The Effect of Firm Characteristics, Corporate Governance, and Capital Structure towards Financial Performance and Islamicity Disclosure Index

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Abstract: - The purpose of this study is to test and explain the influence of firm characteristics, corporate governance, and capital structure on financial performance, and their impact on Islamicity Disclosure Index. The study took place at Indonesia Stock Exchange, by collecting data on 104 units of analysis (from 22 issuers or companies listed on Jakarta Islamic Index) during the trading period of January 2012 until December 2016. The results of this study indicate that firm characteristics have a significant influence towards the financial performance and Islamicity Disclosure Indeks The originality of this study is that it combines, examines, and analyzes the influence of firm characteristics, corporate governance, and capital structure on financial performance and the Islamicity Disclosure Index that has not been studied previously.

Key-Words: - Firm Characteristics, Corporate Governance, Capital Structure, Financial Performance, Islamicity Disclosure Indeks, Economic System

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1 Introduction

The change in the economic system from the capitalist system into the Islamic system occurs due to the inability of the capitalist system to free many countries from the economic crisis. The capitalist economic system is based on the principle of freedom, including freedom of property ownership, freedom of property management, and freedom of consumption. The capitalist economic system has also led to the collapse of a number of financial institutions in the United States and Europe. The financial crisis began with the fall of the major Wall Street players, including Lehman Brother and Washington Mutual, the two largest banks in the United States. Investors began to lose confidence so stock prices in major world exchanges began to fall out.

The financial growth in the world today is unbalanced with the growth of the real sector. The imbalance between monetary flow and goods/service flow threatens the economies of various countries. The amount of money in circulation in the Islamic economic system is not a variable that can be determined alone by the government as an exogenous variable. It is an endogenous variable, which is determined by the amount of demand for money in the real sector, or in other words, the amount of money in circulation has the same value as of goods and services in demand. Thus, the financial sector follows the growth of the real sector. This is the difference between Islamic and capitalist economic system. The capitalist economic system clearly separates the financial sector and the real sector; as a result, the world economy is prone to crisis, especially for developing countries because economic actors no longer use money for the interests of the real sector, but for the sake of speculation. Speculation is the thing that can harm a country's economy, especially countries with unstable political conditions.

The capitalist system has caused many problems. The world economy continues to experience a very unstable phase and an entirely uncertain future in the last few decades. It is returning to deep recession after a difficult period due to high inflation rate, severe unemployment rate, plus high real interest rates, and unhealthy exchange rate fluctuations. These all have damaged the economy of the developed and developing countries because massive projects are forced to reschedule, hundreds of entrepreneurs are out of business, millions of workers are threatened by layoffs, and the prices of goods and services including staple goods have increased uncontrollable.

Thus, it is not surprising that a number of leading economic experts have been criticizing and worrying about the economic capabilities of capitalism in realizing economic prosperity. Many have claimed that capitalism has failed as a system and an economic model. A new wave of consciousness to discover and use a new economic system that brings about the full implications of equity, prosperity, and efficiency of goals has emerged. The new economic concept is considered very urgent to be realized. The economic construction is done by an objective analysis of the overall contemporary economic format with clear views as well as fresh and comprehensive approach. The paradigm shift in the concept and theory of capitalist economy to sharia economy also took place in Indonesia. As a country with the largest Muslim population, Indonesia should be the pioneer of sharia financial development. This is possible remembering the potential, including; (i) the large Muslim population to be the potential customers of the sharia financial industry; (ii) the bright economic outlook, reflected in relatively high economic growth (range from 6.0% to 6.5%) supported by solid economic fundamentals; (iii) an increase in the sovereign credit rate so Indonesia holds a good investment grade that will make investors invest in the domestic financial sector, including the sharia financial industry; (iv) the abundant natural resources that can serve as underlying transactions of the sharia finance industry [11].

Based on the assessment of Global Islamic Financial Report (GIFR) in 2011, Indonesia ranks fourth for the country potential for the development of sharia financial industry after Iran, Malaysia, and Saudi Arabia. The other factor supporting the structure of sharia financial development in Indonesia is the regulatory regime that is considered better than other countries. In Indonesia, the authority to issue sharia financial fatwa is centralized by the National Sharia Council of Majelis Ulama Indonesia (MUI), which is an independent institution. As in other countries, individual scholars can issue fatwas so that the chances of differences are very large [70].

The Jakarta Islamic Index (JII) is one of the indexes in Indonesia Stock Exchange that calculates the average stock price for the types of stocks that have fulfilled the sharia criteria. The sharia shares included in the JII index consist of 30 most liquid Islamic stocks in the Securities List and have the largest 30 market capitalization based on the selection and review results of the Capital Market and Financial Institution Supervisory Agency and the Indonesia Stock Exchange presented every six months (now Financial Services Authority and the Indonesia Stock Exchange). This is what distinguishes JII from ISSI, where ISSI is a stock index that reflects the total sharia shares listed on the Indonesia Stock Exchange [29 and 30].

Signaling Theory signals that Firm Characteristics affects the Financial Performance [83]. Signaling theory emphasizes that reporting firms can increase corporate value through reporting [39]. This theory shows great consistency to the widespread disclosure that companies that do not disclose good information mean that the company is alienating from having a good impression of informing the market about its existence [62]. The larger the company's assets, the more it will improve its financial performance, and the longer the life of the company, the more it will improve its financial performance, so it is able to provide information about its good financial performance. This opinion is reinforced by the results of Doan and Nguyen [38], Minai et al. [73], and Schmitz and Sints [85], which also support the hypothesis of this study that firm characteristics are indicated to have a significant effect on firm financial performance.

