

Shariah Information Disclosure and its Effect on Financial Performance among SMEs in Malaysia

Ain Noor Azman

Post Graduate of Business Economics,
Faculty of Economics and Management, Universiti Putra Malaysia, Malaysia.

Noor Azman Ali

Faculty of Economics and Management,
Universiti Putra Malaysia, Malaysia

Fauziah Mahat

Faculty of Economics and Management,
Universiti Putra Malaysia, Malaysia

Zaidi Mat Daud

Faculty of Economics and Management,
Universiti Putra Malaysia, Malaysia

ABSTRACT

Introduction: Shariah disclosure has become an important aspect in a Small-Medium Enterprises (SMEs). The disclosure of shariah information would enhance the transparency and accountability of SMEs towards its stakeholders which in return helps promote the long-term profitability and sustainability. **Objective:** (1) examine the extensiveness of Shariah disclosure and (2) investigate the relationship between Shariah disclosure on product and services, financing, earnings and expenditure, social functions and environment and its effect on financial performance of SMEs in Malaysia. **Methods:** In total, 131 respondents comprised of owners and top management of SMEs in the state of Selangor, Kedah, Pahang, and Johor. The questionnaire was developed based on Shariah Index for Islamic Social Reporting and the data was analysed using multiple regression. **Results:** The findings indicated that Shariah disclosure on financing found to have significant relationship on the financial performance of SMEs. In contrast, products and services, earning and expenditure, social functions and environment were found to have no significant relationship on the financial performance of SMEs. The results also show that working environment for workers was disclosed extensively by SMEs while, earning expenditure on non-Shariah compliant the disclosure was less extensive.

Keywords: Shariah-related information disclosure, Performance of SMEs, Product and service, Financing, Earnings and expenditure, Social functions, Environment.

INTRODUCTION

Malaysia is one of the Muslim countries that focus on Shariah principles. The common use of the expression “Shariah principles” which is to convey full compliance with Islamic law in the financial transactions is a norm today. Usually, adhering to Shariah principles or staying “Shariah compliant” means observing strictly to the permissible (halal) and abstaining from the prohibited (haram) as commanded by God (Azri, Rahman, Mohd, Hafiz, Yaakub, and Long, 2018). To identify the disclosure of Shariah principles in an institution, a thorough annual report of the organization is being monitored by the Shariah Supervisory Board (SSB).

However, for Small Medium Enterprises (SMEs) industries, their activities are not being monitored by the SSB but it is monitored by the Board of Director of the enterprise. Nevertheless, SMEs communicate towards their stakeholders are through information disclosure. For a company that relies on Shariah aspects for its companies, Shariah-related information is important for the company to disclose the activities of an annual report to its stakeholders.

Shariah-related information disclosure is an important aspect of the company. Stakeholders are looking for an Islamic background through the SME industries. As in accordance to the study of Abdullah and Hoetoro (2011), suggest that as Islam focuses attention on individual and social stability, it is important to adopt Islamic principles to empower SMEs. They argue that Muslim entrepreneurs need to have a vision of producing high quality products and set competitive prices, in order to achieve their objectives in the SME sector, because the rest of the SME sector is trying to improve product quality at minimum cost.

Therefore, it is a must that these SMEs disclose them information according to the Shariah aspects towards the stakeholders as it will give a higher impact on getting the Muslim customers.

When an organization disclose their information to customers such as in the category of products and services, financing, takaful, stocks, and hotel business they have the trust to involve in it. Information disclosed must be based on mandatory disclosure and voluntary disclosure. According to Ousama & Fatima, 2010, it has stated that mandatory disclosures are items that companies must disclose because of statutory regulations therefore; it is the minimum level of information to be disclosed in the annual reports.

Meanwhile, voluntary disclosure is defined as that which is not mandated, thus it constitutes information additional to statutory requirements (Ousama and Fatima, 2010). As such, an organization voluntarily disclosed information to guarantee stakeholders that it is a decent organization.

