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Comparison of Disclosure Level among Islamic Banks and Its Effect on Performance

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Comparison of Disclosure Level among Islamic Banks and Its Effect on Performance

Nadia Hanif[1]
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Abstract

Revealing accurate and complete information of the business is the prime focus of Islamic finance as it proposes to avoidance any sort of Gharar (uncertainty). Lack of disclosure could lead to exploitation of the information by few members in the market at the expense of others. The difference between Islamic Bank and Conventional Bank is that Islamic bank takes disclosure of governance status as a religious obligation as compared to disclosure of conventional banks based upon legal obligation of the country. Similarly, Islamic banks put efforts in disclosing information of Shari'ah governance and social responsibility as per religious obligation as compared to voluntary disclosure by conventional banks. This study is built on the idea that if Islamic Bank considers Shari'ah disclosure and social responsibility as voluntary disclosure then it is expected that there will be a significant difference between all present Islamic banks. Lastly, this study has generated an overall disclosure index using principal factor analysis and evaluated its impact on the performance of the banks to reveal that disclosure entails positive impact on performance.

Keywords: shari'ah advisory board, corporate governance, social responsibility

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1. Introduction

Capital markets are seriously affected by how and what information is being shared by the firms to the participants (Ho and Wong, 2003). Investors always demand correct and in-time information to reach efficient investment decisions. This information could be gathered using several ways. One of the most important, trustable and easy method is the corporation's annual financial reporting. The foremost and important purpose of the annual reports of a firm is to provide useful, correct and timely information to the shareholders, stakeholders and investors. Hence, helping them to access the financial performance and position of a firm along with its future forecasts is essential in order to make final decisions regarding the investment. The two types of information; mandatory and voluntarily are supplied by the firms in their annual reports. Compulsory/mandatory disclosure is important for companies and investors both. Mandatory disclosure is a fundamental market claim for information demanded by various regulatory bodies and laws and has been linked at regional or national level by government authorities or professional organizations. Firms disclose this information through management discussions, financial footnotes, financial statements and other regulatory filings. On the other side, voluntary disclosure, intemperance of compulsions, shows free choice on behalf of managers to supply information to the users of annual reports(Yuen, Liu, Zhang, and Lyu, 2009). In voluntary communication, some firms present conferences, management forecasts, analysts' presentations, internet sites, press releases and other corporate reports. In addition to the regulatory and voluntary disclosure, there could be disclosures regarding firm activities by information intermediaries including industry experts, financial analyst and financial press etc.

Currently, banking industry of Pakistan is facing competition between Islamic banks and conventional banks. The conventional banking proponents argue that Islamic banks are superficial. Whereas Islamic banking proponents provide a wide array of structural and faith related reasons to justify the difference. Islamic banks form a relationship with its clients both from deposit and financing. This practice is far more respectful as compared to creditor and debtor relation formed by conventional banks. The fundamental functions of the Islamic banks promote real asset creation as compared to mere cash rotation by conventional banks. Islamic banks are acting as a facilitator of sale and purchase of real products. It also ensures the usage of funds in the real production process as compared to unconditional loan provision by conventional banks. However, the Islamic banks in Pakistan, have formed the apparent look similar to conventional banks due to federal and central banking regulations for banks and secondly for reducing the cost they access the same market.

Disclosure of governance structure is another major difference between conventional banks and Islamic banks. Conventional banks only disclose their governance structure because of country regulations while they are only voluntarily bound to disclose their social responsibility. The conventional banks are not concerned that their unconditional funds forwarded to clients may lead to exploitation and social injustice. In comparison to this, Islamic banks disclose their information regarding governance, Shari'ah and social responsibility not because of country regulations; it is because of the divine rules provided by Allah in Islam.

Islamic banks are offering a wide range of financial services in which a few are apparently similar to the conventional banks and some other are distinct. Since these products are supporting social welfare, this sector is growing significantly all over the Islamic world. Islamic banks are different from the conventional banks in many aspects. For example, the goal of an Islamic bank is to create a partnership with the depositors and the investors and use the available funds and capital to perform a ritual of finding acceptance of God(Janahi, 1995). Whereas, the conventional banks are profit-making organizations not affiliated to a religious body / religious jurisdiction.

This study is important because it is associated with Islamic banks as it makes itself accountable for fulfilling their social and ethical role in the society. It is mandatory for the Islamic banks to disclose their information related to Shari'ah Advisory Board, social responsibilities and corporate governance. Since Islamic banks are under religious obligation for disclosure, hence a critical analysis is required to probe how much these Islamic banks are similar to each other in terms of their efforts to disclose. This study will also explore whether or not the overall disclosure efforts are translated into the performance of banks

Numerous studies have been conducted on mandatory and voluntary disclosure through annual reports of companies. However, most of the studies have been conducted on the non-financial and financial (conventional banking) sectors operating in developed countries. This study aims at probing the following aspects of Islamic banks in Pakistan;

1. Whether they are significantly disclosing information regarding Shari'ah Advisory Board, social responsibility and corporate governance.
2. Whether they differ in terms of their disclosure of Shari'ah Advisory Board, social responsibility and corporate governance.
3. What is the ranking of banks in terms of the disclosure and the effect of the disclosure index on return on equity (ROE) and earnings per share?

