

Risk Management Model of the Islamic Ethical Practice Dimension (i-EP)

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ABSTRACT

Adoption of Sharia Compliance (SC) is one of the dimensions of *Islamic Ethical Practice* (i-EP) or *Islamic Corporate Social Responsibility* (i-CSR), which can potentially lead companies to obtain several significant capital market benefits, including affecting risk (cost of equity). However, whether and to what extent SC influences the cost of equity is still an issue and has yet to be widely documented at the theoretical and empirical levels, especially in the Indonesian context. Apart from the low level of cash holding, the evidence gap shows that the Indonesian Sharia financial screening criteria are more liberal than the international criteria, which indicates that Indonesian SC leverage contains a higher financial risk premium, thus possibly having implications for estimating the high expected return of investments and in turn the effect of SC on the cost of equity potentially has different empirical significance from international finding. Implications of liquidity and risk premium on the cost of equity indicate that SC's influence on the cost of equity is more complex than simple causality. Therefore, it is necessary to build a more comprehensive system by formulating contingency factors in the relationship between SC and the cost of equity. The finding reveal from 891 observations that the link between SC and cost of equity is fully mediated relationship, which indicates that SC can only affect the cost of equity with good reputation and by improving performance.

INTRODUCTION

Cost of equity capital (CoE) is often used to estimate equity risk premiums, company valuation and capital budgeting, and investment management practices (Cámara et al. , 2009; Hou et al. , 2012). Previous literature shows that the cost of equity depends on the company's economic fundamentals, industry dynamics, and overall national economic conditions (Banz, 1981; Fama and French, 1989; Gebhardt et al., 2001). Meanwhile, from a micro perspective, specific determinants of the cost of equity for a company generally include size, leverage, financial strength, level of disclosure, and overall risk (Hasan et al., 2015). However, empirical

documentation also reports that capital markets give lower value to companies that are seen as unethical. Researchers and practitioners have reported that the stock market rewards ethical companies (Epstein et al., 1994; Verschoor, 1998) because companies with higher ethical commitment can improve relationships with investors and reduce costs (Choi, 2012a) so that investors value the company's ethical commitment more, which is reflected in positive market reactions (Epstein et al., 1994; Choi and Jung, 2008). This empirical argument implies that ethical behavior can influence market perceptions and thus has the potential to reduce the cost of equity.

Research regarding the relationship between the implementation of ethical practices, especially the adoption of Sharia Compliance (SC) with CoE was carried out in developed countries (USA) (Karimov et al., 2020). On the other hand, specific SC-CoE linkage studies have yet to be widely validated at the theoretical and empirical levels, especially in developing countries such as Indonesia. There are several rationalities for investigating the reduction of the cost of equity from a Sharia perspective in Indonesia. First, the existing literature states that specific research is needed in developing country markets because with the unique characteristics of developing countries, findings in developed countries are not always proven to be consistent with those in developing countries (Kamal, 2011) due to significant differences in economic, social, legal and political factors between developed and developing countries. Variations in several factors mean that findings obtained in developed countries cannot be generalized to other countries (Dixon-Fowler et al., 2013). Therefore, attempts to generalize based on findings in developed countries can be misleading, so validation in different economies is needed (Naz et al., 2017; Guizani, 2019). Thus, whether and to what extent the adoption of SC affects the cost of equity, especially in Indonesia, is still an empirical issue that needs to be documented or there is a knowledge gap in the relationship between SC and CoE.

Second, The evidence gap shows that SC Indonesia's securities screening methodology, especially funding ratio screening, tends to be more liberal compared to international Sharia screening, such as Dow Jones Islamic Market (DJIM), Morgan Stanley Capital International (MSCI), Standard and Poor's (S&P) and Financial Time Stock Exchange (FTSE). The Sharia Securities Board sets total interest-based debt compared to total assets of no more than 45%. This criterion goes beyond international screening (DJIM, FTSE, MSCI, S&P) which sets the debt-to-asset ratio at less than or a maximum of 33% (Ho et al., 2012). Based on data processing, Indonesia's average SC leverage level is more than 40%. The higher tolerance limit and level of SC Indonesia's leverage compared to international criteria indicates that Indonesia's SC leverage contains a higher financial risk premium, thus possibly having implications for high estimates of expected return of investments and in turn the effect of SC adoption on CoE reduction potentially has different significance with developed countries.

Third, in the context of liquidity, the Indonesian Sharia Securities Council (DES) does not set a cash limit as a Sharia criterion. However, based on data processing and supported by existing empirical research (Hakim et al., 2021) it is confirmed that the level of SC cash holding in Indonesia tends to be low. Low cash holdings allows increased liquidity risk (Khan et al., 2018) in the form of low company investment in working capital (Baños-Caballero et al., 2014), such as investment in inventory, receivables, and trade payables that can be drawn from

suppliers (Afrifa and Tingbani, 2018). Previous literature shows liquidity risk can impact bankruptcy risk (Venkatachalam, 2017). Likewise, an amount of working capital that is too low can result in negative changes in sales levels, thereby reducing company profits (Michalski, 2016) . Such performance can destroy opportunities to obtain cash receipts and it will be difficult for the company to rebuild these opportunities (Toušek et al., 2023). From a market perspective, such a situation cannot be a signal of growth opportunities for the company so that rational investors will certainly look for the expected rate of return from other investments with commensurate risk or even if they want to buy company shares, the investor will demand a higher rate of return in line with risks faced, which indicates the increasing cost of equity.

On the other hand, low SC cash levels can also have an impact on the level of working capital investment that is not excessive so that it does not trigger agency conflicts between agents and principals (Baños-Caballero et al., 2019) and companies can avoid the high opportunity cost of cash holding so that it can positively impact performance (Raheman and Nasr, 2007). On the other hand, although cash is a key factor in liquidity management, cash is a very unprofitable asset (Mun and Jang, 2015). Previous empirical research found that excessive cash levels harm profitability (Bhattacharya and Nicodano, 2001) due to high levels of idle cash in the company. Unfavorable profitability cannot signal market players to invest by purchasing company shares at high prices (Leland and Pyle, 1977), which indicates low trading volume or stock liquidity. Low liquidity is negatively correlated with the cost of equity capital (Merton, 1987). Therefore, SC's low cash level may lead to a higher market valuation assessment, indicating a lower cost of equity.

