

Business Ethics and Good Governance in Indonesian Sharia Stock Index

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Abstrak

Praktik bisnis yang etis semakin diakui sebagai hal yang penting bagi keberlanjutan. Perusahaan yang mengabaikan standar etika sering kali melakukan perilaku yang didorong oleh keserakahan, termasuk penipuan, untuk memaksimalkan keuntungan. Perusahaan-perusahaan yang terdaftar di Indeks Saham Syariah dianggap sejalan dengan norma-norma etika Islam, dan memosisikan mereka sebagai perusahaan-perusahaan yang secara inheren "etis". Namun, sejauh mana perusahaan-perusahaan ini mengungkapkan kepatuhan mereka terhadap etika bisnis masih belum jelas. Penelitian ini menyelidiki apakah perusahaan-perusahaan yang termasuk dalam Indeks Saham Syariah menunjukkan komitmen terhadap etika bisnis sebagai komponen integral dari tata kelola yang baik. Penelitian ini berfokus pada perusahaan-perusahaan yang terdaftar di Indeks Saham Syariah Indonesia (ISSI) antara tahun 2015 dan 2018, menganalisis 1.512 observasi. Temuan ini mengungkapkan bahwa perusahaan-perusahaan dalam indeks syariah menunjukkan pengungkapan etika yang unggul, yang menunjukkan kepatuhan kualitatif dan kuantitatif terhadap standar etika. Komitmen terhadap etika bisnis ini mendorong praktik bisnis yang lebih sehat dan berkontribusi terhadap keberlanjutan jangka panjang.

Kata kunci — *Etika Bisnis, Tata Kelola Perusahaan, ISSI, Syariah Compliant, Keberlanjutan*

Abstract

Ethical business practices are increasingly recognized as critical to sustainability. Companies that disregard ethical standards often engage in greed-driven behaviors, including fraud, to maximize profits. Firms listed on the Sharia Stock Index are presumed to align with Islamic ethical norms, positioning them as inherently "ethical" enterprises. However, the extent to which these companies disclose their adherence to business ethics remains uncertain. This study investigates whether companies included in the Sharia Stock Index demonstrate a commitment to business ethics as an integral component of good governance. The research focuses on firms listed in the Indonesian Sharia Stock Index (ISSI) between 2015 and 2018, analyzing 1,512 observations. The findings reveal that companies within the Sharia index exhibit superior ethical disclosures, indicating both qualitative and quantitative adherence to ethical standards. This commitment to business ethics fosters healthier business practices and contributes to long-term sustainability.

Keywords — *Business Ethics, Corporate Governance, ISSI, Syariah Compliant, Sustainability*

1. INTRODUCTION

Ethical business practices are fundamental to the long-term sustainability of companies. Adherence to ethical standards, coupled with transparency and accountability in business operations, plays a crucial role in safeguarding a company's reputation, avoiding legal repercussions, mitigating financial risks, and seizing business opportunities. The relationship between ethics and sustainability has been well-documented in the literature (Christensen et al., 2007; Nicholson & Kurucz, 2019; O'Hara, n.d.), underscoring the importance of integrating ethical considerations into business practices as a determinant of future corporate sustainability. Ethical disclosure in financial reporting serves as a critical tool for investors, helping them

assess the potential risks associated with misleading financial information, thereby emphasizing the necessity for companies to disclose their ethical codes (Persons, 2010).

An ethical company is characterized by its commitment to ethical principles, integrity, and social and environmental responsibility. The foundations of business ethics are diverse, often drawing from cultural values (Rashid & Ibrahim, 2008; Stajkovic & Luthans, n.d.; Weaver, 2001), social norms (Blay et al., 2018; Forquesato, 2016), legal frameworks, and religious teachings. Sharia-compliant companies, for instance, adhere to Islamic principles, which prohibit engagement in activities such as gambling, speculative transactions (gharar), interest-based financing (riba), and the production or sale of forbidden goods, such as alcohol and pork. The financial services authority sets

forth both qualitative and quantitative criteria for Sharia compliance. Qualitative criteria include adherence to Islamic ethical principles, while quantitative criteria mandate specific financial ratios, such as limiting non-halal income to a maximum of ten percent and interest-based debt to no more than forty-five percent (OJK). Companies meeting these criteria are classified as Sharia-compliant.