Corporate governance is indicated to have a significant effect on financial performance based on the Agency Theory [60]. The number of independent commissioners will affect the financial performance of the company. According to this theory, the more number of independent commissioners will make the agent to provide more information in accordance with the interests of principals who want financial performance increases as to make independent commissioners work more professional. Agency problems occur when the proportion of management ownership of the stock is less than 100%. Causes of conflict between company management and shareholders include decision-making related to a) corporate activity in funding decisions and b) decision-making related to investment of funds; both of which will ultimately lead to conflict to determine the proportion of retained earnings and dividends to be paid to shareholders [60]. The number of shares owned by the institution will affect the company's financial performance, in accordance with research from [41] which finds an indication that the amount of cash dividend increases as the voting power of the institutional shareholders increases and cash dividend decreases as the voting power of shareholders decreases by company managers [90]. Similarly, the number of shares owned by the public will affect the financial performance because managers feel concerned that dividends increase so the company's stock price can increase so investors are interested to buy. Empirically, the research of Al-Tamimi [13], Ergin [42], and Noor and Hanim [75] indicate that monitoring mechanisms in corporate governance have a positive and significant effect on performance improvement.

Links agency cost with debt in the capital structure. The Agency Theory states that in determining the capital structure, we should also consider the costs incurred by the existence of differences in interests between the owner and the management. Based on this theory, the capital structure positively influences the possibility of bankruptcy, the value of liquidation, and reputation of managers. The capital structure has a bigger effect on the debtors, so the cost of debt becomes bigger too [60].

The large cost of debt is a monitoring cost for management; because the interest cost is fixed, the high cost makes managers to use the funds for the right investment. Thus, the use of debt in the capital structure can prevent unnecessary spending and encourage managers to operate the company more efficiently. This reduces the agency cost and financial performance is expected to increase. This is supported by Ahmad et al. [6], Uwalomwa and Uadiale [92], and Abu-Rub [1] that the capital structure may affect financial performance.

The Stakeholder Theory (Freeman and McVea [44]; Gray, Kouhy, and Lavers [50]) has provided the theoretical support that firm characteristics influences firm disclosure, which according to this theory, firm disclosure is expected to meet the wishes of stakeholders. The company will strive to generate harmonious relationships with its stakeholders, which affect the process f achieving company sustainability. Older corporate life and larger assets will reveal the wider fulfillment of corporate disclosure to stakeholders. This hypothesis has also received empirical support from Bhayani [26], Galani et al. [44] and Lucyanda and Siagian [69] indicating that firm characteristics, reflected by firm size and age, affects the firm disclosure.

In addition, corporate governance is also indicated to have an effect on firm disclosure (Gao and Kling, 2012). Corporate governance that includes the composition of independent commissioners and public shareholding will affect firm disclosure where the conflict of interest between agents and principals will encourage firm disclosure to the public if the there are more independent commissioners and/or more public shareholding. This is reinforced by the Agency Theory (Jensen and Meckling, [60]) and Aburaya [2], Samaha et al. [84] and Gao and Kling [47] stating that good corporate governance will further enhance firm disclosure to parties outside the company.

The Signaling Theory (Watson and Marston [96]) states that the capital structure also affects the Islamicity Disclosure Index. If the company has a good capital structure and, for the company to have a good impression, then the company have disclose to the public about its existence. This is evidenced by the Craig and Diga [36], Hossain and Hammami [55], and Ning Chen [74] indicating that the capital structure has a significant and positive influence on firm disclosure.

The Signaling Theory states that companies with high financial performance use financial information to send a signal to the market [87].It is similar with the capital structure, that the company will reveal the company widely if the financial performance is good. This indicates that financial performance influences firm disclosure. This opinion is proven empirically by An et al. [17], Arshad et al. [19], and Wan Ibrahim et al. [95].

The originality of this study is that it combines, examines, and analyzes the influence of firm characteristics, corporate governance, and capital structure on financial performance and the Islamicity Disclosure Index that has not been studied previously. The second originality in this study is on the subject of the study. This study focuses on the Islamicity Disclosure Index by companies listed on the Jakarta Islamic Index as the subject of research. Previous research has done more research on Islamicity Disclosure Index in sharia banking sector, such as Hameed et al. [51], Farook and Lanis [43], Abu-Tapanjeh [3], Adlina and Ahmad [4], while research on the capital market sector as in this study has not been found.

Based on the background that has been described, the purpose of this study is to test and explain the influence of firm characteristics, corporate governance, and capital structure on financial performance, and their impact on Islamicity Disclosure Index. The results of the previous inconsistent study also motivated the authors to reexamine firm characteristics, corporate governance, capital structure on financial performance, and voluntary disclosure in one research model.

2 Problem Formulation

2.1 Conceptual Framework and Research Hypothesis

Disclosure of information openly about the company is very important for public companies because it is considered by stakeholders in making decisions. Sharia-based capital markets are developed with the aim of accommodating the needs of the majority of Muslims in Indonesia to make investments. JII is an index of issuers whose business activities are not in conflict with sharia.

Open disclosure of information about companies is very important for public companies because it is considered by stakeholders in making decision. *Sharia*-based capital markets are developed to accommodate the needs of the majority of Muslims in Indonesia to make investments. JII is an index of issuers whose business activities are not in conflict with *sharia*. Many determinants affect company performance and broad disclosure of company information. One of them is the company's characteristics. Galani et al. [45] found that firm characteristic had a significant influence on company mandatory disclosure. The larger the size of a company, the easier the company to obtain a source of funding to be utilized by management to improve the company's financial performance. Liargovas and Skandalis (2010) stated that there was a positive relationship between company characteristics and financial performance.

Relating to financial and managerial decisions, namely funding, investment, and disclosure of company information decisions taken by company managers to improve company performance, one of the instruments used to control these decisions is corporate governance. Some empirical evidence has proven that corporate governance had a significant effect on a company's financial performance. Brown & Caylor (2004) revealed that the impact of good corporate governance implementation does not only eliminate the moral hazard and create a healthier business climate but also increase investor and creditor confidence. Gao & King [47] also found that corporate governance, consisting of external audit, internal governance, and external governance, had a significant effect on the fulfillment of corporate mandatory disclosures.

Jensen & Meckling [60] links agency costs with debt in the capital structure. According to the agency theory, capital structure determination must consider the costs arising from debt interest and the differences in interests between owners and company management. Also, agency theory mentioned that capital structure would have a positive influence on the likelihood of a company going bankrupt, the value of liquidation, and the reputation of managers. San & Heng's (2011) study on the Capital Structure and Corporate Performance of the Malaysian Construction Sector showed that Market Value and Earning Per Share were associated with Long-term Debt to Common Equity.