Starting from the knowledge gap, evidence gap and the SC liquidity phenomenon which has the potential to produce a dual effect on the cost of equity, indicates that the role of the i-EP dimension (SC adoption) as a construct which capable of managing risk or reducing the cost of equity is more complex than the causality that simple. Therefore, considering the cost of equity is not only important for market assessment, it is necessary to build a more comprehensive risk management system by formulating contingency (mediation) factors in the SC and CoE relationship. This study predicts that the development of a trivariate relationship model can accommodate the complexity of the problem and further clarify the mechanism of the i-EP dimension (SC adoption) in managing risk or reducing the cost of equity. Based on this proposition, this study formulates symbolic capital (reputation) and profitability as mediation in the SC-CoE relationship. The trivariate relationship that was built produced 3 (three) mediation effects, namely mediation (1) symbolic capital in the SC and CoE relationship; (2) symbolic capital in the relationship between SC and performance; (3) performance in SC and CoE relationships. Referring to the conceptual model developed, the main aim of this research is to show that risk can be managed or the cost of equity can be reduced through at least 2 (two) factors, namely by building symbolic capital and improving performance.

The significance of the results of this research contributes to several things. First, this research develops a new theoretical model by formulating symbolic capital and performance to mitigate problems in the relationship between the i-EP dimensions (SC adoption) and the cost of equity. Therefore, this study expands the theories of RBV Theory, Good Management Theory, Corporate Governance Model (Stakeholder Theory and Agency Theory), Islamic financial

concepts (Islamic Corporate Social Responsibility or Islamic Ethical Practice), Investor Recognition Hypothesis, and Signaling Theory. Second, the mediation of symbolic capital and performance adds evidence to the contingency theory which holds that the validity of a phenomenon takes into account more complex causal relationships (at least trivariate relationships) by identifying the third variable (interaction, moderation, and mediation) (Donaldson, 2006). Third, the mediation significance of symbolic capital adds to previous empirical research evidence that shows the role of reputation as a mediating construct in a relationship model.

The overall structure of this study consists of several parts. Section 2 discusses the literature review and hypothesis development. The research design including sample, indicator measurement, and research model is presented in Section 3. Empirical results are presented in Section 4, discussion and conclusions are outlined in Section 5.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Several empirical studies argue that companies that integrate ethics and social responsibility into strategic planning are found to have lower risks (Jo and Na, 2012; Sun and Cui, 2014; Cai et al., 2016; Harjoto and Laksmana, 2018). These empirical results align with market equilibrium theory which states that companies with high ethical behavior are associated with lower risk (Mossin, 1966; Merton, 1987; Heinkel et al., 2001). Other empirical research shows that companies that are committed to an ethical identity will experience reduced agency costs, transaction costs, and other related costs (Hosmer, 1994; Jones, 1995; Foo et al., 2007; Cheng et al., 2014), including the cost of equity (Choi, 2012). Therefore, there is sufficient evidence to state that a strong commitment to business ethics will result in a lower cost of equity capital (Pae and Choi, 2011). Specifically, existing research findings confirm that companies operating in environmentally sensitive industries (ESI), such as the cigarette industry, have high costs of equity capital and vice versa (El Ghoul et al., 2011), which indicates that investors charge high levels of return on sin stocks (He et al., 2013).

In contrast, Sharia index membership is a subset of Socially Responsible Investment (SRI) (Hassan and Girard, 2010; Adams and Ahmed, 2013; Charfeddine et al., 2016) or financial transactions that are limited to halal ones and annulled haram or gharar ones and confirmed to hurt the cost of equity (Karimov et al., 2020). Existing empirical research shows that SC is one of the dimensions of Islamic Ethical Practice (Zain et al., 2015). Therefore, company operations and finances are subject to Islamic rules and principles (Guizani, 2019). Specifically, SC operates based on 2 (two) combinations of criteria (screening) (Cheong, 2021), namely (1) business screening (Chen and Yu, 2023) or industry (sector) screening and (2) financial ratio (Naz et al., 2017) or quantitative screening.

In the context of financial screening, SCs are required to have or maintain debt, receivables (liquidity), cash at a low level (Farooq and Alahkam, 2016; Chen and Yu, 2023) and have minimal physical assets (Ashraf et al., 2017). The implementation of a low level of leverage has implications for SC's capital structure being much lower (Alnori and Alqahtani, 2019), so that SC is characterized as a less-leveraged company (Forte and Miglietta, 2011) or is seen as a less risky company or has low default risk (Pok, 2012). The theoretical perspective shows that

the cost of equity contains a financial risk premium positively related to leverage (Modigliani and Miller, 1958; Modigliani and Miller, 1961). This proposition was tested by other researchers and found that the implied equity cost of capital as a proxy for the cost of equity capital increased along with leverage (Dhaliwal et al., 2006). Using the earnings-based valuation model, the same evidence is found that leverage is positively related to the cost of equity (Ahn et al., 2008). These findings indicate that leverage is a determining factor in a company's cost of equity (Kouser et al., 2016). From an investor's perspective, low leverage is a positive investment signal so that the market will set a lower required rate of return (Derigs and Marzban, 2008). This argument indicates that a low leverage ratio determines a company's cost of equity (Kouser et al., 2016). Based on this empirical argument, the low SC funding ratio feature allows SC to hurt the cost of equity. Thus, a hypothesis can be formulated:

H1: SC as one of the dimensions of i-EP is positively correlated with cost of equity

Previous literature shows that SC adoption is one of the external factors that influences a company's decision to engage in ethical practices, which is then used to gain favorable perceptions from investors (Alsaadi et al., 2017). Several other empirical studies have found that ethical behavior can increase the moral capital of an organization (Zhang and Wiersema, 2009; Connelly et al., 2011; Maung et al., 2020), which in the next stage will be valued by investors as a source of reputation for the company (Portes and Sensenbrenner, 1993). These empirical results align with other empirical studies that state that companies that prioritize ethical behavior and social responsibility will gain several benefits, including increased reputation (Gino and Pierce, 2009; Tamunomiebi, 2018). Meanwhile, the RBV perspective provides the view that ethics is believed to be able to create reputation (Hosmer, 1994; Fombrun et al., 2000a). Therefore, ethical issues are important for organizations to survive and build a good reputation (Daft and Marcic, 2012).