2. Literature Review

One of the prominent differences between Islamic financial institutes (IFI) and non-Islamic institutes is that IFIs make Shari'ah Advisory Board (SAB) mandatory. SAB focuses on the financial transactions in terms of their compliance with the

Shari'ah rulings. This practice enables IFI to become a better partner with the depositors and firms/companies(Hassan and Dicle, 2007). The reliance of the investors on the Islamic financial institutions will have an immediate impact on stability and the capability to act as a financial intermediate and positively affect the performance of Islamic financial institution (Pellegrini and Grais, 2006). The role of Shari'ah Advisory Board in the business is to check and verify that each and every transaction is in compliance with Shari'ah. According to Haqqi(2014), every financial institute needs an Advisory Board, like Ikhlas Finance House (IFH) of Turkey, which can help in avoiding a collapse of a reputable Institute.

The Shari'ah Advisory Board becomes part of every board meeting and it is independent of any internal or external influence. This board guides the IFI in preparing policies, regulations and financial transactions in accordance with the Shari'ah rules. This board has expertise of Islamic legal and Fiqhi resources. As compared to the board of governors, the members of Shari'ah advisory board have all members having almost same qualification which helps to transfer knowledge in a faster and clearer way to the policy makers. The objectives of the board include religious compliance of the business, providing counseling to stakeholders, regulators and central bank(AAOIFI, 2004; Daoud, 1996). In light of Shari'ah Advisory Board's role and importance, the present research aims to probe whether all the Islamic banks are same in terms of their disclosure status and does this status has some association with the profit of the bank.

The following verses indicate the appointing of a Scribe Committee which will look over all the financial transactions and this committee must be independent of the influence of the management:

> "O you who have believed, when you contract a debt for a specified term, write it down. And let a scribe write [it] between you in justice. Let no scribe refuse to write as Allah has taught him. So let him write and let the one who has the obligation dictate. And let him fear Allah, his Lord, and not leave anything out of it. But if the one who has the obligation is of limited understanding or weak or unable to dictate himself, then let his guardian dictate in justice. And bring to witness two witnesses from among your men. And if there are not two men [available], then a man and two women from those whom you accept as witnesses – so that if one of the women errs, then the other can remind her. And let not the witnesses refuse when they are called upon. And do not be [too] weary to write it, whether it is a small or large, for its [specified] term. That is more just in the sight of Allah and stronger as evidence and more likely to prevent doubt between you, except when it is an immediate transaction which you conduct among yourselves. For [then] there is no blame upon you if you do not write it. And take

witnesses when you conclude a contract. Let no scribe be harmed or any witness. For if you do so, indeed, it is [grave] disobedience in you. And fear Allah. And Allah teaches you. And Allah knows of all things." (Al-Quran 2:282).

"So by the mercy of Allah, [O Muhammad SWT], you were lenient with them. And if you had been rude [in speech] and harsh in heart, they would have dispersed from around you. So pardon them and ask forgiveness for them and consult them in the matter. And when you have decided, then rely upon Allah. Indeed, Allah loves those who rely [upon Him]." (Al-Quran3:159).

Recent researches showed mixed relationships such as a negative relationship (Wright and Ferris, 1997), positive relationship (Waddock and Graves, 1997), and no relationship(McWilliams and Siegel, 2001) of corporate social responsibility. From the past few years, academic researchers and businesses are similarly showing an improved level of interest for CSR(Mackey, Mackey, and Barney, 2007).

Some scholars such as Swanson (1999), Whetten, Rands, and Godfrey (2002) and businesses have claimed that organizations have a responsibility toward a society that works well beyond just maximizing the shareholders. Whereas some other scholars claimed that such a narrow vision could direct management to overlook other important stakeholders including customers, suppliers, employees and society at whole. However, sometimes it happens that the interest of stakeholders succeeds the interest of the organization's equity holders in decision making phase of management, even if this trimmed down the present cash flow value of firm(Clarkson, 1995; Donaldson and Preston, 1995; Freeman, 2010; Mitchell, Agle, and Wood, 1997; Paine, 2003; Wood and Jones, 1995).

This conflict could be resolved by observing that at times socially responsible behavior might augment the present value of the company's future cash flows and that might be consistent with the wealth-maximizing concentrations of the company's shareholders(Mackey et al., 2007).

The aspect of social responsibility is a mandatory characteristic of all Shari'ah compliant businesses and IFIs. Usmani (2002), asserted that it is the social role of the Islamic bank to support social justice and practice accountability to ensure that the business transactions are connected with morality, so it is clear that banks must disclose their social responsibilities. This leads to the answer of the second research question; whether different Islamic banks differ in terms of their social responsibility disclosure. Below illustrated verses of Holy Quran place emphasis on the need of business to proceed to spend on social welfare moderately and pay Zakah.