The findings above indicate that the reality of the assumption of a perfect capital market is impossible to occur. Therefore, imperfect capital markets (transaction costs, agency costs, and asymmetric information) and corporate finance decisions will affect the company's financial performance and the extent of disclosure of company information. For that matter, it is important to understand how financial policy factors, especially capital structure, firm characteristics, and corporate governance affect the company's financial performance and disclosure of company information. The explanation above can describe the conceptual model, as shown in Figure 1.

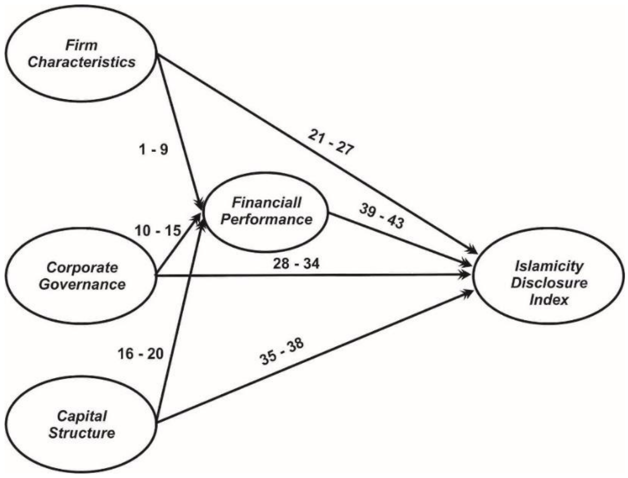

Fig.1. Conceptual Framework

Tabel 1. Hypothesis Testing

H	Hypothesis	Theoretical	Previous Research
H1	Firm Characteristics have significantly relationship to *Financial Performance*	Theory of Signaling [81]	Schmitz *and* Sints [85]; Doan *and* Nguyen[38]; Minai *et al.*[73].
H2	*Corporate Governance* have significantly relationship to	Theory of Agency [60]	Klapper *and* Love [63]; Al-Tamimi [13 and 14]; Ergin[42];

H	Hypothesis	Theoretical	Previous Research
	Financial Performance		Noor *and* Hanim[75].
H3	Capital Structure have significantly relationship to *Financial Performance*	Theory of Agency [60]	Ahmad *et al.*[6]; Uwalomla *and* Uadiale [92]; Abu-Rub [1].
H4	Firm Characteristics have significantly relationship to *Islamicity Disclosure Index*	Theory of Stakeholder [50]	Watson *et al.*[96]; Lucyanda *and* Siagian [69]; Bhayani [26]; Galani *et al.* [46]; Hossain *and* Hammami [55].
H5	*Corporate Governance* have significantly relationship to *Islamicity Disclosure Index*	Theory of Agency [60]	Haniffa *and* Cooke (2005); Akhigbe *and* Martin [8]; Samaha *et al.*[84]; Gao *and* King [47]; Akhtaruddin *et al.*[10]; Aburaya [2].
H6	Capital Structure have significantly relationship to *Islamicity Disclosure Index*	Theory of Signaling [81]	Ning Chen[74]; Craig *and* Diga [36]; Hossain *and* Hammami [55]
H7	*Financial Performance* have significantly relationship to *Islamicity Disclosure Index*	Theory of Signaling [81]	Ibrahim *et al.* (2011).

2.2 Research Method

The study took place at Indonesia Stock Exchange, by collecting data on 104 units of analysis (from 22 issuers or companies listed on Jakarta Islamic Index) during the trading period of January 2012 until December 2016. Annual reports, financial reports, and other data regarding the issuers were obtained from the Investment Gallery of the Indonesia Stock Exchange (IDX) (formerly was Indonesia Stock Exchange Corner) and Indonesia Capital Market Directory (ICMD). This location was chosen because of several criteria.

The population of this study is the total number of listed companies on the index list of JII. This sample was taken with a purposive sampling method. There are 30 issuers in JII for each period. The selected issuers are listed on the JII list for four periods, totaling 222 elements so that there are 110 listed companies.The type of data was secondary data. This research used non-probability sampling by a purposive sampling technique. A purposive sampling technique is conducted on populations that have certain criteria[18]. This study examines the companies that have met the criteria, i.e. companies listed on JII from January 2012 to December 2016 and published their audited financial statements and annual reports periodically from 2012 to 2016. The exogenous variables are firm characteristics, corporate governance and capital structure, while the endogenous variables are financial performance and Islamicity Disclosure Index.

This research uses statistical analysis of inference. Statistical analysis is a technique used to use sample data, and the results are applied to a population.The Inferential statistical analysis used was the Partial Least Square (PLS) data analysis with WarpPLS software. The steps in PLS are: (1) designing a structural model, (2) designing a measurement model, (3) constructing a path diagram, (4) converting a path diagram to a system of equations, (5) estimating parameters, (6) goodness of fit, and (7) hypothesis testing.

3 Problem Solution

Evaluation on the goodness of fit model is presented in Table 1. Table 1 shows that the overall results for Model Fit and Quality Indices are good enough and fulfill all the criteria so the analysis can be continued.