As a special form (Peillex and Ureche-Rangau, 2013) or part (Hassan and Girard, 2010; Adams and Ahmed, 2013; Charfeddine et al., 2016) of ethical investment, SC adoption must face greater financial constraints compared to non-SC (Guizani and Abdalkrim, 2021) due to its unique financial features (Farooq and AbdelBari, 2015), namely low leverage and low level of liquidity (Satt et al., 2020). The implementation of financial screening on SC (cash ownership and leverage) may have an impact on financial stability and strength as well as the annulization of controversial industries (sector screening) improving reputation (Durand et al., 2013). These empirical results align with other empirical results that state that ethical screening in SC improves the company's reputation because it provides more value to shareholders and lower risk (Yuen et al., 2017). Besides that, low leverage in SC can minimize future returns, leading to an increase in reputation (Pérez-Cornejo et al., 2019). Likewise, with its low leverage attribute, it is seen by the market as a company that tends to experience less possibility of default in debt payments so that it is relatively riskless or low risk (Pok, 2012). Low financial risk is confirmed to boost reputation (Fombrun and Shanley, 1990; Brammer and Pavelin, 2006; Brammer et al., 2009) because it potentially does not affect the value received by stakeholders, so it is seen as meeting the expectations of company stakeholders (Pérez-Cornejo et al., 2019). Conversely, when risks push a company into crisis, it indicates that the company is unable to meet the

expectations and interests of its stakeholders and as a consequence, the company's reputation will be reduced (Coombs, 2007; Eccles et al., 2007).

The agency theory perspective states that companies that integrate Islamic values into business operations demonstrate an intention to commit to good governance standards and one of which is through greater transparency and disclosure (Albassam and Ntim, 2017). Therefore, it is confirmed that adopting Islamic business principles can improve the quality of financial reports (Alshammari, 2014). These empirical results prove that SC has better governance (Ullah, 2018; Chen and Yu, 2023). Existing literature states that good governance is one of the most important factors influencing corporate reputation (Hill, 2004) or is a condition for developing corporate reputation (Kumaran and Thenmozhi, 2015). Based on the financial and non-financial features inherent in SC and the quality of governance, Shariah Compliance (SC) can have implications for reputation. Thus, a hypothesis can be formulated:

H2: SC as one of the dimensions of i-EP is positively correlated with reputation

Islamic principles emphasize that money can only function as a means of exchange, which cannot be transacted as an asset to generate profits. Apart from that, money should be productive, because hoarding money is prohibited in Islam (Forte and Miglietta, 2011; Saiti et al., 2014). Therefore, most of the company's assets must be in illiquid form so SC is prohibited from excessive investment, such as cash (Derigs and Marzban, 2008). Cash ownership limits affect cash use, limiting managers from manipulating cash (Guizani, 2017). SC tends to have a low level of agency conflict severity because managers tend to behave less opportunistically (Katper et al., 2015). Other empirical research finds that SC uses cash solely for the company's potential growth (Siddiqui, 2007). Thus, it is confirmed that complying with Sharia law positively impacts company performance (Kr and Fu, 2014).

In addition to cash limits, SCs are prohibited from drawing excessive debt (El-Alaoui et al., 2018). Instead, they must maintain low debt levels to avoid excessive uncertainty (gharar) (el Alaoui et al., 2017). Proponents of Islamic finance argue that some Sharia business characteristics, such as low debt, can contribute to better performance (McGowan Jr and Muhammad, 2010). These empirical results are in line with supporters of Islamic finance who argue that several sharia business characteristics, such as low debt and sector screening can contribute to better performance (McGowan and Junaina, 2010) and the implementation of sector screening is seen as a healthy business practice that encourages accountability, transparency and justice thus having a positive impact on SC performance (Phipps, 2012). This empirical statement is confirmed in other research that quantitative screening can produce large financial benefits to SCs because it can provide fairness in business, transparency and accountability, effectively promoting long-term financial health (Pepis and de Jong, 2019).

These empirical results align with other empirical results showing that restrictions imposed on SC help companies behave more carefully through transparency and better business ethics, while avoiding excessive risk and leverage, thereby encouraging improved performance (Kr and Fu, 2014). In contrast, other empirical studies show that excessive leverage and involvement in lending activities leads to lower performance (Ashraf and Mohammad, 2014). Specifically, it was found that the adoption of Shariah compliance had a positive impact on

profitability, which was proxied by ROA, ROE, and growth (Saba et al., 2021), especially during periods of crisis (Sadeghi, 2008; Ho et al., 2014). Thus, a hypothesis can be formulated:

H3: SC as one of the dimensions of i-EP is positively correlated with performance

Reputation management refers to all practices carried out by a company that aim to improve public perception of the company (Sandberg, 2012). Therefore, management academics and practitioners argue that reputation is as important as operational, legal and financial aspects (Jones et al., 2000). RBV theory defines reputation as a perception of a company's past actions and future prospects, which describes its overall attractiveness to all constituents compared to its main competitors (Fombrun, 1996; Roberts and Dowling, 2002). Companies with a high reputation can attract attention and increase investors' awareness of company shares, thereby increasing share liquidity and ultimately decreasing the cost of equity (Cao et al., 2015). Therefore, a negative relationship exists between reputation and the cost of equity (Smith et al., 2010).

Previous literature shows that companies with a higher reputation generally have higher quality financial reports (Cao et al., 2015). On the other hand, higher quality financial reports can reduce the cost of equity due to reduced information asymmetry (Francis et al., 2004; Francis et al., 2005; Barth et al., 2013). Referring to the relationship between reputation and the quality of financial reports and the relationship between financial quality and the cost of equity, the proposition is that companies with a higher reputation should experience a decrease in the cost of equity due to reduced information asymmetry due to high-quality financial reports (Cao et al., 2015). This empirical proposition is validated by other empirics who find that the higher the company's reputation, the lower the information asymmetry, which indicates a decrease in the cost of equity (Kim et al., 2020). Therefore, existing empirical research suggests that a higher reputation level is associated with a lower cost of equity (Pfister et al., 2020). Thus, a hypothesis can be formulated:

H4: Symbolic capital (reputation) is negatively correlated with cost of equity

Organizational reputation describes how an organization is viewed by stakeholders (Feldman et al., 2014). Existing literature conceptualizes reputation as representing the perception or assessment of a company from various constituents (Bromley, 2000; Meijer and Kleinnijenhuis, 2006; Winn et al., 2008). Meanwhile, other views conceptualize reputation as an image accumulation over many years (Gotsi and Wilson, 2001; Mahon, 2002). The initiator of the RBV defines reputation as an intangible asset because it is rare, difficult to imitate or replicate, complex and multidimensional. Hence, it takes a long time to accumulate, difficult to manipulate by the company, unlimited in use and does not experience depreciation (Fombrun and van Riel, 1997). Regardless of various definitions, reputation is recognized as being able to help organizations gain trust and credibility from the public to help achieve organizational goals and objectives (Mahon and Wartick, 2003; Baur and Schmitz, 2012; Roper and Fill, 2012). Several theoretical frameworks underlie the arguments above: signaling theory, strategy theory, and RBV theory. According to signaling theory, reputation is seen as a signal of information about the behavior and quality of an organization's performance, thereby increasing consumer confidence in the organization's products and services and investor confidence in the

organization's performance (Smith et al., 2010). Therefore, reputation is confirmed to positively impact financial performance (Weng and Chen, 2017).