"And whatever you give for interest to increase within the wealth of people will not increase with Allah. But what you give in Zakah, desiring the countenance of Allah – those are the multipliers." (Al-Quran30:39).

"And if someone is in hardship, then [let there be] postponement until [a time of] ease. But if you give [for your right as] charity, then it is better for you, if you only knew. "(Al-Quran 2:280).

"And do not make your hand [as] chained to your neck or extend it completely and [thereby] become blamed and insolvent." (Al-Quran 17:29).

"Here you are – those invited to spend in the cause of Allah – but among you are those who withhold [out of greed]. And whoever withholds only withholds [benefit] from himself; and Allah is Free of need, while you are the needy. And if you turn away, he will replace you with another people; then they will not be the likes of you." (Al-Quran 47:38).

"Righteousness is not that you turn your faces toward the east or the west, but [true] righteousness is [in] one who believes in Allah, the Last Day, the angels, the Book, and the prophets and gives wealth, in spite of love for it, to relatives, orphans, the needy, the traveler, those who ask [for help], and for freeing slaves; [and who] establishes prayer and gives Zakah; [those who] fulfill their promise when they promise; and [those who] are patient in poverty and hardship and during battle. Those are ones who have been true, and it is those who are the righteous." (Al-Quran 2:177).

According to Flack (2007), annual reports have facilitated the organizations to improve their accountability among stakeholders, shareholders and other interested people because annual reports were recognized as the behaviors of a corporation towards its annual reporting activity. Disclosure in annual reports is a tactical instrument, which has the capacity to raise the organization's capital at the lowest achievable cost (Healy and Palepu, 1993; Lev, 1992). Information disclosure in annual reports is applied as a source of communication with all the stakeholders, shareholders, investors and concerned parties both qualitatively and quantitatively(Al-Shammari, 2008).

Annual reports issued by companies provided insufficient information to its users (Baker and Haslem, 1973;Chang, Most, and Brain, 1983;Wallace,1988;Yusoff and Mohd Hanefah, 1995; and Yuen et al., 2009). Many annual reports showed very little and less information in actuality as we can say that these reports remained confined to the mandatory disclosure and did not move towards the voluntary disclosure (Haw, Qi, and Wu, 2000;Hooks, Coy, and Davey,2002). A lot of information ranked very crucially by stakeholders and investors to reach their investment decisions is missed in actual reported annual reports by the companies. This could be covered and extended voluntarily in their voluntary disclosure section to improve the quality of information sharing in order to meet the required items ranked important (Haw et al., 2000; Hooks et al., 2002).

Akhtaruddin (2005) examined the effect of company specific characteristics comprising profitability, industry size, company age and company status on the level of mandatory disclosure holding a sample of 94 listed companies in Bangladesh. The study reached the conclusion that listed firms showed only 49% of the items of information which ensured that the existing regulators are inefficient monitors for compulsory disclosure. The results showed that industry size measured by sales has a significant effect on mandatory disclosure. The study concluded that company status, profitability, and age are insignificant and do not affect mandatory voluntary disclosure.

Alsaeed (2006) found the level of voluntary disclosure of the companies having characteristics including ownership dispersion, firm size, profit margin, return on equity, audit firm size, industry type and company age. He analyzed a sample of Saudi Stock Exchange using one year data while covering non-financial listed companies. The study found that the company size has a significant impact on the level of disclosure and rest of the variables had no effect.

However, unlike conventional businesses, financial institutes and banks, which are only voluntarily putting efforts for the social responsibility with no benchmark; the Islamic banks of Pakistan are provided clear guidelines from Shari'ah regarding how the social welfare spending should be conducted.

The third aspect of the IFI is the structure and transparency of the corporate governance. According to Cadbury (1993), the objective of the corporate governance is to create a balance between the financial and social responsibility of the business. Higher transparency of the business structure will make the clients more confident. Furthermore, the transparency of information will not allow anyone to illegally exploit the market at the expense of other clients. Moore, Archibald and Greenidge (2003) explained the four principles of corporate governance which were developed by Organization for Economic Co-operation and Development (OECD) in 1999.

Corporate governance is an arrangement of control mechanisms that are particularly designed to ratify and monitor management decisions in order to guarantee the effective operation of a corporation on behalf of its stakeholders(Donnelly and Mulcahy, 2008).

Corporate governance directly influences the economic development of a country. However, it is essential to design corporate governance mechanism for efficient decision making. Corporate governance covers a number of diverse economic relations and corporate ownership structure impact on its performance is one of these. Current studies on governance proposed that cultural, social and economic factors of a country have an impact on corporate ownership structure which in result influence the firm performance (Zeitun and Gang Tian, 2007).