Table 1. Model Fit and Quality Indices

No	*Model fit and quality indices*	Criteria	Result	Remark
1	*Average path coefficient* (APC)	$p < 0.05$	0.457 ($p<0.001$)	Very good
2	*Average R-squared* (ARS)	$p < 0.05$	0.504 ($p<0.001$)	Very good
3	*Average adjusted R-squared* (AARS)	$p < 0.05$	0.488 ($p<0.001$)	Very good
4	*Average block* VIF (AVIF)	*Acceptable if* <= 5, *ideally*	3.018	Ideal

No	*Model fit and quality indices*	Criteria	Result	Remark
		<= 3.3		
5	*Average full collinearity* VIF (AFVIF)	*Acceptable if* <= 5, *ideally* <= 3.3	4.112	Ideal
6	*Tenenhaus GoF* (GoF)	*Small* >= 0.1, *medium* >= 0.25, *large* >= 0.36	0.411	Ideal
7	*Sympson's paradox ratio* (SPR)	*Acceptable if* >= 0.7, *ideally* = 1	0.714	Ideal
8	*R-squared contribution ratio* (RSCR)	*Acceptable if* >= 0.9, *ideally* = 1	0.995	Ideal
9	*Statistical suppression ratio* (SSR)	*Acceptable if* >= 0.7	0.751	Ideal
10	*Nonlinear bivariate causality direction ratio* (NLBCDR)	*Acceptable if* >= 0.7	0.751	Ideal

Hypothesis testing on WarpPLS analysis used a t-test. The decision rule of hypothesis testing used a re-sampling method with a t-test. The decision of hypothesis testing is done as follows: it is weakly significant if the p-value ≤ 0.10 (alpha 10%), it is significant if the p-value ≤ 0.05 (alpha 5%) and it is highly significant if the p-value ≤ 0.01 (alpha 1%).

Table 2. Analysis Result

No	Relationship		Coefficient	*p-value*	Remark
1	*Firm Characteristics*	*Financial Performance*	0.733	<0.001 ***	*highly significant*
2	*Corporate Governance*	*Financial Performance*	-0.202	0.004 ***	*highly significant*
3	*Capital Structure*	*Financial Performance*	-0.048	0.256	Not significant
4	*Firm Characteristics*	*Islamicity Disclosure Index*	0.636	<0.001 ***	*highly significant*
5	*Corporate Governance*	*Islamicity Disclosure Index*	-1.210	<0.001 ***	*highly significant*
6	*Capital Structure*	*Islamicity Disclosure Index*	0.138	0.032 *	*significant*
7	*Financial Performance*	*Islamicity Disclosure Index*	0.236	<0.001 ***	*highly significant*

The table above shows that the significant variable is firm characteristics on financial performance with a coefficient value of 0.733, corporate governance on financial performance with a coefficient value of -0.202, firm characteristics on the Islamic disclosure index with a coefficient value of 0.636, corporate governance on Islamic disclosure index with a coefficient value of -1,210, capital structure islamicity on disclosure index with a coefficient value of 0.0138, and financial performance on Islamic disclosure index with a coefficient value of 0.236.

3.1. The Effect of Firm Characteristics on Financial Performance

Firm characteristics have a significant influence on financial performance. This finding is consistent with H1, which predicts that firm characteristics have a significant effect on financial performance. The significance of these findings indicates that empirically firm characteristics have always been or are a decisive factor in the financial performance of firms listed on the Jakarta Islamic Index in Indonesia. The findings also indicate that the financial performance of companies listed on the Jakarta Islamic Index is always determined by the firm size and age variables.

The direction of the firm characteristics path coefficient is positive and significant in accordance with Schmitz and Sints [85], Doan and Nguyen [38] as well as Minai *et al.* [73] showing that firm characteristics have significant effect on financial performance. This finding is also inconsistent with previous studies conducted by Gorynia *et al*.[49], Hendricks and Singhal [53], Henri and Journeault[54], Nor *et al.* (2008), Ahmadian and Ma'atoofi [7], and Alias [12] showing the non-significant effect of firm characteristics and financial performance.

Large corporations will find it easier to obtain funding because they have a guarantee of existing resources. The ease of obtaining funding sources will assist the company in developing its business through business diversification. The existence of this business diversification will make business risk to be diverse and facilitate the company to gain profit in large numbers.

The results are in accordance with the Signaling Theory by Ross [81], which indicates how companies signal to users of financial statements that the company has advantages over other companies in terms of total assets as the overall wealth of the company to support the company's operations. These signals are used to inform investors related to the current condition of the company and future developments. This signal is also useful for investors to consider whether to keep investing or not. Based on the Signaling Theory, when there is asymmetric information between the principals (owners/investors) and the agent (managers), the disclosure of signals from the company is crucial to be noted in order for the company to obtain or retain its economic resources.

The age of the company refers to the time span of companies to exist and operate, have the ability compete in the businesses, and able to survive in the competition. The measurement of a company's age is calculated based on the initial listing or IPO date until the date of annual report announcement. Companies that have a long age will have a tendency to increase profits as they have high experience in managing business. Companies that have long operated will be able to manage their business better so they will be able to generate higher profits compared to newly established companies.

Companies of a long age will tend to have a lot of experience, and with much experience, they can better understand the business undertaken. With this good understanding of the industry, the company will tend to act very carefully in the management of its business and more efficient in running the company.. This efficient management will help to improve financial performance and will result in high profits.

The results of this study is in accordance with the Signaling Theory [81] that firm characteristics influence financial performance. Companies of a long age will have the ability to compete in the industrial market. The age of the company will reflect how strong the company stands and is able to compete. The age represents the ability in finding business opportunities to continue to survive and operate in a relatively long time. Management will convey these conditions as a signal that the company has good credibility. Such these long age companies will be more aware of the needs of the users of financial statements through completeness in the disclosure of financial statements.

3.2. The Effect of Corporate Governance on Financial Performance

Corporate governance has a significant effect on financial performance. This finding is consistent with H2, which predicts that corporate governance has significant effect on financial performance. The significance of these findings indicates that empirically corporate governance has always been or a decisive factor in the financial performance of firms listed on the Jakarta Islamic Index in Indonesia. The findings also indicate that the financial performance of companies listed on the Jakarta Islamic Index is always determined by the independent board members, managerial ownership, institutional ownership, and public ownership.

The negative and significant direction of corporate governance coefficient does not support the study by Al-Tamimi [13] on the effect of corporate governance implementation on conventional banks and sharia banks in Saudi Arabia on performance and financial distress; the results of this study indicate that corporate governance has a significant and positive influence on the performance and financial distress of banks in Saudi Arabia. In Turkey, Ergin [42] studies firms incorporated in the Istanbul Stock Exchange (ISE) for the 2006 to 2010 period and has found that corporate governance consisting of stakeholders, public disclosure, and transparency have a significant effect on company performance and also on financial performance.