According to strategy theory, corporate reputation is a valuable asset for an organization because it can differentiate it from other industries and create barriers to entry for potential competitors. In addition, a positive reputation is a strategic resource for building credibility and gaining stakeholder support (Melewar et al., 2005). The RBV perspective classifies a company's reputation as a valuable and distinctive intangible resource that can help an organization gain competitive advantage. Therefore, RBV theory formulates that reputation can provide valuable results to stakeholders, which not only helps reduce uncertainty thereby reducing transaction costs (Fombrun et al., 2000b), but also produces superior performance (De Chernatony, 1999; Baden-Fuller and Ang, 2001; Kitchen and Laurence, 2003; Berens, 2004). These empirical results are also supported by other empirical studies which prove that there is a link and even a strong relationship between reputation and financial performance (Herremans et al., 1993; Roberts and Dowling, 2002; Toms, 2010).

From the various theoretical frameworks and empirical arguments above which show the relationship between symbolic capital and performance as well as the reciprocal (two-way) relationship between reputation and performance, a hypothesis can be formulated:

H5: Symbolic capital (reputation) is positively correlated with performance

Conceptually, financial performance is an element of internal (micro) fundamental factors, which consist of the company's expected profits in the future (Fuller and Jr. Farrell, 1987) and is an indicator that shows how good the company's position and efficiency is in using assets to obtain income and expand operations (Copisarow, 2000). Signalling theory is of the view that high financial performance is a positive signal regarding the hope of getting a high return from investment in the company, so that this signal will direct market players to invest by purchasing company shares at high prices (Leland and Pyle, 1977). The more market players willing to buy shares of a company will encourage an increase in trading volume or share liquidity, which ultimately affects the cost of equity (O'Hara, 2003).

Existing literature shows that high company performance can reduce uncertainty (Faulkender et al., 2006) so that the risks faced by shareholders are lower (Rehman and Zaman, 2011). At low levels of risk it will reduce the cost of equity capital (Faulkender et al., 2006; Rehman and Zaman, 2011). Therefore, investors set a low cost of equity in companies with high financial performance (Rappaport, 2006; Esmaeili and Sharifabadi, 2015) because better performance can build trust between shareholders and the company, thereby leading to a reduction in the cost of equity (Poshakwale and Courtis, 2005). This research's results align with other research showing that high company performance can reduce the cost of equity (Waddock and Graves, 1997; Rehman, 2010a). In particular, previous empirical studies suggest that businesses use return on assets as a proxy for measuring firm performance and the required rate of return on investment. The empirical results found that there is an inverse relationship between return on assets and the cost of equity, and the rate of return on assets is the best predictor for the cost of equity (Vázquez and Trombetta, 2007). Thus, a hypothesis can be formulated.

H6: Performance is negatively correlated with cost of equity

Corporate reputation is interpreted as an evaluation of the quality of the company (Love et al. , 2017) by stakeholders regarding the company's behavior compared to other companies and stakeholders' expectations regarding instrumental and normative practices (Deephouse and Carter, 2005; Deephouse et al. , 2016). Several previous literatures have demonstrated the role of mediation (Fombrun, 1996; Greening and Turban, 2000; Lai et al. , 2010; Galbreath and Shum, 2012; Saeidi et al., 2015; Pham and Tran, 2020; Xu et al., 2023) reputation in the relationship between CSR and performance. However, existing studies have relatively neglected the mediating role of reputation in modeling the relationship of SC with performance and cost of equity. The rationale for mediating reputation in the relationship between SC and performance and the cost of equity is based on several facts. First, SC and CSR are two sides of the same coin (Williams and Zinkin, 2010) . Therefore, conceptually SC involves procedures that are close to CSR (Hassan et al., 2021) or is a construct that has similarities to CSR, namely ethical investment (Aribi and Gao, 2011; Khan, 2016; Quttainah and Almutairi, 2017). Based on the similarity of SC and CSR, the implicit mediation of reputation in the relationship between CSR and performance can also be observed in the relationship between SC and performance and the cost of equity.

Second, most managers view reputation as one of the most important intangible assets (Hall, 1992, 1993; Chun, 2005), because a high reputation is associated with a lower cost of equity (Pfister et al., 2020) and there is a link between strong relationship between reputation and financial performance (Herremans et al., 1993; Roberts and Dowling, 2002; Toms, 2010). On the other hand, ethical issues are important for organizations to survive and build a good reputation (Daft and Marcic, 2012). The empirical arguments above indicate a trivariate relationship between business ethics, reputation, and criterion variables (performance and cost of equity).

Based on the arguments above, implicitly reputation may be an important mechanism in providing additional totals in the relationship between SC and performance and the cost of equity. Thus, it can be hypothesized:

H7: SC reduces cost of equity by improving reputation

H8: SC enhances performance by improving reputation

Apart from reputation, this study also places performance as a construct underlying the relationship between SC and the cost of equity. The rationality of performance mediation in the relationship between SC and performance is based on several facts. First, studies of the relationship between SC and equity capital cost are still need to be carried out (Karimov et al., 2020). As far as being observed, no studies on the relationship between SC and the cost of equity have been found in the Indonesian context. Therefore, whether SC impacts the cost of equity, particularly the mechanisms underlying this relationship, becomes an empirical issue that needs to be resolved. Second , previous empirical research shows a negative influence of CSR on the cost of equity (El Ghouli et al. , 2011) and an indirect relationship between CSR and the cost of equity (Breuer et al., 2018; Chen and Zhang, 2021). Considering that SC and CSR are not different in principle, substance, philosophy and form (Cheong et al., 2019), an indirect influence can be implicitly observed in the relationship between SC and the cost of equity capital. Third, performance is one of the main predictors that can influence market perceptions and on the

other hand, performance is a consequence of SC (Kr and Fu, 2014; Saba et al., 2021). This empirical argument indicates a trivariate relationship between SC, performance, and cost of equity. Thus, it can be hypothesized:

H9: SC reduced cost of equity by improving performance

RESEARCH METHOD

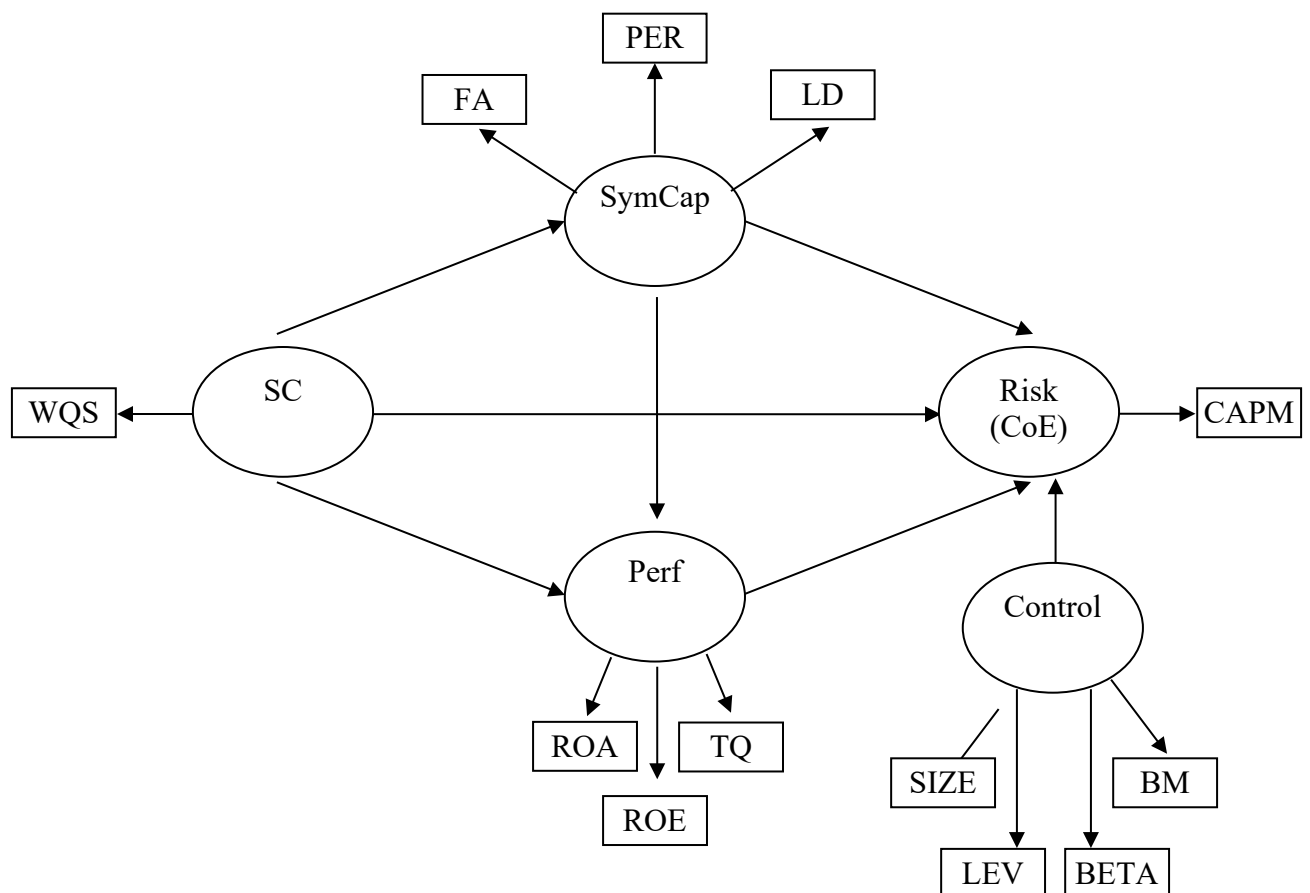
Sample and Data

The research sample includes all companies consistently listed in the Indonesian Sharia Stock Index (ISSI) from 2012 to 2022. After eliminating incomplete data, financial reports in foreign currency, companies that experienced suspension and delisting and were not actively traded, we obtained 81 companies. which is consistently recorded in ISSI. Thus, the total research observations were 891 observations. Data sources were obtained from the Indonesian Capital Market Directory (ICMD) financial and annual reports, company performance summaries, and the IDX Facts Book.

Conceptual Model

Conceptually, this research model is illustrated in Figure 1, as follows:

Figure 1. Conceptual Model



Description: SC = *Shariah Compliance*; SymCap = *Symbolic Capital (Reputation)*; Perf = *Performance*; CoE = *Cost of Equity*; WQS = *Weighted Quantitative Screening*; CAPM = *Capital Asset Pricing Model*;

FA = Firm Age; LD = Listing Date; PER = Price Earnings Ratio; ROA = Return on Assets; ROE = Return on equity; TQ = Tobin Q; BM = Book to Market; LEV = Leverage; Beta = Systematic Risk

Mathematical Model

Referring to the conceptual model and hypothesis formulation, the mathematical model of this research is stated as follows:

$$\text{Risk}_{i,t} = \beta_0 + \beta_1 \text{SC}_{i,t} + \beta_2 \text{SymCap}_{i,t} + \beta_3 \text{Perf}_{i,t} + \text{SC}_{i,t} * \text{EWCM}_{i,t} + \sum \text{Control}_{i,t} + \varepsilon_1 \quad \dots\dots\dots (1)$$

$$\text{SymCap}_{i,t} = \beta_0 + \beta_1 \text{SC}_{i,t} + \beta_2 \text{Perf}_{i,t-1} + \varepsilon_2 \quad \dots\dots\dots (2)$$

$$\text{Perf}_{i,t} = \beta_0 + \beta_1 \text{SC}_{i,t} + \beta_2 \text{SymCap}_{i,t} + \varepsilon_3 \quad \dots\dots\dots (3)$$

Variables and Measurement

Variables in this research include Shariah Compliance (SC), Cost of Equity (CoE), Performance, Symbolic Capital (Reputation), and Control Variables. The following are the measurement specifications for each variable.