Usually, firms show their annual reports to transfer information over and above what is mandatory. The academicians study such (voluntary) disclosures with relation to characteristics of corporate governance(Ajinkya, Bhojraj, and Sengupta, 2005; Arcay and Vazquez, 2005; Barako, Hancock, and Izan, 2006; Chau and Gray, 2002; Cheng and Courtenay, 2006; Eng and Mak, 2003; Haniffa and Cooke, 2002; Ho and Wong, 2001; Lim, Matolcsy, and Chow, 2007; Makhija and Patton, 2004). On the whole, the results of these studies were mixed that the relationship between voluntary disclosure and corporate governance are conflicting.

Corporate governance influences the operations of the corporation and consequently improves the operating activities. It procures higher expected returns and more effective operations compared to those which did not maintain governance mechanisms(Black, Jang, and Kim, 2006). Jensen and Meckling (1976), also concluded that high-quality governance creates investor confidence and goodwill about the company. It is also inferred that the probability of bankruptcy is associated with poor characteristics of corporate governance (Dalton, Daily, Certo, and Roengpitya, 2003).

In many countries, religious faiths are regarded as a personal matter (Rice, 1999) and are alienated from daily life business practices. However, there is the propagation of handsome empirical literature which tried to link different perspectives of businesses with faith and beliefs (Angelidis and Ibrahim, 2004; Cavanagh and Bandsuch, 2002; Giacalone and Jurkiewicz, 2003). Recently the dominant Islamic financial service industry (The application of Shari'ah principals to financial practices) is a clear example of this faith-business practices connection. Some researchers have connected the business practices with Christianity (Jones, 1995; Lee, McCann, and Ching, 2003) and Judaism (Pava, 1997, 1998), even though there is no real use of the main beliefs of these two faiths to contemporary business dealings except a small number of faith-based funds, for example Roman Catholics' Ave Maria Rising Dividend etc. Nevertheless, we have noticed a small but increasing awareness about Islamic ethics in business in current scholarly research works (Beekun, 1997; Graafland, Mazereeuw, and Yahia, 2006; Rice, 1999; Wilson, 1997, 2006).This concept of corporate governance is not new in Islam as it can be seen through the verses of the Holy Quran

> "And if you are on a journey and cannot find a scribe, then a security deposit [should be] taken. And if one of you entrusts another, then let him who is entrusted discharge his trust [faithfully] and let him fear Allah, his Lord. And do not conceal testimony, for whoever conceals it – his heart is indeed sinful, and Allah is Knowing of what you do."(Al-

Quran2:283).

"O you who have believed, do not consume one another's wealth unjustly but only [in lawful] business by mutual consent. And do not kill yourselves [or one another]. Indeed, Allah is to you ever Merciful. (Al-Quran4:29).

"And do not consume one another's wealth unjustly and send it [in bribery] to the rulers in order that [they might aid] you [to] consume a portion of the wealth of the people in sin, while you know [it is unlawful]." (Al-Quran 2:188).

"And O my people, give full measure and weight in justice and do not deprive the people of their due and do not commit abuse on earth, spreading corruption." (Al-Quran 11:85).

It can be seen from the above verses, that book keeping with the implicit message of the need for transparency and disclosure in the business dealings. This leads to the third research question of the study; does the corporate governance disclosure differ in between the Islamic banks and does it have any association with the profit of the bank.

Considering the Shari'ah based regulation for disclosure, this makes Islamic banks unique as compared to the conventional banks. Al Quran states that it is sure that the man who follows Allah cannot be the same as who asks for the wrath of Allah:

"Is the man who follows the good pleasure of Allah Like the man who draws on himself the wrath of Allah, and whose abode is in Hell? – A woeful refuge!" (Al-Quran 3:162).

3. Research questions

Based on the research objectives following are the research questions which this study will try to answer in order to achieve the objectives.

1. Does an Islamic bank significantly disclose information regarding Shari'ah advisory board, social responsibility and corporate governance?
2. Do the Islamic banks in Pakistan differ in terms of their disclosure of Shari'ah advisory board, social responsibility and corporate governance?
3. What is the ranking of the banks in terms of disclosure index?
4. What is the effect of the disclosure index on ROE and earnings per share?

4. Methodology

4.1. Sample

This study will use the financial reports of 2013-14 of the Islamic banks in Pakistan. These banks include Meezan Bank, Dubai Islamic Bank, Albarka Bank, Burj Bank and Bank Islami. These financial reports will be used to extract the qualitative information as named below.

4.2. Data Collection

This study will check various indicators for its disclosure under the following headings established by Paino et al. (2011).