A key question arises: do companies listed as Sharia-compliant truly embody these ethical principles and values? This question is particularly relevant in the context of the Indonesian Sharia Stock Index (ISSI), where it is imperative to assess whether companies listed on the ISSI demonstrate a genuine commitment to business ethics in their annual reports compared to their non-ISSI counterparts. Despite the growing significance of Sharia compliance in the corporate world, the existing literature offers limited insights into the relationship between Sharia labels and business ethics, highlighting the need for further research in this area.

This study examines business ethics disclosures in the annual reports of companies listed on the Indonesian Stock Exchange (IDX) from 2015 to 2018, encompassing 1,512 observations. Employing t-tests to compare distinct characteristics and regression analysis, the findings reveal that companies listed on the ISSI exhibit more comprehensive ethical disclosures than those not listed.

The article is organized as follows: introduction, literature review, data and research method, finding and discussion, and conclusions.

2. LITERATURE REVIEW

This study draws on two theoretical frameworks to explore the relationship between ethical business practices and corporate sustainability: Legitimacy Theory and Signal Theory.

Legitimacy Theory

Legitimacy Theory posits that organizations alter their structures and operations to align with societal norms and expectations regarding acceptable practices (Deegan, 2002). This theory is often employed to explain why companies engage in social activities and disclose such activities as part of their responsibility to the public. Within the context of this research, adherence to ethical standards is considered a crucial component of maintaining legitimacy. Ethical commitments are reflected in the disclosures made in a company's annual report, which serve to demonstrate the company's alignment with societal values and norms.

For companies listed on the Indonesian Sharia Stock Index (ISSI), compliance with Sharia principles is a form of ethical adherence. The recognition that a

company upholds ethical standards is evidenced through the disclosure of a code of ethics and the promotion of ethical values in its annual report. By doing so, these companies seek to legitimize their operations within the broader societal framework, which includes both economic and religious considerations (Suchman, 1995). Recent studies have expanded on Deegan's work, emphasizing that legitimacy is not static but continuously renegotiated as societal expectations evolve, particularly in the context of sustainability and ethical practices (Tilling & Tilt, 2010; Hoque, 2022).

Signal Theory

Signal Theory, developed by Spence (1973), examines the actions of signalers and the subsequent responses of receivers based on the signals given. In the corporate context, management provides signals to external parties, such as investors, through various forms of information disclosure. These signals are intended to influence the perceptions and evaluations of the company by the market and other stakeholders (Gumanti, 2009).

The disclosure of business ethics practices can be viewed as a signal to stakeholders that the company is committed to ethical standards, thus enhancing its reputation and perceived trustworthiness. For companies adhering to Sharia principles, such disclosures also serve as a signal of their adherence to ethical and religious norms, potentially attracting investors who prioritize ethical and socially responsible investments (Connelly et al., 2011; Bergh et al., 2014). Recent research has further highlighted the importance of signaling in contexts where ethical and sustainability practices are increasingly valued by investors, particularly in emerging markets (Chen et al., 2020; Pankaj & Wankhede, 2021).

Previous Research

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A company is considered to operate ethically when it adheres to applicable laws and regulations, maintains transparency and honesty with stakeholders—including employees, customers, suppliers, and shareholders—and demonstrates social responsibility toward society and the environment. The ethical frameworks guiding corporate behavior

often derive from cultural values, social norms, legal requirements, and religious principles.

Numerous studies have explored the sources and implications of ethical business practices. Ethical values rooted in culture, social norms, law, and religious beliefs significantly influence corporate behavior (Rashid & Ibrahim, 2008; Weaver, 2001). For instance, cultural values shape ethical standards in business practices across different regions, while religious principles often dictate moral obligations in Islamic finance and business ethics (Dusuki & Abdullah, 2007).

The relationship between ethics and corporate sustainability has also been a focus of research. Oliveira et al. (2000) found that companies with a strong commitment to ethical practices tend to prioritize sustainability, as ethical considerations drive their efforts to maintain and enhance their reputations. Mella and Gazzola (2015) further elaborated on this relationship, arguing that companies concerned with ethics inherently strive to build and sustain a positive reputation. Conversely, companies that neglect ethical values often face negative moral repercussions among their executives, diminishing their ability to thrive in a social context and damaging their reputations (Preston, 1998; Mella & Gazzola, 2015).