The results of this study are not in line with the Agency Theory of Jensen and Meckling [60], which states that the difference in interests between owners and managers of the company will lead to agency conflicts. Corporate governance is a guideline and control mechanism for managers to manage companies in the best practice. Managers will make financial decisions that can benefit all parties (owners, managers, and other stakeholders). Managers work effectively and efficiently to lower capital costs and minimize risks. The effort is expected to generate high profitability. Investors will earn returns as expected.

The significant influence of corporate governance on financial performance with the negative direction is also due to the low managerial ownership in the ownership structure in manufacturing companies in Indonesia as the sample of this study on an average of 0.01 or 1%, the dominance of institutional ownership on an average of 0.60 or 60%, and the rest is the common shareholder of 39.7%. The low managerial ownership and dominance of institutional ownership in the ownership structure of the companies listed on JII as the sample of this study indicates that good corporate governance demonstrated by managerial ownership is weak and institutional ownership does not serve as an effective monitoring agent as expected. It also indicates concentration of corporate ownership on the ownership structure of companies listed on JII as the samples by institutional ownership. The ownership concentration of the company in the ownership structure of the companies listed on JII, either by the corporate body or the holding company and the family, through institutional ownership will result in a clear separation of ownership and control of the sample companies. This finding also indicates that the management of these companies is still under control or is an extension of the majority shareholder that is a corporate entity or a holding company controlled by certain family members through institutional ownership; thus, the management of the company will prioritize the interests of the majority shareholders through the corporate legal entity or holding company and family through institutional ownership over the interests of all shareholders.

The Agency Theory clearly explains the relationship between agents and principals. In a company, the principal is the owner while the agent is the manager. To run its business, the owner gives authority to another party called agent to manage the company in the hope that the agent can provide the best in achieving the goal of the owners that is optimizing the benefits and value of the company. The owner will authorize the agent to make decisions on behalf of the owner. However, the separation of ownership by management will cause problems, known as the agency conflict. This problem can be minimized by a mechanism that reduces the manager’s chance of doing an action detrimental to the principal. The wrong policy is to establish an independent board of commissioners to monitor the mechanism made by the principal in overseeing agents. This supervisory activity can also be done by involving third parties, in this case the investors [62]. This is because the investors also have a tendency to protect their investments in the company by participating in continuous monitoring of company performance.

Agency problems between shareholders and managers may occur when management does not own a majority share of the company. Shareholders would want managers to work with the goal of maximizing shareholder wealth. In contrast, corporate managers may act not to maximize shareholder wealth, but have an interest in individual prosperity, safety, lifestyle, and other benefits such as luxury offices, professional membership, telephone facilities, cars and holiday tickets, all of which charged at the expense of the company.

3.3. The Effect of Capital Structure towards Financial Performance

The capital structure has a non-significant effect on financial performance. This finding is inconsistent with H3, which predicts that the capital structure has a significant effect on financial performance. These findings indicate that empirically, the capital structure is not always or not a determinant factor for financial performance at companies listed on the Jakarta Islamic Index. The findings also indicate that the financial performance of companies listed on the Jakarta Islamic Index is not always determined by the capital structure variable but by other variables.

The negative direction of the path coefficient indicates that empirically the increasing proportion of debt usage in the capital structure will lower dividend. The results of this study also illustrate that the greater the proportion of debt used in capital structure, the greater the fixed obligation of debt repayments and interest borne by the company, so the amount of profit available to shareholders will be reduced.

The findings are not in line with the opinion of Jensen and Meckling [60], which links the agency cost with the debt in the capital structure. The Agency Theory mentions that in determining the capital structure, we should consider the costs arising from interest of the debt, and the existence of different interests between owners and management. Based on the Agency Theory, the capital structure will positively affect the possibility of companies to experience bankruptcy, the value of liquidation, and reputation of managers. The capital structure has a bigger effect on the debtors, so the cost of debt becomes bigger too.

The findings of this study are not in line with the results of previous studies by Gleason *et al.* [48],Chathoth and Olsen[32], Berger and Patti [24], Margaritis and Psillaki[71], Chinaemerem and Anthony [33], Awunyo-vitor and Badu [21], Widegren and Jörgensen [97], Skopljak and Luo[86], Boodhoo [27], Su andVo[89], Saeedi and

Mahmoodi[83], David and Olorunfemi[37], Kochhar [64], Pratheepkanth[80], and Ebaid [40] that the capital structure significantly affects financial performance.

This study is in accordance with the opinion of Brigham and Gapenski [28], which says that the greater the cost of debt and the greater the fixed interest charge, the greater the probability for a decrease in earnings—and this will lead to financial difficulties and the higher probability for the cost of financial difficulty will be imposed. Therefore, debt can also cause financial hardship and lower financial performance.

The differences in the results of this study with the Agency Theory of Jensen and Meckling [60] and previous research results that support the Agency Theory may be due to the followings. First, the Agency Theory is developed on developed countries with advanced capital market conditions, whose historical background and cultures are different with real conditions in the Indonesian capital market, which is still classified as an emerging market. Secondly, the general condition of the capital market in Indonesia as a mediation funding company is relatively small compared to the capital market in the developed countries. Third, the dominance of institutional ownership and the low managerial ownership in the ownership structure of the company indicates no clear separation between ownership and control over the company; and this condition will result in most of the sample companies being controlled by the majority shareholders, being under control or being an extension of the majority shareholders controlled by the founding family or certain family.

The higher the debt ratio indicates the greater the loan capital used to generate profits for the company. If the economy is good and interest rate is low, high debt ratio can yield high level of profit for company, and the vice versa--if the economy is difficult and interest rate is high, high debt ratio can cause financial problem.

Basit and Irwan [22] state that Debt to Equity Ratio has no effect to financial performance measured using ROE. This indicates that the change in DER has no impact on revenue. A large Debt to Equity Ratio (DER) indicates that the capital structure derived from debt used to finance the equity is also large. Creditors will have a perception that high DER will not be profitable because it will impose higher risk to be borne due to the failure that may occur at the company. For the security of outsiders, the best ratio is when the amount of capital is greater than the amount of debt or at least the same. However, this is rather different from the shareholders or management who generally has different perceptions that DER should be large.