4.2.1. Shari'ah Advisory Board.

a) Performance overview
b) Roles and responsibilities of SAC
c) SAC composition
d) SAC remuneration
e) Zakat obligation
f) Zakat amount
g) SAC reports
h) Profit equalization reserves
i) Classification of deposit in terms of mudarbah and non-mudarbah
j) Placement from banks
k) Detail presentation of income statement on sharing of deposits and profit

4.2.2. Social Responsibility

a) Employee welfare
b) Screening clients for Shari'ah compliance
c) Responsibilities dealing with clients
d) Earning and expenditure prohibited by Shari'ah
e) Zakat
f) Qard-ul-Hasan
g) Reduction of adverse impact on environment
h) Social development and environment based quotas
i) Customer service
j) Micro, small business and social investments
k) Charitable activities
l) Waqf management

4.2.3. Corporate Governance

a. Director responsibilities
b. Director composition
c. Directors remuneration
d. BOD information on CEO
e. Size of BOD
f. Composition of BOD
g. Appointment of BOD
h. Directors training
i. Relationship of BOD to management
j. BOD committees
k. BOD reports
l. Chairman statements
m. CEO statements
n. Audit committee responsibilities
o. AC reports
p. AC activities

4.3. Analysis

The data gathered is the qualitative dummy variable for each bank showing disclosure or non disclosure of the characteristic. Each bank will have11 dummies for the disclosure of Shari'ah advisory board, 12 dummies for the disclosure of social responsibility and 16 dummies for the disclosure of corporate governance. The data for the profitability of each bank is also collected for the year 2013-14.

Table1
Descriptive Statistics

	Obs.	Mean	Std. Dev.	Skewness	Std. Error of Skewness	Kurtosis	Std. Error of Kurtosis
Shariah Advisory Board	5	0.4909	0.21894	-0.601	0.913	-0.945	2.000
Social Responsibility	5	0.3571	0.23690	-0.685	0.913	1.132	2.000
Corporate Governance	5	0.5176	0.38213	-0.322	0.913	-2.486	2.000

Table 1 provides the skewness and kurtosis statistics, and their standard deviation. Using both we can determine whether there is any tendency or outliers in the data. While analyzing the skewness values, the T values are calculated with the reference of no skewness (skewness = 0) value, here the null hypothesis is that there is no skewness in the data. In table – 2 we can see that all of theT values are smaller than T = 2 in magnitude. This shows that there is a tendency in the data; all the banks are located symmetrically around the mean disclosure value.

While analyzing the excess kurtosis values (kurtosis – 3), the T values are calculated with the reference of no excess kurtosis (kurtosis = 3), here the null hypothesis is that there are not too many outliers as compared to a normally distributed data. We can see that all the values are smaller than T = 2 in magnitude, which shows that considering the differences in the banks, none of the banks is anoutlier for the three disclosure indexes.

Table2
Skewness and Kurtosis T Test

	Skewness T value	Kurtosis T value
Shari'ah Advisory Board	-0.65	-0.47
Social Responsibility	-0.75	0.57
Corporate Governance	-0.35	-1.24

4.3.1. One Sample T test

The group of dummies for each bank will be analyzed in one sample T test to see whether there is any bank which is different from others in terms of its level of disclosure. This will enable us to see if the Islamic banks in Pakistan are homogeneous in terms of their disclosure status.

This study will check for the disclosure of the above criterions of Pakistani Islamic banks. First, the T test method is applied to see whether all the banks are similar to each other in terms of the three categories provided.

Table 3 shows the disclosure status variable for each bank shows disclosure of Shari'ah advisory board, social responsibility and corporate governance. The T test shows that all the banks are different from 0 which means that all the Islamic banks are putting their significant efforts to disclose the information for their customers as depicted by the Shari'ah.

Table3

One-Sample Test

	Mean	Sig. (2-tailed)	Mean Difference	Confidence interval Lower	Upper
Meezan Bank	0.7'	0.013	0.770	0.39	1.15
Albaraka Bank	0.1:	0.184	0.119	-0.14	0.38
Bank Islami	0.5.	0.013	0.540	0.27	0.81
Burj Bank	0.6:	0.025	0.610	0.19	1.03
Dubai Islamic Bank	0.24	0.123	0.236	-0.16	0.63

Figure 1 consists of box plot showing the ranking of each bank in terms of its disclosure status. It can be seen that Meezan Bank is ahead of all its counterparts, which is followed closely by Burj Bank and Bank Islami. In this box plot, Dubai Islamic Bank and Albaraka Bank are following the leaders but lagging behind significantly.

