>
<td>6.63</td>
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<tr>
<td>Return on Avg Assets (ROAA)</td>
<td>-0.58</td>
<td>-0.12</td>
<td>-1.11</td>
<td>-0.86</td>
<td>-0.91</td>
<td>-0.72</td>
<td>1.22</td>
<td>1.18</td>
<td>0.62</td>
<td>0.55</td>
<td>0.55</td>
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<td>Liquidity</td>
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<tr>
<td>Net Loans / Dep &amp; S T</td>
<td>67.28</td>
<td>73.81</td>
<td>70.56</td>
<td>68.24</td>
<td>63.96</td>
<td>68.77</td>
<td>78.07</td>
<td>78.16</td>
<td>78.10</td>
<td>79.17</td>
<td>80.39</td>
<td>78.78</td>
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</table>

2. Capital Adequacy

The financial strength of one bank is measured by Capital Adequacy Ratio (CAR), which is determined by bank’s availability of capital to support bank’s risk assets (Dincer et al., 2011). Both Boubyan and Ithmaar Bank are regulated under one comparable standard BASEL III that obligates a minimum of 12% of total capital for a safe indicator. Ithmaar Bank has moderately stable total capital ratio for all the five years. In addition, the bank scored above the minimum requirement. However, Ithmaar is below the global Islamic Bank’s capital ratio that scored 26% in average.

In contrast with the Bahraini, Boubyan Bank has a slightly declining trend for the CAR. It has a good score in 2011 (25.06%), but then the rating plunged to 17.04% for the last year. Although this result shows no distress to the financial performance, since the bank scored above the determined requirement. Along with Ithmaar Bank, Boubyan Bank’s CAR rating is below the world-wide Islamic Bank standard for the consecutive years (Figure 2, Appendix 1).

3. Asset Quality

Asset Quality is another significant indicator vis-à-vis to Capital Adequacy since the depreciation of asset become the determiner of solvency risks for most of the time. To calculate the asset quality, the method used by this paper is to compare loan loss provisions to net interest revenues. Ithmaar Bank reveals minus score on this rating, as the result of their policy to provide high provision to overcome the global crisis. Aside from the Bahraini, Boubyan Bank shows a significant decreasing in their provisions, indicated that they managed to mitigate their loan’s risk (Figure 3, Appendix 1).

4. Management Quality

For some researcher, management quality is determined by a non-financial performance such as the expertise and educational level of the management, or by calculating operating expense as a percentage of total assets. However, this essay will rate management quality through cost to income ratio that the lower the score, the better the performance will be. Despite they score above the global standard, Ithmaar Bank has a downward trend movement from 2011-2015. Boubyan Bank on the counterpart curved a better slope for all the years and scored below the globe’s standard. Thus, both banks were success in maintaining their efficiency level. (Figure 4, Appendix 1).

4. Earnings Ability

In this part, the bank’s efficiency is measured by three ratios; Net Interest Margin, Return on Average Assets (ROAA) and Return on Average Equity (ROAE). For NIM, Ithmaar Bank scored negative for the consecutive years, whereas Boubyan Bank contrarily showed positive score even though they cannot achieve the world wide IB’s standard. As for ROAA, whilst Ithmaar Bank keep scoring far below expectation, Boubyan Bank scored a remarkable return above the global standard in 2014 and 2015. And for ROAE, Boubyan Bank made a significant result in the recent year with more than 4 points gap

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with the world wide, while Ithmaar Bank acknowledged losses as well as the two latter points as the consequence of their strategy in increasing the provision, peculiarly in non-performing loans.

5. Liquidity

This measurement is considered as the most vital component since it shows the ability of the banks to settle their short-term liabilities and deal with the unexpected phenomenon such as sudden withdrawal from the depositor. Thus, to calculate the liquidity of a bank is to compare the liquid asset to total deposit and short-term funding. Both banks have a contrast result for this point, as Ithmaar Bank indicated a slightly increasing trend, Boubyan Bank showed vice versa. They plunged down revealed that have been succeed in maintaining their liquidity level. But, both Ithmaar Bank and Boubyan Bank are indicated a lower standard than the global requirement (Figure 8, Appendix 1).

3.2 Financial Impact on Operational and Policies Changes

Although suffered losses from the analysed years, Ithmaar Bank has made some significant changes that affected their financial performance. They changed their group structure by involving the creation of holding company which will be listed on the Bahrain Bourse and the Kuwait Stock Exchange. This structure will assist them to lower the risk profile and enhance shareholder value. Another key decision made as well, such as; initiative for increased revenue, improved margins, the divestment of non-core assets, and cost reduction across Ithmaar Group. On the contrary, Boubyan Bank has not made any vital decision or policy that influence their financial performance throughout the years.

3.3 Islamic Financial Reporting (Zakah, Qard Hassan, Charity Fund)

Related to zakah, Ithmaar Bank does not collect or pay zakah on behalf of its owners and its investment account holders. But the Independent Auditor and Sharia Supervisory Board claimed that the Bank has fulfil the requirement of zakah reported in annual report, comply with AAOIFI FAS-9. As for Qard Hassan, this is a new product launched in 2015 and has no record for the recent year. In addition, gains made from sources prohibited by sharia and all the amount collected from customers’ late payment and penalties were posted to Charity Fund. Conversely, Boubyan Bank is compulsory to pay zakah, as their local law act no 46/2003, all listed company should pay zakah.