The current trend of economic growth and the rapid industrial development has made Malaysia as one of the most open economies in the world. According to Hashim (2000), the SMEs are expected to contribute 50 percent of the gross domestic product (GDP) in 2020. The exporters in SMEs are mainly located in the manufacturing sector (57.6%), services (40.6%) and agriculture (1.8%). Based on the statements made by various organizations and ministries over the past decades, the total SMEs could be in the range of 10,000 to 30,000.

Recognizing the SMEs potential and future growth to the economy of the country, the government of Malaysia has initiated greater efforts in encouraging SMEs involve in international business (Chelliah, Sulaiman, and Yusoff, 2010). In recent years, the Malaysian annual national budgets have also given considerable allocations to the development of SMEs. Various efforts were implemented to facilitate financing and market access for small businesses. Focus was also given to capacity building and talent development.

Performance of SMEs plays a vital role on the development of the industry. Knowing whether the information disclosed is implemented according to the shariah principles, stakeholders and the manager should act according to the Shariah Supervisory Board. The Shariah is the Islamic law of human conduct that regulates all matters of Muslims' lives. The Qur'an prescribes mankind to engage in activities that are lawful and good and also prohibit those that can harm and dispute in the society (Mohd-Sanusi, Ismail, Hidayati, and Harjito, 2015). Most organizations that depend on Islamic concept must take after the shariah principles with a specific end goal to persuade Islamic clients on the product itself.

The Shariah approved companies are those whose activities are in compliant with the principles of Shariah. On the other hand, the non-approved companies entail those involved in activities that contradict with the principles of Shariah for instance, gambling (maysir), debt interest (riba) and producing or selling prohibited products or services (Mohd-Sanusi, Ismail, Hidayati, and Harjito, 2015). This research is to study the importance of information disclosure based on Shariah Compliance among SMEs in Malaysia and the effect towards performance of SMEs.

LITERATURE REVIEW

Product and services and performance of SMEs

Shariah-related information disclosure on products and services are based on the information on the content, the quality of each product, the safety and the usefulness of the products. When disclosing information on these items, it is to ensure that the related information does not contradict with Shariah principles where it should not have any non-halal ingredients and the services should not have interest (riba'), uncertainty (gharar) or gambling (maysir).

One of the effects of the disclosure towards the financial performance is when the content is not thoroughly disclosed, it will bring a feel of uncertainty towards the product as so it will reduce the amount of demand from Muslim customers. Therefore, it should be that the more extensive the information is being disclosed, the stronger the financial performance of SMEs.

SMEs consumers' confidence on the product and service is dependent on the criteria as in the operations of the business must fully comply with Shariah principles and the consequential wealth and financial progress of the SMEs operators need to be disclosed. According to Ousama & Fatima, (2010), as to when an SMEs is not offering any products and services prohibited by Shariah, all products and services should be in a good quality and condition. Thus, SMEs are expected to disclose information about the quality. Usefulness and safety of their product and services to show their accountability and transparency to the society.

Therefore, their results show that they had the highest mean of disclosure which indicates that Shariah-approved Companies prefer to disclose information on products and services as their findings were similar to Kin's, (1990). Therefore, the hypothesis for this research would be:

H1: There is a relationship between Shariah-related information disclosure of products and services and performance of SMEs.

Financing and Performance of SMEs

For SMEs to survive and to prolong their business, having a strong financial position is a must as it helps in strengthening the business activities. Shariah-related information disclosure on the source of financing must be disclosed as to whether the source is from Shariah financing or non-Shariah financing. These disclosures of information financing are to show that the capitals of the industry are from halal and legal financing as it will avoid any gain of interest and doubtful activities. Therefore, disclosing on Shariah-related information does affect the performance of SMEs.

According to Azmi, Ab Aziz, & Muhamad, 2016, it is only recently that the literature started to focus on the Shariah disclosures of Shariah-compliant companies which can be related to SMEs. For a Shariah-compliant company, Ullah et al. (2014) listed the items in the required category that are similar to the screening requirements, adopted by users of the Shariah screening method to determine the Shariah-compliant status of companies. Interest paid for loans and received from the savings are not allowed from a Sharia perspective.