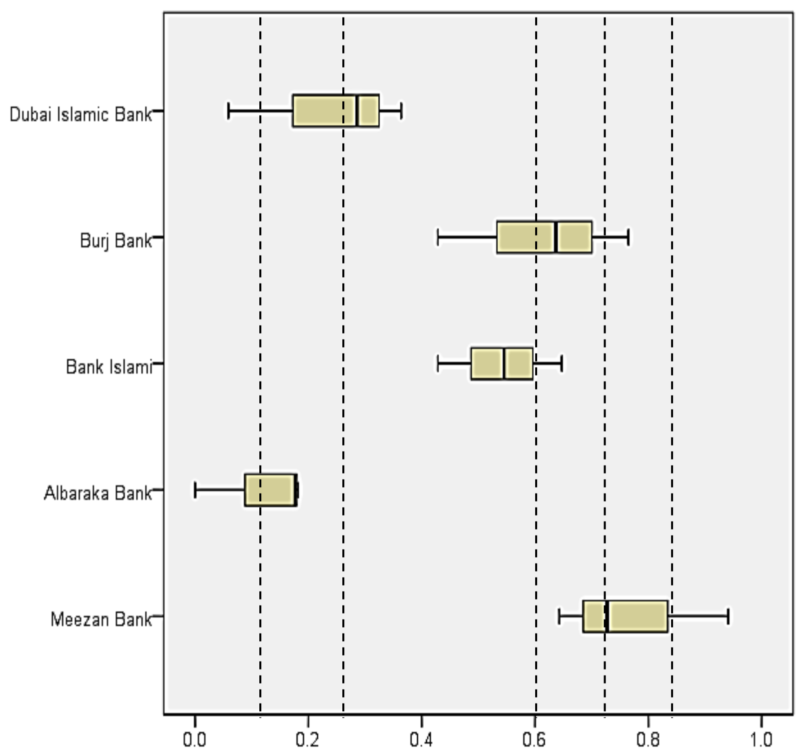

Figure1.Box Plot of Disclosure of Banks

Table 4 checks the disclosure level of Islamic banks from another angle. Here each disclosure status of Shari'ah advisory board, social responsibility and corporate governance for all the banks is checked. It can be seen that all the T values are higher than 2 means that the disclosure status is significantly different from 0. It means, all the banks are jointly ensuring that they are disclosing their status related to Shari'ah Advisory Board, social responsibility and corporate governance.

Table 4
One-Sample Test

Variables	Mean	Std. Error	Sig. (2-tailed)	Mean Difference	Lower	Upper
Shari'ah Advisory Board	0.49	0.1	0.007	0.491	0.22	0.76
Social Responsibility	0.36	0.1	0.028	0.357	0.06	0.65
Corporate Governance	0.52	0.17	0.039	0.517	0.04	0.99

Figure 2 consists of the box plot showing the comparison of disclosure status. Here we can see that corporate governance is the most disclosed status, which is followed by Shari'ah advisory board and social responsibility. It can also be observed that Albaraka Bank has appeared as an outlier in the social responsibility because its social responsibility disclosure status is 0.

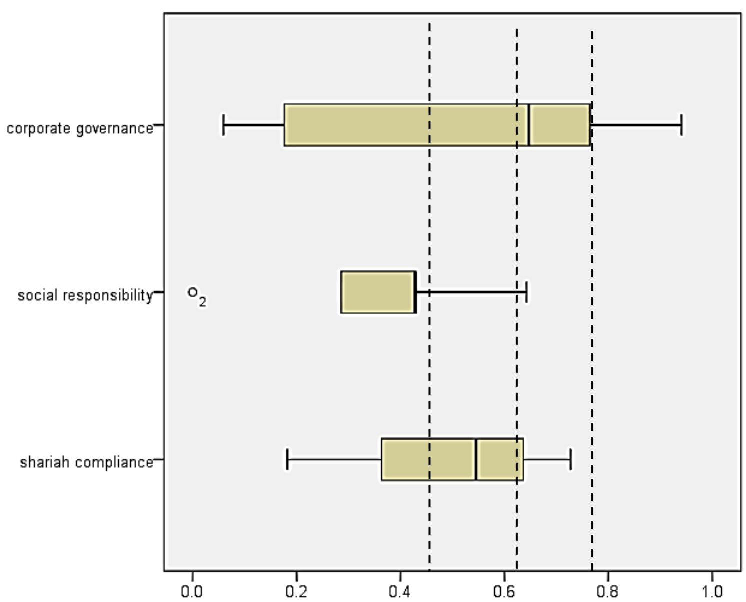

*Figure2***.** Box plot of Disclosure Type

4.3.2. Factor Analysis

Each group of dummies is analyzed using factor analysis to create an index of the disclosure. This index is created from the individual disclosure indices of Shari'ah advisory board, social responsibility and corporate governance. The first advantage of an index is that we have one number for each bank showing their disclosure status as compared to other banks. Higher the number means higher the degree of disclosure of that bank. The second advantage is that it makes the qualitative information to form quantitative data which can be used in further analysis.

Table 5 shows that when one index is constructed from the principle factor analysis that factor explains 93.9% of the variation in the three indexes. This very high value represents the reliability of the disclosure index as it will be comprehensively representing the disclosure status of the Islamic banks in Pakistan. The component matrix in table – 6 shows that the disclosure status of Shari'ah advisory board is 99.4% similar to the disclosure index. Disclosure status of social responsibility is 96.6% similar to the disclosure index and disclosure status of corporate governance is 94.6% similar to the disclosure index.

Table 5
Total Variance Explained

Component	Initial Eigen values			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	2.816	93.88	93.88	2.816	93.88	93.88
2	0.170	5.68	99.56			
3	0.013	0.44	100.00			

Extraction Method: Principal Component Analysis.

Figure 3 consists of the disclosure index plotted in a bar chart. It shows how banks are different to each other. Here we can see that Meezan Bank leads the chart, followed by Burj Bank, Bank Islami which has positive value while Dubai Islamic Bank and Albaraka Bank are showing a negative value. While analyzing the box plot (figure 4) we can see that while considering the dispersion of the disclosure index none of the banks is considered as an outlier.