Equity Cost of Capital (CoE)

The cost of equity capital is generally estimated based on 2 (two) approaches), namely ex-post and ex-ante. However, previous literature shows that the ex-post approach, such as the modified PEG ratio model (Easton, 2004), is an approach to estimating the cost of equity capital that is generally more consistent and can predict company-specific risks, so it is one of the most reliable proxies. to estimate the cost of equity (Botosan et al., 2011) . However, using the PEG ratio cannot be fulfilled in Indonesia because the EPS growth rate is relatively unstable. Therefore, this study uses a analysts forecast approach, namely the Capital Asset Pricing Model (CAPM), which is also used to calculate the cost of equity capital in the Indonesian capital market.

Shariah Compliance (SC)

By adopting and modifying the previous empirical approach (Satt *et al.*, 2020), SC is measured based on the weighted average value of 3 (three) *quantitative screening criteria*, namely a maximum *debt ratio* of 45% and a maximum *non - permissible income ratio* of 10% (Indonesian Criteria), as well as a maximum *cash ratio* of 33% (International Criteria).

Symbolic Capital (Reputation)

Measuring company reputation is divided into 2 (two) methods: qualitative and quantitative (Trotta and Cavallaro, 2012) . However, survey-based qualitative approaches (Kaur and Singh, 2018) tend to be inefficient (Brown and Perry, 1994; Fryxell and Wang, 1994; Tomak, 2014; Kaur and Singh, 2018), so to overcome their weaknesses (Tomak, 2014) the academics have developed various quantitative indicators that can replace each other (Kaur and Singh, 2018) including Firm Age (Diamond, 1991; Datta *et al.*, 1999; Padrón *et al.*, 2005; Sahudin *et al.*, 2011), Price Earning Ratio (Catuogno *et al.*, 2013), and Listing Date (Qu *et al.*, 2012; Fontaine and Zhao, 2013). Based on these quantitative measurements, this study uses Firm Age (FA), Price Earning Ratio (PER), and Listing Date (LD) as reputation proxies. The indicator formulation is as follows:

$$F_{i,t} = \text{Current Year}_{i,t} - \text{Incorporation Year}_{i,t}$$

$$PER_{i,t} = \frac{\text{Laba Bersih}_{i,t-1}}{\text{Weighted Average Number of Common Shares}_{i,t}}$$

$$LD_{i,t} = \text{Current Year}_{i,t} - \text{Listing Year}_{i,t}$$

Performance

To obtain a more detailed understanding, this study measures performance from 3 (three) perspectives: management perspective through ROA, shareholders through ROE, and the market perspective using the Tobin Q indicator. The use of the three indicators was formulated from several previous empirical research that used ROA, ROE, and Tobin Q as performance indicators (Hassan *et al.*, 2015; Mollah and Zaman, 2015; Platonova *et al.*, 2018; Jan *et al.*, 2019).

Control Variables

To prevent biased calculation results and avoid empirical model specification errors due to the possibility that other factors are thought to influence the dependent variable, so that they have the potential to interfere with the results of testing the independent variable on the dependent variable, by referring to previous studies the control variable in this study includes firm size, which is measured from the natural logarithm of market value (Pfister *et al.*, 2020; Chen and Zhang, 2021), book-to-market ratio (BM), leverage, beta (Hasan *et al.*, 2015; Pfister *et al.*, 2020; Chen and Zhang, 2021).

Data Analysis Techniques

This research model produces multiple mediations and some constructs are measured using more than one indicator. Therefore, PLS-SEM is a statistical analysis technique used for hypothesis testing, and data is processed using Warppls software.

EMPIRICAL RESULTS

The results of descriptive statistics from exogenous and endogenous variables are illustrated in table 1 below:

Table 1. Variable Descriptive Statistics

| Variable | Indicator | N | Mean | Min | Max | Std. Dev |
|-------------|-----------|-----|---------|---------|---------|----------|
| S.C | WQS | 891 | 0.468 | 0.004 | 2,279 | 0.338 |
| SymCap | F.A | 891 | 35,694 | 2,600 | 88,300 | 11,118 |
| | LD | 891 | 19,685 | 0.110 | 40,800 | 8,395 |
| | PER | 891 | 236,927 | -1043.4 | 8131.57 | 716,555 |
| CoE | CAPM | 891 | 0.072 | -0.033 | 0.300 | 0.022 |
| Performance | ROA | 891 | 0.107 | -0.279 | 7,061 | 0.461 |
| | ROE | 891 | 0.192 | -4,962 | 15,555 | 1,028 |
| | Tobin Q | 891 | 1,073 | 0.069 | 14,354 | 1,253 |
| Controls | Size | 891 | 28,234 | 21,897 | 33,608 | 2,174 |
| | BM | 891 | 1,812 | 0.020 | 40,054 | 2,683 |
| | Beta | 891 | 0.090 | -0.891 | 0.505 | 0.111 |
| | Lev | 891 | 0.140 | 0,000 | 0.559 | 0.122 |

Source : processed data

In table 1 consists of various financial and control indicators for a set of 891 observations. The main indicators include SC (WQS), reputation (FA, LD, PER), cost of equity (CAPM), and performance (ROA, ROE, Tobin Q). The data showed that the mean values ranging from 0.072 to 236,927 for main variables. The mean values for control variable ranging from 0.090 to 28, 234. The minimum and maximum values for this variable ranging from 0,000 to 21,897 and from 0,505 to 40,054, respectively. The standar deviation values also provided in Table 1.

Inferential statistics include (a) evaluation of the outer model which includes validity tests (convergent and discriminant) and reliability, as well as (b) evaluation of the structural model (inner model) which includes testing (1) the significance of the relationship between constructs; (2) adjusted R²; (3) effect size (f²); (4) Goodness of Fit (GoF); and (6) Q² predictive relevance. In table 2 and 3 it is known that the testing for validity based on the loading factor and Average Variance Extracted (AVE) meet the required criteria. Therefore, the correlation between indicators and their constructs, or latent variables, confirms convergent validity. In table 4 it is known that the discriminant validity was tested using the square root value of AVE for each construct (values in brackets) is greater than the correlation value between other constructs (values below the AVE square root value). Thus, the combined indicators are not unidimensional. Additionally, internal consistency reliability as illustrated in table 5 shows that the composite reliability and cronbach's alpha coefficient of each construct meets the criterion set at > 0.7. Therefore, it can be declared that all construct were reliable. Based on validity and reliability testing, the overall indicators and constructs of this study are valid and reliable.