DER shows the efficiency of the company in utilizing owner's equity in order to anticipate short-term and long-term debt. According to Syamsuddin (2004), DER is a ratio that can indicate the relationship between the amount of long-term loan provided by the creditor with the amount of capital given by the owner of the company. DER is used as a measure of how far a company is financed by a creditor. The higher the DER value, the greater the money taken from outside will be. However, in reality, a company that has a small DER value is not necessarily better than a company that has a large DER, because sometimes debt is needed. A non-indebted company may lose the opportunity to grow because to grow, working capital is required that is unlikely to be financed by profits earned by the company. Therefore, DER depends on the situation the business is facing—as long as the company produces a decent profit, the high DER value will not be a problem, because most of the company's earnings can be used to pay the debt. The most important is to see changes in the value of DER from year to year, in which the value must be better, because it can be used as a reference that the company has good prospects. Based on the above description, it can be concluded that DER can have a positive or negative impact on stock prices. The positive influence is in the sense that the higher DER value means the higher the stock price of the company. The negative influence means that the higher DER value represents lower stock price of the company.

Collateralizable assets (CA) have no effect on the financial performance since demand for CA guarantee by the creditor is in the form of assets to shareholders when requiring funding [67]. Low CA owned by the company will increase the conflict of interest between shareholders and creditors, and creditors will prevent companies from paying large dividends to shareholders for fear of their receivables being unpaid. The declining CA indicates that the dividend distribution will decrease or even no dividend will be distributed. As a result, there is no influence of CA against dividend payout ratio (DPR).

3.4. The Effect of Firm Characteristics towards Islamicity Disclosure Index

Firm characteristics have a significant influence on Islamicity Disclosure Index. This finding is consistent with H4, which predicts that firm characteristics have significant effect on Islamicity Disclosure Index. These findings indicate that empirically firm characteristics have always been the determining factor of the Islamicity Disclosure Index of companies listed on the Jakarta Islamic Index or that Islamicity Disclosure Index of companies listed on the Jakarta Islamic Index is always determined by firm characteristics, which consists of firm size and age.

The results of this study support the research conducted by Galani *et al.* [45] on 43 companies listed on the 2009 Athens Stock Exchange in Greece, stating that firm characteristics consisting of firm size, profitability, age, and type of industry profile have a significant effect on mandatory corporate disclosure consisting of 100 items of disclosure under the International Standards Committee.

The results of this study are in accordance with the Stakeholder Theory (Gray *et al*.,[50]), which explains that every stakeholder has the right to obtain information on all company activities. The Stakeholder Theory emphasizes the accountability of every organization far beyond financial performance. It also explains that the organization may conduct a voluntary policy to disclose a series of information on corporate governance, its environmental and social performance, and its business processes exceeding its obligations to meet expectations of stakeholder. Voluntary disclosure of information is one way to attract investors and satisfy stakeholder wishes.

Based on the Stakeholder Theory, corporate managers are expected to conduct activities in accordance with what is expected by stakeholders and report on activities and policies to stakeholders. This theory sees a firm view not only as a mechanism for obtaining financial gain, but rather as a vehicle in coordinating the interests of stakeholders requiring good relationship between management and all stakeholders. The theory assumes that corporate accountability is related not only to improvement in economic or financial performance, but also to performance in voluntary disclosure of information about business processes, corporate governance, as well as intellectual, social, and environmental performance.

An information disclosure report will be useful to users especially prospective investors if the information is presented completely so it is easy to understand, as well as being relevant, reliable, and comparable. However, it should be realized that in general corporate disclosure reports usually do not provide any information that may be required by users in economic decision-making; the reports will illustrate past events and prediction of the future.

This result is in accordance with research conducted by Akhtaruddin [9], Hou and Reber [56], Watson *et al.* [96], Xiaowen (2012), Zadeh and Eskandari [99], Alias[12], Bazine and Vural [22], Michael [72], Galani *et al.*[46], Ousama and Fatima [77], Hassan[52], Uyar[93], Hossain and Hammami[55], and Karim and Ahmed [61] showing that firm characteristics affect Islamicity Disclosure Index.

3.5. The Effect of Corporate Governance towards Islamicity Disclosure Index

Corporate governance has a significant negative effect on Islamicity Disclosure Index. This finding is consistent with H5, which predicts that corporate governance has significant effect on Islamicity Disclosure Index. These findings indicate that empirically corporate governance is always the determining factor of the Islamicity Disclosure Index on companies listed on Jakarta Islamic Index. On other words, the Islamicity Disclosure Index of companies listed on the Jakarta Islamic Index is always determined by the corporate governance consisting of independent board members, managerial ownership, institutional ownership, and public ownership.

The findings are in line with Gao and King [47] conducting a study on Chinese companies listed on the Shenzhen Stock Exchange (SZSE) from 2001 to 2007; they have found that corporate governance consisting of external audits, internal governance, and external governance have a significant effect on the fulfillment of mandatory corporate disclosure.

Studies by Liao[68], Cong and Freedman[34], Li *et al.* (2012), Yonekura *et al.* (2012), Sun *et al.*[91], Bhasin, Makarov and Orazalin [25], Ştefãnescu [88], Htay [57], Htay[58], Htay *et al.* [59], Perraudin *et al.*[78], Hermalin and Weishbach (2012), Peters and Romi[79], Samaha [84], Akhtaruddin *et al.*[10], Rouf [82], and Alves [16] also confirm that menemukan bahwa *Corporate Governance* significantly affect disclosure.