Table 6

Component Matrix[a]

Component	1
Shariah Advisory Board	0.99
Social Responsibility	0.97
Corporate Governance	0.95

Extraction Method: Principal Component Analysis.
a. 1 component extracted.

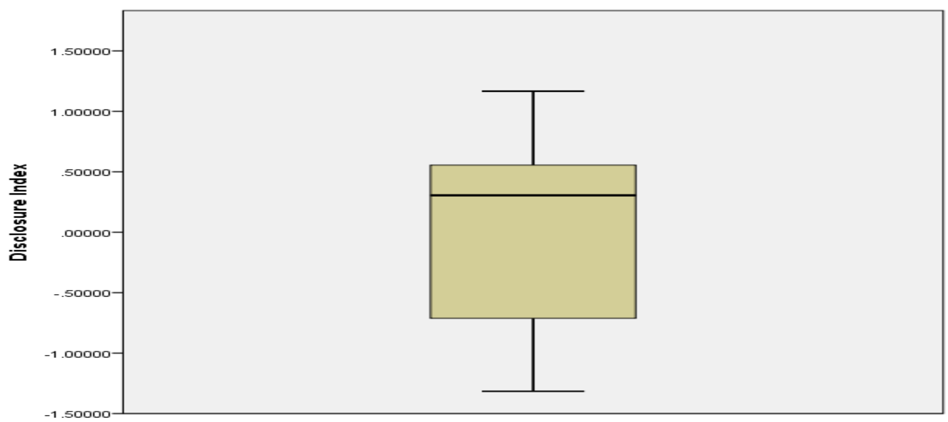

*Figure4.*Box plot of Disclosure Index

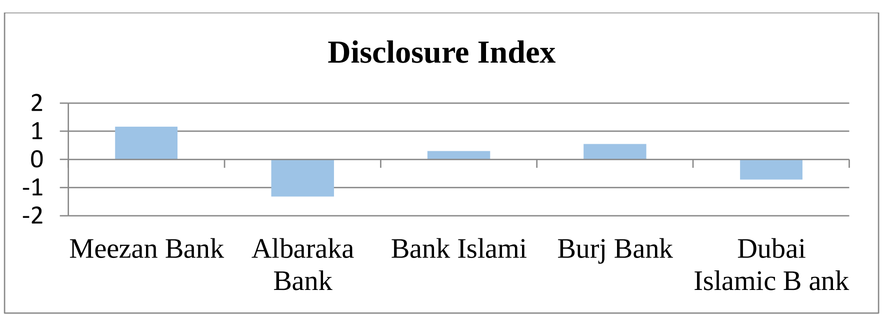

*Figure3.*Comparisons of Banks

The above indices will then be used to check association with the profit of the bank. It is expected that higher the disclosure leads to higher customer confidence and hence higher profitability. Here we will have three indexes so we will be able to rank which index has a higher association with the profit.

4.3.3. Correlation Analysis

The correlation of the disclosure index is checked against earnings per share and return on equity of the banks. In table 7 we can see that the index is positively correlated with both the performance and profitability indicators of the Islamic Banks, also this correlation is significant for the case of ROE. Hence the improvement in disclosure index is strongly similar to the improvement in the ROE.

Table 7
Correlation Index

		Disclosure Index	Earnings per share	ROE
Disclosure Index	Pearson Correlation	1	0.542	0.714
	Sig. (1-tailed)		0.172	0.088
	N	5	5	5

4.3.4. Curve Estimation

We have plotted the curve which shows the impact of disclosure index on each of the profitability indicator. Table 8 shows that if disclosure index is increased by 1% then the earning per share of the firm is increased by 1.07% on average which is also shown in the graph (figure. 5).

Table 8

Model Summary and Parameter Estimates

Dependent Variable: Earning per share

Equation	Model Summary					Parameter Estimates	
	R Square	F	df1	df2	Sig.	Constant	b1
Linear	0.29	1.25	1	3	0.34	1.104	1.071

The independent variable is Disclosure Index.