3.4 Non-Financial Performance

1. Narrative Reporting Analysis

The narrative analysis conducted in this essay is utilised DICTION and LIWC as the tools to find out whether both Banks, Ithmaar Bank and Boubyan Bank, are performing a bias disclosure, reflected on their Chairman’s Statement, to neglected negative outcome or to emphasize positive achievement that might led to impression management. Moreover, it can be seen that most of the time the management lack

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conscientious and might set an asymmetric information that could led to the agency cost problem.\textsuperscript{15} This notion is based on agency theory to manipulate the attribution to appear more favorable for investors as manager have contractual utility maximization obligation to them.\textsuperscript{16} As Islamic banks imposed the value \textit{amanah} they are expected to disclose their financial statement without impression management.\textsuperscript{17} Impression management is indicated by six indicators generated by two software; optimism, certainty, positive and negative emotion, word count and complexity. These components will be compared to the Bank’s profitability from year to year.

2. Optimism and Certainty (DICTION)

Optimism is defined as “Language endorsing some person, group, concept or event or highlighting their positive entailments”. This indicator represents egocentric bias and used during negative profitability to cover current performance as predictive future positive performance.\textsuperscript{18} Meanwhile, certainty is indicating resoluteness, inflexibility, and completeness to speak ex cathedra. Impression management is identified when the company experienced negative profitability and use less certain language to cover their real performance.\textsuperscript{19}

Language and tone that describe someone’s positive implication is defined as optimism factor, while certainty is refer to “a language that indicates resoluteness, inflexibility, completeness, and a tendency to speak ex cathedra”.\textsuperscript{20} When the company gained a negative output from their financial performance, profitability in this case, they will use less words to disclose about that losses and use certain language to cover it.\textsuperscript{21}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{Figure_1.png}
\caption{Ithmaar Bank and Boubyan Bank Chairman Statement Text Analysis}
\end{figure}


In the period of 2012-2013, Ithmaar Bank was suspected to perform in impression management, since they incurred losses three time bigger than last period, while their level of certainty is raised. The repetition of such involvement took place between 2014 and 2015, when their losses increase into five times bigger compared to previous year, whilst both of their certainty and optimism level climbed up to a positive slope. Compare to Bahraini, Boubyan Bank’s profit is increasing from time to time. As the result, they are spared from the impression management implementation.

3. Positive and Negative Emotion, Word Count and Complexity (LIWC)

Positive emotions are used by management as a tool for impression management by emphasizing positive outcome. Meanwhile in reality they incurred loss, and vice versa with negative emotion.\(^{22}\) In addition, the management will consider in choosing a complex and long narrative statement to cover the losses.

![Figure 2: LIWC Text Analysis of Boubyan Bank](image)

Based on the generated result of DICTION and LIWC, Boubyan Bank has no intention to involve in impression management act, although their positive and negative emotion considered as stable and their word count is increasing through times, but those are in correlated with their profit that raised progressively. On the opposite, Ithmaar Bank performed impression management during 2011-2013, reflected from their incremental losses from one period to another, compare to their positive and negative emotion, and word count and complexity that increase to the opposite slope.

4. Voluntary Disclosure Discussion

In briefly, Ithmaar Bank has a better voluntary disclosure than the counterpart, Boubyan Bank. Thus, Boubyan Bank might retain their capital since they reveal more financial disclosure to the annual report, and this is aligned to the capital need theory.\(^{23}\)


5. Corporate Social Responsibility

Based on Belal et al checklist under corporate social responsibility part, Ithmaar Bank has proved that they provide more disclosure on the annual report, for CSR and Sharia Compliance part, vis-à-vis to their reputation from Bahrain, which is adopted AAOIFI as the guideline and regulation for accounting and financial disclosure. CSR disclosure is not mandatory originally, but since the Banks are on the Islamic Finance industry, it has become a social mandatory obligation to give such information to the shareholders.24

![Figure 3: LIWC Text Analysis of Ithmaar Bank](image)

4. Conclusion

CSR disclosure is a vital information represented a firm regarded their activities to connect to stakeholders. Based on analysis on financial performance, utilizing CAMEL rating as indicators, Boubyan Bank indicated a better performance rather than their Bahraini counterpart. They showed a significant decreasing in their provisions to net interest revenues (indicator of asset quality); curved a better slope for all the years in term of management quality; scored a remarkable return above the global standard for Net Interest Margin (NIM), Return on Average Assets (ROAA) and Return on Average Equity (ROAE) for Earnings’ standard; and had been succeed in maintaining their liquidity level. In the other hand, Ithmaar Bank led in Capital Adequacy indicator by performing moderately stable total capital ratio for all the five years.

Align with the financial performance, Ithmaar Bank indicated an employment of impression management, corresponded with their losses over the years. It proved by their certainty and optimism level that raised steadily following the financial losses. Additionally, their positive and negative emotion (reflected on Chairman’s statement on Financial Report) increase to the opposite slope (negative). To sum up, it is mandatory for firms to disclose their CSR report within Financial Report. Furthermore, a good performance financially should be subsequently followed by an astonishing managerial routine described by avoidance of unnecessary, or even manipulative, management strategies.

References