The negative direction of corporate governance coefficient according to the research result from Htay [57] shows evidence that corporate governance is negatively related to Islamic Disclosure Index. The result of this study contradicts the Agency Theory of Jensen and Meckling [60] emphasizing the importance of the company owners (shareholders) to leave the management of the company to the experts or agents. Managers understand more about internal information and prospects than owners (shareholders) do. It is ultimately necessary to have a good oversight system through corporate governance to provide assurance that the management of the company is efficient. Corporate governance arises in relation to Principal Agency Theory to avoid conflict between principals and agents. Conflicts arising from differences of interests must be well managed. Corporate governance mechanisms well implemented in the company will be able to increase the effectiveness of the company to provide complete information on the business activities undertaken by the company.

Further, Htay *et al.* [59] confirm that the spread of institutional ownership will affect the disclosure of company information. The results of this study are not in accordance with the Agency Theory of Jensen and Meckling [60] stating that the agency relationship is a contract where one or more people (agents) will perform a service on behalf of the principal and that the agent is authorized to make the best decision. If both parties have the same goal to maximize the utility, then the agent is believed to act in a way in line with the principal's interests.

Agents are required to provide periodic information to the principals about the business process it is working on. The principal will provide assessment on the performance of the agent through the disclosure or reports submitted. Therefore, corporate information disclosure is a mean of management accountability to its owners. The agency theory assumes that the individual will act to maximize their own interests, then information imbalance will encourage the agents to do things they wants and hide the unknown information from the principal.

The differences in the results of this study with the Agency Theory by Jensen and Meckling [60] and previous research results that support the Agency Theory may be caused by the followings. First, low managerial ownership and dominant institutional ownership in the ownership structure of companies listed on JII indicate no clear separation between ownership and control of the company and this condition will result in the majority of companies still being controlled by the majority shareholders through the corporate entity or the holding company or by the founding family. Second, empirical conditions of market in Indonesian are emerging markets whose historical background and culture is different from empirical conditions in capital markets in developed countries where the Agency Theory is built.

The dominant institutional ownership in the ownership structure of JII-classified enterprises in Indonesia has a negative effect on corporate information disclosure. This indicates that the role of managerial ownership remains weak and institutional ownership does not serve as an effective monitoring agent as expected. The findings also indicate that ownership division or the number of regular holders in manufacturing companies in Indonesia is still weak related to company's optimal monitoring. The results of this study also indicate that in the emerging capital market, ownership structure has a negative institutional effect toward the disclosure of company information. The dominance of institutional ownership in the ownership structure of the company sampled by this study indicates a concentration of company ownership, i.e. institutional ownership.

The greater the ratio of shares owned by the public, the greater the likelihood that the company will disclose the information in the annual report. The greater the share of shares owned by the public, the more the parties will need information about the company, meaning the wider the disclosure of corporate information required in the annual report. The more shares owned by the public, the more people would control the development of the company. That way, the company will have a broader tendency to disclose information. However, considering the Islamicity Disclosure Index included in the type of voluntary disclosure, issuers listed on the Jakarta Islamic Index (JII) are not required to meet the Islamicity Disclosure Index.

3.6. The Effect of Capital Structure towards Islamicity Disclosure Index

The capital structure has a significant influence on Islamicity Disclosure Index. This finding is consistent with H6, which predicts that capital structure has significant effect on Islamicity Disclosure Index. These findings indicate that empirically the capital structure is a decisive factor in the Islamicity Disclosure Index of companies listed on JII. These findings also indicate that the decision of capital structure in companies listed on JII is always determined by the capital structure.

Furthermore, Ning Chen (2009) has found that the capital structure in terms of the size of corporate debt has a significant and positive impact on the disclosure of corporate information on 1039 companies listed on the New York Stock Exchange (NYSE) for the period 1995-1999 and 2001-2005. The results of other empirical studies such as those of Cahaya *et al.*[31], Cornell and Shapiro[35], Arvidsson [20], Williams [98], Aerts *et al.* [5] also confirm that the capital structure has a significant effect on corporate disclosure.

Capital structure is a comparison between long-term debt towards own capital. Company's funding may come from own capital, share capital, retained earnings, and reserves. If the company uses its own capital and there is deficit, then management needs to consider funding from outside the company (debt financing). In the selection of capital structure management, the management of the company must first determine the favorable way of choosing funding to ensure the company's viability. The selection of forms and types of funds should take into account of the intended use of the funds—if they are used to meet short-term needs, they should be funded with short-term funding sources and long-term funding sources must be used for long-term investment.

The Signaling Theory by Ross [81] states the management company tends to have better information and have a tendency to provide company information to potential investors. Information in the form of "good news" owned by the company is be related to future business prospects where it is expected to increase the value of the company. More information disclosed will make it more informative and useful to the public, yet the more information disclosed means more cost to be borne. Investors and potential investors will need the information in the composition of capital structure. This is more due to the security of capital owned by investors in the presence of high debt levels in the capital structure.

The path coefficient direction of capital structure is positive; this means that the capital structure has positive and significant influence to Islamicity Disclosure Index. These findings indicate that increased use of debt in the capital structure will increase the Islamicity Disclosure Index for companies listed on the JII. This is because the use of debt in the capital structure of companies provides benefits of tax savings from interest payments.

Baimukhamedova (2015) has found a positive relationship between leverage as measured by the ratio of total liabilities to total assets and the level of information disclosure. This indicates that firms with larger amounts of debt tend to have high levels of corporate disclosure and transparency.
Furthermore, Semper and Beltran (2014) show that leverage as measured by Debt to Equity Ratio has a significant influence on the risk disclosure and risk factor index. Market conditions require companies to disclose more information about risks so greater disclosure of information leads to higher equity costs.

Companies with a greater proportion of debt in their capital structure will bear a large agency fee as well. The greater the company's debt means the greater the likelihood of a welfare transfer of creditors to shareholders and managers (Meek and Gray, 1995). Thus, a company with a high debt composition will have more obligations to share the debt composition information with its long-term creditors [94]. Companies that have high DER will provide more information due to creditor demands, as the creditor is one of the stakeholders who have an interest in the company's report in order to ensure that the company has enough cash when obligation matures in the future.