Table 2. Validity Based on Loading Factor

| Construct | Indicator | Mark Loading | Criteria | P- value | Conclusion |
|------------|-----------|--------------|----------|----------|---|
| SC | WQS | 1,000 | >0.7 | <0.001 | Cannot be tested because only 1 indicator |
| SymCap | F.A | 0.851 | | <0.001 | Fulfil |
| | LD | 0.893 | | <0.001 | Fulfil |
| | PER | 0.617 | | <0.001 | Can be considered |
| Perf. | ROA | 0.970 | | <0.001 | Fulfil |
| | ROE | 0.965 | | <0.001 | Fulfil |
| | Tobin Q | 0.659 | | <0.001 | Can be considered |
| Risk (CoE) | CAPM | 1,000 | | <0.001 | Cannot be tested because only 1 indicator |
| Controls | Size | 0.933 | | <0.001 | Fulfil |
| | BM | 0.806 | | <0.001 | Fulfil |
| | Beta | 0.680 | | <0.001 | Can be considered |
| | Lev | 0.635 | | <0.001 | Can be considered |

Source: output Warlppls

Table 3. Validity Based on AVE

| Variable | AVE | Criteria | Conclusion |
|-------------|-------|----------|---|
| SC | 1,000 | >0.5 | Cannot be tested because only 1 indicator |
| SYMCAP | 0.565 | | Fulfill |
| PERFORMANCE | 0.694 | | Fulfill |
| RISK (CoE) | 1,000 | | Cannot be tested because only 1 indicator |
| CONTROL | 0.500 | | Can be considered |

Source: output Warlppls

Table 4. Correlation between Latent Variables and Square Root AVE

| | S.C | SymCap | Perf. | Risk_CoE | Controls |
|----------|---------|---------|---------|----------|----------|
| SC | (1,000) | | | | |
| SymCap | 0.155 | (0.751) | | | |
| Perf | 0.283 | 0.189 | (0.833) | | |
| Risk_CoE | -0.042 | -0.031 | 0.050 | (1,000) | |
| Controls | 0.200 | 0.048 | 0.393 | -0.045 | (0.707) |

Source: output Warlppls

Table 5. Internal Consistency Reliability

| Variable | Cronbach 's alpha | Composite Reliability Coefficients | Criteria | Conclusion |
|-------------|-------------------|------------------------------------|----------|---|
| SC | 1,000 | 1,000 | >0.7 | Cannot be tested because only 1 indicator |
| SymCap | 0.779 | 0.781 | | Fulfil |
| Performance | 0.744 | 0.862 | | Fulfil |
| Risk_CoE | 1,000 | 1,000 | | Cannot be tested because only 1 indicator |
| Controls | 0.795 | 0.707 | | Fulfil |

Source: output Warlppls

To examine the hypotheses, The overall test results of the relationship between constructs, the significance of the influence of exogenous variables on endogenous ones, and the strength of the relationship among variables are shown in Figure 2 and table 6.

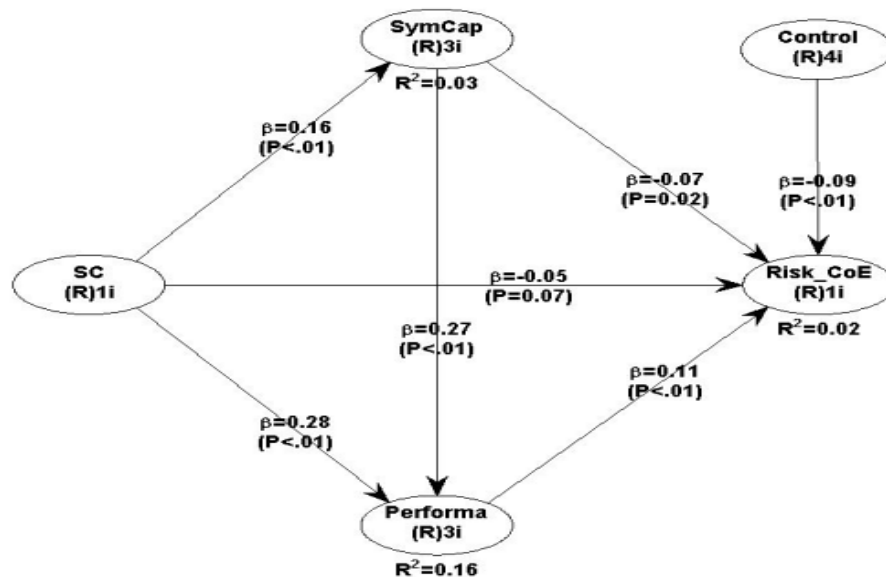


Figure 2. Path Coefficient and P - Value

Source: output Warlppls

Table 6. Significance Test

| Hypothesis | Path | Path Coefficient | P-Value | Connection | Conclusion |
|------------|---------------|------------------|---------|------------|-----------------|
| H1 | SC → Risk_CoE | -0.050 | 0.066 | Negative | Not significant |
| H2 | SC → SymCap | 0.162 | < 0.001 | Positive | Significant |

| Hypothesis | Path | Path Coefficient | P-Value | Connection | Conclusion |
|------------|------------------------|------------------|---------|------------|-------------|
| H3 | SC → Performance | 0.280 | < 0.001 | Positive | |
| H4 | SymCap → Risk_CoE | -0.070 | 0.018 | Negative | Significant |
| H5 | SymCap → Performance | 0.270 | < 0.001 | Positive | |
| H6 | Performance → Risk_CoE | 0.109 | < 0.001 | Positive | |
| H7 | Control → Risk_CoE | -0.086 | 0.005 | Negative | Significant |

Source: output Warlppls

The findings reveal that SC is negatively correlated with cost of equity with a path coefficient of - 0.050 ($p = 0.066$ or insignificant). Therefore, the first hypothesis is rejected. This results do not support previous empirical research which found that companies operating in environmentally sensitive industries, such as the cigarette industry, have high costs of equity capital (El Ghouli *et al.*, 2011) and investors generally charge high levels of return on *sin* stocks, such as alcohol and tobacco (He *et al.*, 2013). SC does not significantly affect the cost of equity, possibly due to (1) the higher corporate risk premium which result in higher estimated expected return of investments and thus unable to drive a significant reduction in the cost of equity; (2) the low level of corporate cash holding reduces the company's effectiveness in generating maximum sales due to the low level of working capital investment. As a result, the company's profits are low. From the market perspective, this situation cannot be a signal of growth opportunities for the company so that rational investors will certainly look for the expected rate of return from other investments with commensurate risk or the company's shares will become illiquid. The low liquidity could not significantly reduce the cost of equity.