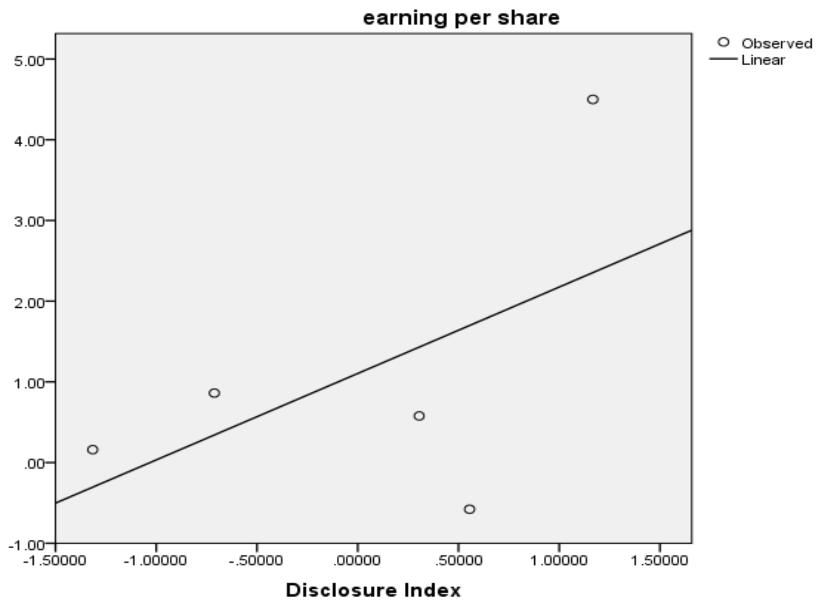

Figure 5 – Curve fitting of Earning per share

Table 9 shows that if the disclosure index increases by 1% then the return on equity will increase by 6.86% on average which is represented by the graph (figure6).

Table 9

Model Summary and Parameter Estimates

Equation	Model Summary					Parameter Estimates	
	R Squar(	F	df1	df2	Sig.	Constant	b1
Linear	0.51	3.11	1	3	0.18	5.518	6.856

The independent variable is Disclosure Index.

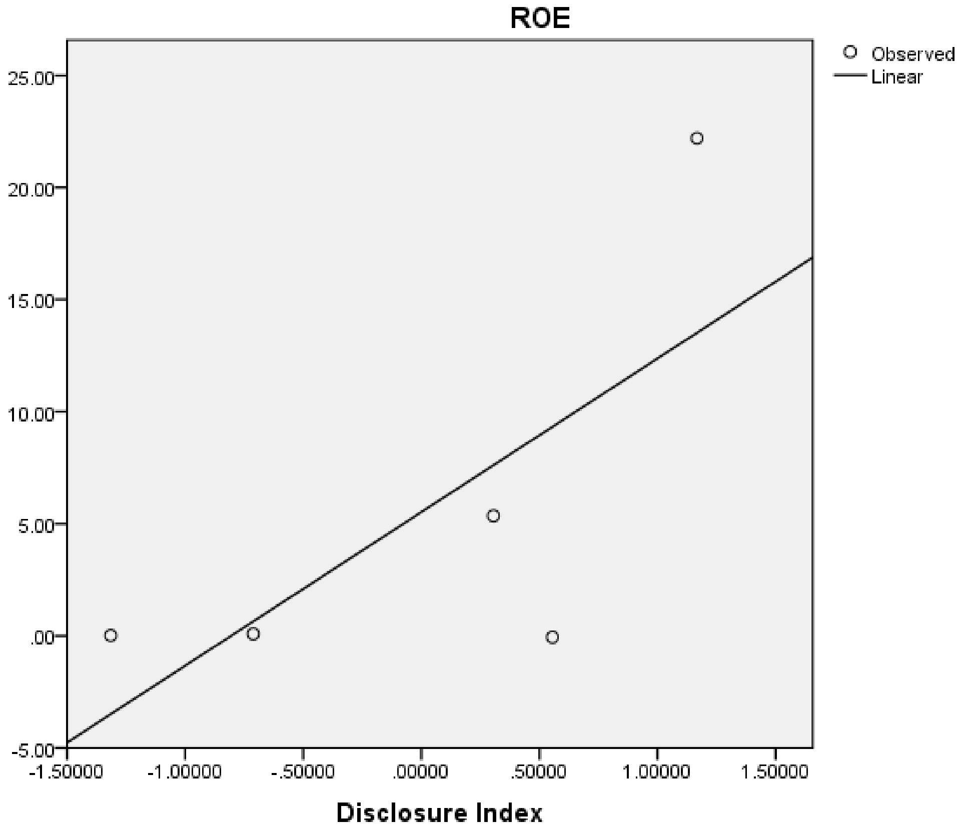

*Figure 6.*Curve fitting of return on equity

5. Conclusion

This study explained that divine Shari'ah law impels Islamic banks to disclose the information of corporate governance, Shari'ah advisory board and social responsibility in order to reduce uncertainty to the highest extent possible. On the other hand in conventional financial institutes, social responsibility is only considered moral obligation or voluntary action and is done for the sake of improvement in the image of the Institute. This practice makes Islamic financial institutes more transparent and prone to promote social welfare.

This study has proposed a procedure to calculate the disclosure index for Islamic banks using the data of Shari'ah advisory board, corporate governance and social responsibility disclosure. The principle factor analysis was deployed to construct the disclosure index. The benefit of forming the index is that this makes all the banks comparable to each other. This index showed that Meezan Bank beat its counter parts in terms of the overall disclosure.

The results of the study reveal that because of the fact that Islamic banks are bound to disclose their dealings as per Shari'ah law which is mandatory, and ensures that all the Islamic banks are similar to each other in disclosing their accounts and dealing. This applies that Islamic banks and Institutes are more trust worthy while handling our savings as they comply with the rules set by Allah. Also, higher disclosure means that in Islamic market, access to information will ensure saving people from any sort of exploitation.

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