Collateralizable assets are assets that can be pledged to creditors to guarantee corporate loans. Titman and Wessels (1988) argue that firms with more collateral assets have a smaller agency problem between creditors and shareholders because such assets can serve as collateral for debt. Given that collateralizable assets function to minimize the agency problem, it is expected that the amount of collateralizable assets owned by the company will be positively related to dividends.

Assurance assets are company assets that can be used as collateral to creditors. Creditors often pay attention to the amount of collateral in the form of assets when it will lend to the company. If the company has a large asset, it is good news signaling that the company has the ability to guarantee debt.

3.7. The Effect of Financial Performance toward Islamicity Disclosure Index

Financial performance has a significant influence on Islamicity Disclosure Index. This finding is consistent with H7, which predicts that financial performance significantly influence Islamicity Disclosure Index. The findings indicate that empirically financial performance is always the determining factor of the Islamicity Disclosure Index of companies listed on the Jakarta Islamic Index. The findings also indicate that the Islamicity Disclosure Index of companies listed on the Jakarta Islamic Index is always determined by the financial performance consisting of profitability ratio, productivity ratio, growth ratio, and liquidity ratio. Financial performance describes the company's operational efficiency in using owned assets to generate profit. The financial performance of the company acts as one of the factors considered by potential investors to determine the investment in the company.

The results of this study support the research An *et al.* [17] on 49 listed companies on a dual-listed basis in Shanghai and Shenzhen Stock Exchange and Hong Kong Stock Exchange (also called dual-listed A and H share companies). The results of the study confirm that the financial performance has a significant and positive effect on the company to do public disclosure.

Based on the Signaling Theory, the more financially strong a company, the wider disclosure of information it will provide as a signal of management's success in managing the company's finances. The theory suggests that firms with high financial performance use financial information to send signals to the market [87]. The theory explains how success or failure signals should be communicated to the principal. This indicates that the company's financial performance will affect the company's disclosure.

The results of this study are also in accordance with the results of research from Kusumawati [66] confirming that the financial performance (profitability), firm size, company listing status, auditor type, and ownership structure significantly influence the voluntary disclosure by the company. Ibrahim *et al.* (2011) explain that the company's financial performance (profit) and leverage have a significant effect on the increasing of good corporate governance (GCG) disclosure to the public. Environmental performance and financial performance significantly influence the environmental disclosure of 198 companies listed on 1994 IRRC Environmental Profiles Directory [15].

From the investor's point of view, the optimal current ratio will provide protection against the possibility in case of liquidation of the company. The greater current assets of current liabilities will help to protect creditor's claims of liability. However, the too high current ratio indicates poor management of current assets; this is due to the idle cash balance, the excessive inventory compared to the needs, as well as the policy of credit sales that are less precise which makes excessive accounts receivable.

Liquidity ratio describes the company's ability to pay the obligations that must be paid immediately with cash or current assets (Harjanto, 2001). The means of payment owned by the company at a certain time is a strength owned by the company. The company will be said to be in a liquid condition if the company is able to pay all the financial obligations that will mature immediately. The higher the company's liquidity level, the smaller the risk investors should bear. The ability to pay all obligations is a signal that the company is in a state of liquidity. Financially strong will firms be more likely to reveal more complete information than weaker companies will. A more complete disclosure to the public does not mean that the company feels threatened, yet it shows the success of the company's operations. The success of the company is a positive signal for external parties as potential investors or other stakeholders having interests in the company [94].

4 Conclusion

The followings are the implications of the present study:

1. The results of this study indicate that firm characteristics have a significant influence towards the financial performance and Islamicity Disclosure Index. These results indicate that firm characteristics can be used to predict the financial performance and Islamicity Disclosure Index of companies listed on JII and Indonesia Stock Exchange. This happens because the company's age shows the span of the company to exist and operate, to be able compete in the businesses, and to able to survive in the competition. Companies that have been long in the business tend to have more experience, and that experience will help the company to better understand the business undertaken.
2. The results of this study indicate that corporate governance by the independent board members, managerial ownership, institutional ownership, and public ownership have a significant influence with negative direction on financial performance and Islamicity Disclosure Index. Corporate governance mechanism is merely a formality because the company wants to meet the requirements of the Financial Services Authority through its regulation Number 33/ POJK.04/2014 stating that each company listed on the Indonesia Stock Exchange is required to have at least 30% of independent directors not to uphold GCG principles.
3. The results of this study indicate that capital structure cannot be used as a reference or prediction tool in determining the performance of firms, but it can be used to predict Islamicity Disclosure Index. These findings prove empirically that the decision to use debt in the capital structure does not affect the financial performance of companies listed on JII in Indonesia. This is because the greater the proportion of debt used in the capital structure, the greater the fixed obligations of repayments of debt and interest borne by the company that the amount of profit available to shareholders will decrease. The practical implication of this finding is that although capital structure decisions have no effect on financial performance, it can be used to predict the Islamicity Disclosure Index. The reason is that the use of debt in the capital structure

of companies in companies listed on JII Indonesia provides benefits of tax savings from interest payments. The tax savings from interest payments are good news as well as a signal that the company has a great benefit compared to the cost incurred. The information is a signal to the public that the company has a prospect in the future.

4. The results of this study indicate that financial performance significantly and positively affects the Islamicity Disclosure Index and these results indicate that financial performance is a factor that determines the Islamicity Disclosure Index. This finding can also be interpreted that an increase in financial performance will lead to an increase in the completeness of the disclosure of corporate information. These findings indicate that good financial performance means that the company is in a solvable, liquid, and profitable state. The condition is good news as a signal for potential investors and the public.

This study has a limitation as it is only conducted on companies listed on Jakarta Islamic Index listed on the Indonesia Stock Exchange, so the result cannot be generalized to all public companies in Indonesia. Therefore, to obtain better results and generalization, further research should cover not only the manufacturing sector, but also other sectors by considering the positive financial performance.

Our recommendations for the development of this study in the future are related to the content of the study, as follows: (1) increasing the financial performance indicators at each ratio; (2) adding qualitative external factors such as socio-political conditions, security, culture, legal certainty, capital market regulation, and technology and government policies related to financial performance; and (3) confirming the results of this study in the future.

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