From reports on Che Azmi et al., 2016, study, they define accounting-related disclosures as disclosures that will affect the way items in the financial statements are presented, such as a distribution of the profit/revenue of the company that is based on halal and haram activities. From their interviews, it shows that managers from Shariah-compliant companies are willing to disclose information related to Shariah as their specific purpose of informing readers about their involvement in Islamic financial practices. Therefore, the hypothesis for this research would be:

H2: There is a relationship between Shariah-related information disclosure of financing and performance of SMEs.

Earnings and Expenditure and Performance of SMEs

Earnings and expenditure are the cash flows of an enterprise. Information on the earnings and expenditure must be disclosed as when it involves in screening the annual reports, the auditor must know on to whether it is disclosing according to Shariah or not.

According to Haniffa, Hudaib, and Mirza (2004), the results from their study shows that the financial statements should disclose any earnings that have been realized from sources or by means which are not permitted by the Shariah. Likewise, the disclosure should be made of any expenditures for purposes not permitted by the Shariah. This disclosure should be made whether such earnings or expenditures are the results of good faith but an incorrect understanding of the Shariah.

Moreover, the reporting from Azmi's (2017) study shows that any earnings or expenditures derived from Shariah non-compliant activities enhance the transparency of business and financial dealings of Islamic banks. Therefore, this research is adapted from other institutions for information disclosure on earning and expenditure. The hypothesis for this research would be:

H3: There is a relationship between Shariah-related information disclosure of earnings and expenditure and performance of SMEs.

Social functions and performance of SMEs

Social functions are the social act from the industry as in terms of donations, giving zakat as part of their financial cleansing and waqaf to those in need. Some industry may not have any waqaf as some had just started their business. Donations can be given as to when there are asked for and zakat must be paid at every year as in cleansing of their financial. For zakat, there are calculations in calculating the amount of zakat to be given. For example, the payable zakat is 2.5% time by the percent owned by the zakat times the net current asset.

According to Othman, Thani, and Ghani, (2009), the stress on social justice goes beyond providing details regarding the environment, minority interests, and workers. This is because issues arise related to the well-being of the society about interest and unfair trading practices such as income distributions (known as zakat).

This indicates that from the result from their study that Shariah approved companies disclose more information on social and community involvement issues voluntarily compared to the other information in the disclosure index, to portray their image as good corporate citizens. Such concern is reliable to the partner's theory whereby management gives information to clients to keep up with the enterprise's success. Therefore, the hypothesis for this research would be:

H4: There is a relationship between Shariah-related information disclosure of social functions and performance of SMEs.

Environment and financial performance of SMEs

Empirical evidence on the relationship between shariah-related information disclosures and financial performance is undetermined. Some studies report a positive outcome on the relationship between environmental disclosure and financial performance. Gray, Kouhy, and Lavers, (1995) recommend that disclosures do not seem to be related to profitability at the same time of the year. Nonetheless, there is other evidence (Cormier and Magnan, 1999) to suggest that environmental disclosures might be related to delayed profits.

Moreover, Al-Tuwaijiri, Christensen, and Hughes (2004) examine a simultaneous equation relationship between environmental disclosure and financial performance, suggesting that relationships in both directions are practical. In the Malaysian context, Yusoff et al. (2006) suggest that there might be no perceptible connection between environmental disclosure and economic benefit because disclosure practices are driven by social concerns rather than profit considerations.

Moreover, the findings of A.H., Abdullah and Sulaiman's (2015), study reveal the quality of Environmental Disclosure in the context of a developing country, Malaysia, taking into consideration the usefulness of the disclosure. To accommodate associated difficulties, this research here focusses on the relationship between Shariah-related information disclosure on the environment and financial performance of SMEs, so that a clear direction of the causal relationship may be identified and measured. Therefore, the hypothesis for this research would be:

H5: There is a between Shariah-related information disclosure of the environment and the financial performance of SMEs.