Empirical evidence suggests that companies disregarding product quality or engaging in environmentally harmful practices are quickly stigmatized and abandoned by consumers. This underscores the importance of ethical behavior in maintaining consumer trust and societal approval (Kang et al., 2016). Additionally, research has shown that ethical business practices contribute to long-term success by fostering consumer loyalty, reducing legal risks, and enhancing overall corporate performance (Brammer et al., 2007).

Companies listed on the Indonesian Sharia Stock Index (ISSI) are those that meet the criteria set by the Financial Services Authority (OJK) for adherence to Islamic principles. These companies are expected to uphold higher ethical standards in their operations, given their alignment with religious values. Therefore, this study hypothesizes that "Companies included in the ISSI will exhibit better business ethics than companies not registered in the ISSI."

3. METHOD

Data and samples

This study utilizes panel data from companies listed on the Indonesia Stock Exchange (IDX) between 2015 and 2018. The sample includes firms classified as Sharia-compliant, which are listed on the Indonesian Sharia Stock Index (ISSI). Sharia-compliant companies are identified based on the

criteria set by the Financial Services Authority (OJK). In this research, companies included in the ISSI are coded as '1,' while those not included are coded as '0.'

The study's primary data source is the annual reports of these companies, focusing on their business ethics disclosures. The presence or absence of ethics-related information in these reports is used to measure the company's ethical commitment. Specifically, if a company discloses ethics-related information in its annual report, it is coded as '1'; otherwise, it is coded as '0' (Berrone et al., 2007; Choi & Pae, 2011).

To ensure the reliability and validity of the data, rigorous data cleaning processes were applied. Incomplete or inconsistent data entries were identified and excluded, resulting in a final sample size of 1,512 firm-year observations from an initial pool of 2,495 companies. This sample size ensures sufficient statistical power for the analyses conducted.

Research Variables

The key variables in this study are designed to measure the extent of business ethics disclosures among companies. The dependent variable is the Business Ethics Disclosure Score (BEDS), which is calculated based on 20 specific disclosure items. These items are categorized into six distinct dimensions:

1. Ethical Values: The company explicitly states its commitment to ethical values.
2. Code of Ethics: The existence and implementation of a formal code of ethics.
3. Promotion of Ethical Values: Efforts by the company to promote ethical values internally and externally.
4. Whistleblower Policy: The presence of policies and mechanisms to protect whistleblowers.
5. Sustainability Practices: Integration of sustainability practices in business operations.
6. Ethics Committee: The establishment of a committee dedicated to overseeing ethical conduct within the company (Garegnani et al., 2015).

Table 1. Sample Selection Criteria

Descriptions	observation amount
IDX Firms	2.495
Less : Missing data	983
final observation	1.512

Each of these items is binary-coded, where '1' indicates the presence of a disclosure and '0' indicates its absence. The BEDS is then calculated by summing the scores of these 20 items, providing a comprehensive measure of a company's ethical disclosure practices.

Method of Analysis

The data analysis is conducted using a combination of descriptive statistics, t-tests, and regression analyses. Descriptive statistics provide an overview of the data distribution, highlighting key characteristics of the sample. T-tests are used to compare the mean differences in business ethics disclosures between Sharia-compliant and non-compliant companies. Regression analyses are employed to examine the relationship between Sharia compliance (as an independent variable) and the BEDS (as a dependent variable), controlling for other relevant variables such as company size, profitability, and industry type.

The statistical analyses are performed using Stata software, ensuring robust and replicable results. The model's goodness-of-fit and the potential for multicollinearity are assessed through diagnostic tests, including the Variance Inflation Factor (VIF) and residual analysis. Additionally, robustness checks are conducted to verify the stability of the findings across different model specifications and sample subsets.