RESULTS

Demographic profile of the respondents

Based on the sample collected through the distribution of questionnaires, from table 1.1 can be observed that from the total sample size of 127 respondents, the majority of the respondents are the owner of the enterprise. The majority of the respondents are the owner (44.1%) followed by the executive officer (18.9%), manager (15%), director (3.1%) and CEO (2.4%).

In terms of working experience, most of the respondents have work 5 years or less (52.0%), followed by 6 to 10 years (22.8%), 11 to 15 years (13.4%), 16 to 20 years with (3.1%) and the least is 21 years and above (3.0%). As for the years of operation for the company, most of the companies have been in operation within 5 years or less with (42.5%) followed by years been operated 6 to 10 years with (21.3%), 11 to 15 years with (15.0%), 21 years and above with (6.8%) and the remaining (2.7%) is 16 to 20 years.

The results of the survey also showed that 44.1% of the company has employees less than 5. While 31.5% have employees between 5 to 20. The company that has employees between 21 to 40, between 41 to 60 and more than 80 is 16.5%, 3.1%, and 4.7% respectively.

Results from the respondent for industry shows that those under agro-based industries are the majority with (47.2%) followed by manufacturing industry with (18.9%), primary agriculture with (12.6%), services (12.6%), manufacturing-related services (7.1%) and information & communication technology with (1.6%).

Table 1.1: The Demographic Profile of the Respondents

		Frequency (N)	Percentage, (%)
Position	Owner	56	44.1
	Director	4	3.1
	CEO	3	2.4
	Manager	19	15.0
	Executive officer	24	18.9
	Other	21	16.5
	Total	127	100.0
Education	PhD	3	2.4
	Post-graduate	5	3.9
	Degree Holder	35	27.6
	Diploma	33	26.0
	Others	51	40.2
	Total	127	100.0
Working Experience	21 years and above	11	8.7
	16-20 years	4	3.1
	11-15 years	17	13.4
	6-10 years	29	22.8
	5 years or less	66	52.0
	Total	127	100.0
Operation	21 years and above	21	16.5
	16-20 years	6	4.7
	11-15 years	19	15.0
	6-10 years	27	21.3
	5 years or less	54	42.5
	Total	127	100.0
Employees	More than 80	6	4.7
	41-60	4	3.1
	21-40	21	16.5
	5-20	40	31.5
	Less than 5	56	44.1
	Total	127	100.0
Industry	Manufacturing	24	18.9
	Manufacturing related services	9	7.1
	agro-based industries	60	47.2
	Services	16	12.6
	Primary agriculture	16	12.6
	ICT	2	1.6
	Total	127	100.0

Normality Test

The results of the normality test are displayed in table 1.2 below which shows all variables are following normal distribution with the values of skewness and kurtosis for all the independent and dependent variables of this research. From the Table below, the value of skewness for all variables is range from- 1.256 to -0.347. In contrast, the value of kurtosis for all the variables is ranging from -0.457 to 0.952. Based on the result, all the value for independent and dependent variables are acceptable in terms of normality. According to West, Finch, and Curran (1995), this is because the value of skewness and kurtosis for all the variables is in accordance to the rule of thumb where all the value is less than two and seven respectively.

Table 1.2. Normality Test

Variable	mean	STD	Min	Max	Kurtosis	Skewness
Perf SME	4.7585	1.24558	1.00	6.00	.952	-1.256
PS	4.2165	.77111	1.75	5.00	.600	-.989
F	3.9783	.79683	2.00	5.00	-.457	-.486
EE	3.7913	.90346	1.00	5.00	-.008	-.347
SF	3.8556	1.06374	1.00	5.00	.616	-.998
EN	3.9869	.77483	1.33	5.00	.134	-.579

Reliability Test

According to Nunally, (1978), based on Table 1.3, the result indicated that all of the variables were acceptable as the Cronbach's Alpha was more than 0.70. According to rules of thumb of reliability test, for variable on the environment, 0.698 is acceptable but questionable. As to some literature, Nunally (1978) stated that even modest reliabilities of .60 or .50 may be acceptable and be maintained that in theoretical studies. To agree with the statement, Hair, Black, Babin, Anderson, and Tatham (2006), proposed that though "generally agreed" lower limit for Cronbach's alpha value is .70, it may decrease to .60 and still be acceptable, especially in exploratory studies and in research in the Social Sciences.

Table 1.3. Reliability Test

Variables	Construct	Cronbach's Alpha	Number of Items
DV	Financial Performance of SMEs	0.902	3
IV	Products and services	0.88	4
IV	Financing	0.795	4
IV	Earnings and expenditure	0.745	4
IV	Social functions	0.930	3
IV	Environment	0.698	3

DATA ANALYSIS

Objective 1: to examine the extensiveness of Shariah-related information disclosure

Table 1.4. Descriptive Statistics for Items

Code	Item	Mean	Std. Dev.	Mean
PS1	The true information on the content of the product.	4.1496	.99266	7
PS2	Information on the quality of products and services provided by enter.	4.2441	.87029	4
PS3	Information about the safety of the products	4.2283	.89255	5
PS4	Information on the usefulness of the product	4.2441	.83301	3
F1	Information on the source of financing – Shariah	4.1417	.93201	8
F2	Information on the source of financing – non-Shariah	3.8661	1.04928	12
F3	Information on riba (interest)	4.0945	.99549	9
F4	Information on gharar (doubt) activities	3.8110	1.06706	13
EN1	Information on voluntary efforts to control pollution	3.8898	1.00970	11
EN2	The working environment is by the Shariah Principles. (Clean, Islamic)	4.3150	.80377	1
EN3	Information about non-muslim employees	3.7559	1.25809	16
EE1	Shariah Compliant Earnings	4.2835	.89883	2
EE2	Non-Shariah Compliant Earnings	3.2913	1.45902	18
EE3	Shariah Compliant Expenditures	4.2283	.91884	6
EE4	Non-Shariah Compliant Expenditures	3.3622	1.40673	17
SF1	Information on donations	3.7874	1.16585	15
SF2	Information on zakat	3.9921	1.05782	10
SF3	Information on Waqaf	3.7874	1.17939	14

The table above shows the results of the extensiveness of each item from the questionnaire for this research. This shows that from table 4.7, the highest mean is the EN2 which is on the working environment according to Shariah-related information disclosure with the mean of 4.3150. This shows that the working environment is the most extensive on the Shariah-related information disclosure disclosed by some SMEs.

Moreover, the lowest mean is EE2 which is on the non-Shariah compliant earnings on Shariah-related information disclosure with the mean of 3.2913. This shows that the information disclosed on the non-Shariah compliant earnings is less extensive towards the organization. Therefore, from SMEs perspective, the industries have the same opinion on as to disclosing the non-Shariah compliant earnings is a worrying factor as stakeholders may require more transparent disclosures. Overall, according to each variable, products, and services are categorized as the highest mean where Shariah-related information disclosure on products and services are considered as extensive among the industries.

Other than that, the lowest categories of Shariah-related information disclosure are among earnings and expenditure items. It shows that from the results above, the lowest categories are from information on non-Shariah compliant earnings and non-Shariah compliant expenditure.

Objective 2: To examine the relationship between Shariah-related information disclosure and the financial performance of SMEs.

Table 1.5. Multiple Linear Regression on SMEs financial performance

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	3.824	.799		4.787	.000
Product and Service	.097	.159	.060	.611	.543
Financing	.365	.174	.234	2.096	.038
Environment	-.228	.182	-.142	-1.256	.211
Earnings and expenditure	.055	.153	.040	.361	.718
Social Functions	-.059	.122	-.050	-.483	.630

Products and services

Products and service is a significant predictor of SMEs financial performance among the respondents. However, the Regression Model indicated that product and service are not a significant predictor of SME's financial performance. The result illustrated in Table 4.10 indicated that there is no significant relationship between product and service and SME's financial performance ($\beta = 0.97$, $t = .611$, $p > .05$). Therefore, it shows that when information is being disclosed on the product and services, it does not significantly affect financial performance as the industry where it will still maintain financial performance.