4. RESULT AND DISCUSSION

T-Test Analysis

Table 2 presents the results of the t-test conducted to compare the ethical disclosure characteristics between companies listed on the Indonesian Sharia Stock Index (ISSI) and those not listed. The t-test reveals a statistically significant difference in the level of ethical disclosures between the two groups. Specifically, companies included in the ISSI exhibit a higher level of ethical disclosures compared to non-ISSI companies. This finding underscores the notion that Sharia-compliant companies are more inclined to adhere to and disclose ethical practices, likely due to the stringent requirements imposed by Sharia principles.

Panel B of Table 2 provides a detailed breakdown of the ethical disclosure items. Among the 20 disclosure items, three show significant differences between ISSI and non-ISSI companies. These items include the presence of a code of ethics, the promotion of ethical values, and the implementation of a whistleblower policy. The significant differences in these specific disclosures highlight the emphasis placed on ethical conduct by Sharia-compliant companies, which aligns with their commitment to Islamic ethical standards.

Table 2. Two Sample Independent T-Test

Panel A				
	NON ISSI	ISSI	Coef	t-value
Ethic Disclosure	0.603	0.636	-0.034**	-2.082

Panel B

	NON ISSI	ISSI	Coef	t- value
Ethical Values	0.630	0.704	-0.074**	- 2.523
Code of Ethics	0.624	0.718	-0.094***	- 3.226
Promoting Ethics	0.576	0.549	0.027	0.849
Whistleblowing Policy	0.611	0.622	-0.011	- 0.358
Sustainability Practices	0.749	0.780	-0.031	- 1.164
Ethics Committee	0.405	0.395	0.010	0.336
Vision and Mission Upholding	0.624	0.687	-0.063**	- 2.119
Ethical Values Etic Disclosure	0.603	0.636	-0.034**	- 2.082

Regression Analysis

The regression analysis further supports the findings of the t-test. The results indicate that companies listed on the ISSI are more likely to engage in comprehensive ethical disclosures than their non-ISSI counterparts. The positive and significant coefficient associated with the ISSI variable suggests that being included in the Sharia index is a strong predictor of higher ethical disclosure levels.

These findings align with the principles of Legitimacy Theory, which posits that organizations seek to legitimize their operations by conforming to societal norms and expectations (Deegan, 2002). In this context, companies listed on the ISSI appear to enhance their legitimacy by adhering to Sharia principles and transparently disclosing their ethical practices. The higher ethical disclosures observed among ISSI companies can be interpreted as an effort to maintain legitimacy in the eyes of stakeholders, particularly in a predominantly Muslim market where adherence to Islamic values is highly regarded.

Table 3. Regression

	Ethic Disclosure
ISSI	0.033** (2.007)
Leverage	-0.018*** (-3.404)
ROA	-0.036 (-1.477)
Size	0.024*** (5.896)
_Cons	0.265*** (4.299)
R2	0.032
N	1496

t statistics in parentheses * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Implications and Interpretation

The results of this study have significant implications for understanding the role of ethical disclosures in Sharia-compliant companies. The findings suggest that ethical disclosure serves as a mechanism for these companies to signal their commitment to ethical standards and, by extension, their alignment with the values of their stakeholders. This is consistent with Signal Theory, which posits that companies communicate certain behaviors and attributes to stakeholders through disclosures, influencing perceptions and building trust (Spence, 1973; Connelly et al., 2011).

For investors, the ethical disclosures made by ISSI companies serve as a signal of the company's ethical integrity and commitment to responsible business practices. Such disclosures not only enhance the company's reputation but also contribute to its long-term sustainability by fostering investor confidence and stakeholder trust (Husted & de Jesus Salazar, 2006; Luo & Bhattacharya, 2009). Furthermore, the findings support the argument that voluntary ethical disclosures can enhance a company's legitimacy and potentially lead to better financial performance and sustainability outcomes (Brammer & Pavelin, 2006; Eccles et al., 2014).

5. CONCLUSION

In conclusion, the study demonstrates that companies listed on the ISSI are more likely to engage in ethical disclosures than non-ISSI companies. This behavior is driven by both a desire to maintain legitimacy in a market where Sharia compliance is valued and a strategic intent to signal ethical commitment to stakeholders. The findings contribute to the broader literature on business ethics, legitimacy, and signaling, offering insights into the ethical practices of Sharia-compliant companies and their implications for corporate governance and sustainability.

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