Financing

Financing is a significant predictor of SME's performance among the respondents. Likewise, the Regression Model indicated that financing is a significant predictor of SME's financial performance. The result illustrated in Table 4.10 indicated that there is a significant relationship between financing and SME's financial performance ($\beta = .365$, $t = 2.096$, $p < .05$), this also means that financing significantly contributes to SMEs financial performance. SMEs need financing throughout their stages of development to support their financial performance. It shows that disclosing Shariah-related information disclosure on financing is significantly contributes to SME's financial performance.

Earnings and expenditure

Earnings and expenditure are a significant predictor of SME's financial performance among the respondents. However, the Regression Model indicated that earnings and expenditure are not a significant predictor of SME's financial performance. The result illustrated in Table 4.10 indicated that there is no significant relationship between earnings and expenditure and SMEs financial performance ($\beta = .055$, $t = .361$, $p > .05$). Earning and expenditure are important to see the flow of the cash of an enterprise. Disclosing such information related to Shariah does not significantly affect the financial performance of SMEs.

Social functions

Social function is a significant predictor of SME's financial performance among the respondents. However, the Regression Model indicated that social function is not a significant predictor of SME's financial performance. The result illustrated in Table 4.10 indicated that there is no significant

relationship between social function and SMEs financial performance ($\beta = -.059$, $t = -.483$, $p > .05$). Islam underlines social justice. In this way, SMEs are relied upon to be more socially dependable than their conventional counterparts.

Environment

The environment is a significant predictor of SME's financial performance among the respondents. However, the Regression Model indicated that the environment is not a significant predictor of SME's financial performance. The result illustrated in Table 4.10 indicated that there is no significant relationship between social function and SMEs performance ($\beta = -.228$, $t = -1.256$, $p > .05$). Shariah-related information disclosure on the environment is a voluntary disclosure. It shows that when an enterprise is responsible for the environment it will disclose.

Therefore, the result in Table 1.5 shows that t statistic and alpha value at 0.05 of all the variables are significance, meaning that there is a predictor of SMEs financial performance except product and service, earnings and expenditure, social functions and environment which are found to be not significant as the $p > 0.05$ meaning they are not a predictor of SMEs financial performance. It has been concluded that H2 is supported while H1, H3, H4, and H5 are not supported.

SUMMARY

This study has contributed to the limited literature in the study area and available literature in the field at large as a body of knowledge and for further research.

This study is an expansion of the literature in the field of the study especially on the extensiveness of Shariah-related information disclosure. The findings of this study contribute to SMEs on the five items of Shariah related information disclosure towards the SME's financial performance. The impact of the findings could help SMEs to produce a better understanding of the disclosure of information related to Shariah according to Accountability Theory.

To the best of my knowledge, this study is the first few studies to develop a questionnaire adapted from Shariah Indexes of past studies that attempted to study the relationship between Shariah-related information disclosure and the financial performance of SMEs. This area of the study is yet to be explored further for future research.

The result of this study has produced some significant suggestions for the owners and managers of SME to enhance the performance of their industries. The results show that only Shariah-related information disclosure on Financing has a significant effect on the performance of SMEs. It shows that SME industries should involve more in disclosing information related to Shariah in every aspect. Furthermore, when disclosing the information, the SMEs should rely on Shariah experts so that when it is disclosed on the Shariah-related information disclosure such as products and services, earnings and expenditure and social functions, every person involved would understand and can adapt to it.

Moreover, this study will also be important for the policymakers e.g. SME Corp., the government and top-level management of SMEs in Malaysia and other countries especially the Shariah Supervisors for industries. As for the significant results of the findings, the policymakers can make

the disclosure mandatory as it is important in the financial performance of SMEs as this study and also past studies have found it to be significant.

Furthermore, for future research, researchers can explore more on other theories and improvements could be made. Researchers could also dig deep on the information needed by visiting the site of SMEs by doing interviews and searching the annual reports.

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