From figure 2 and table 6 are also known the significance of the relationship between other variables. **First**, SC has a significant positive effect on reputation. Thus, hypothesis 2 is accepted. This estimation is in line with previous empirical findings which show that ethical screening on SC improves the company's reputation because it provides more value to shareholders and lower risk (Yuen *et al.*, 2017) and the implementation of financial screening on SC (cash holding and leverage) have an impact on financial stability and strength thereby increasing reputation (Durand *et al.*, 2013). This finding also shows that the Sharia proxy as measured by WQS (*weighted quantitative screening*) has a valid impact on reputation. **Second**, SC is positively correlated with performance with a path coefficient of 0.280 ($p < 0.001$). Therefore, hypothesis 3 is accepted. This result add to several previous empirical evidence which confirms that complying with Sharia law has a positive impact on company performance (Kr and Fu, 2014) because the implementation of *sector screening* is seen as a healthy business practice that encourages accountability, transparency, and fairness so that it has an impact on SC performance (Phipps, 2012), and the enforcement of *quantitative screening* can provide fairness in business, transparency and accountability, which is effectively encouraging and producing large financial benefits for SC (Pepis and de Jong, 2019). This finding also shows that the Sharia proxy as measured by WQS (*weighted quantitative screening*) has a valid impact on symbolic capital (reputation).

Third, reputation is negatively correlated with cost of equity with a path coefficient of - 0.070 ($p = 0.018$ or significant). Thus, hypothesis 4 is accepted. The negative impact of reputation on the cost of equity means that the higher the reputation, the lower the cost of equity. This estimation result is in line with previous empirical research which revealed that a higher level of reputation is associated with a lower cost of equity (Pfister *et al.*, 2020) because a high reputation can attract attention and increase investors' awareness of company shares, thereby increasing share liquidity and ultimately leading to a reduction in the cost of equity capital (Cao *et al.*, 2015). **Fourth**, reputation has a significant positive effect on performance. Therefore,

hypothesis 5 is accepted. This result support the RBV which translates reputation as an intangible resource that is very valuable and distinctive so that it can produce superior performance (De Chernatony, 1999; Baden-Fuller and Ang, 2001; Kitchen and Laurence, 2003; Berens, 2004; Brammer and Millington, 2005). These empirical results are also supported by other empirical studies proving a link and even a strong relationship between reputation and financial performance (Herremans *et al.*, 1993; Roberts and Dowling, 2002; Toms, 2010).

Fifth, performance has a significant positive effect on the cost of equity. The result of this estimation contradict the hypothesis formulation, which predicts a negative relationship between performance and the cost of equity. Thus, hypothesis 6 is rejected. The positive relationship between performance and the cost of equity capital can be interpreted as the higher the performance, the higher the company's cost of equity. This result contradict the theoretical studies of signaling and previous empirical studies (Billett and Rynngaert, 1997; Poshakwale and Courtis, 2005; Faulkender *et al.*, 2006; Rappaport, 2006; Vázquez and Trombetta, 2007; Rehman and Zaman, 2011; Chen *et al.*, 2012; Esmaeili and Sharifabadi, 2015; Abbas *et al.*, 2018) which states that high financial performance can reduce the company's cost of equity. One of the several factors cause the positive relationship between performance and the cost of equity possibly due to the relatively low company performance has. Descriptive statistics show that on average company performance as proxied by ROA, ROE, and Tobin Q is relatively low.

In market view, the company's low economic performance signals *bad news* and in such situations generally rational investors will demand a higher rate of return in line with the risks faced, which indicates a high cost of equity capital. **Sixth**, the control variables are proxied by *size*, *leverage*, *BM*, and *beta* is negatively correlated to the cost of equity with a coefficient value of -0.086 ($p = 0.005$). Even though the control variables significantly influence the cost of equity capital, the ability of all exogenous variables to explain variations in the cost of equity capital is very limited or in the low category (1.5%). This result indicate that other factors predominantly influence the cost of equity.

Adjusted R² and Effect Size (f²)

Variations in predictor variables influence the criterion variable and the effectiveness of predictor variables influences the criterion variable at the structural level (effect size) is illustrated in table 7 below.

Table 7 Adjusted R² and Effect Size (f²)

| Construct | Adjusted R ² | Effect Size | | Rule of Thumb | Conclusion |
|-------------|-------------------------|-------------------------|-----------------|--|------------|
| | | Construct Relationships | Estimated Value | | |
| SymCap | 0.025 | SC → SymCap | 0.026 | ≥0.02 small ≥0.15 intermediate ≥0.35 big | Small |
| Performance | 0.156 | SC → Performance | 0.082 | | Small |
| Risk_CoE | 0.015 | SC → Risk_CoE | 0.002 | | Very small |
| | | SymCap → Performance | 0.076 | | Small |
| | | SymCap → Risk_CoE | 0.004 | | Very small |
| | | Performance → Risk_CoE | 0.007 | | Very small |
| | | Control → Risk_CoE | 0.006 | | Very small |

Source: output Warlppls

From table 7, it is known that the adjusted R²SymCap (reputation) is 0.025. This coefficient means that the variation in SC in influencing reputation is 2.5% and variables outside the research model influence the remaining 97.5%. Meanwhile, the adjusted R² performance and

cost of equity capital (Risk_CoE) are 0.156 and 0.013 respectively. The performance coefficient of 0.156 means that variations in SC and reputation influence performance by 15.6% and the rest is influenced by other factors. Meanwhile, the *adjusted* R² coefficient for the cost of equity capital is 0.013, indicating that variations in SC, reputation and performance influence the cost of equity capital by 1.3% and other constructs influence the remainder. Overall, the variation in predictor variables influencing the criterion variable is relatively low. Likewise, the effectiveness of the predictor variables influencing the criterion variables at the structural level (effect size) is classified as very low.

Goodness of Fit (GoF) and Predictive Relevance (Q²)

The model feasibility test index and *predictive relevance* are illustrated in table 8 below.

Table 8. Goodness of Fit (GoF) and Predictive Relevance (Q²)

| Goodness of Fit | | | Predictive Relevance | | |
|--------------------------------|--------------------|-----------------------------------|----------------------|-------------|----------------|
| Index | Parameter | Rule of Thumb | Construct | Coefficient | Rule Practical |
| Average Path Coefficient (APC) | 0.146 P < 0.001 | Acceptable if P < 0.05 | SymCap | 0.028 | Good if >0 |
| Average R-squared (ARS) | 0.068 P < 0.010 | | Performance | 0.158 | |
| Average Block VIF (AVIF) | 1,060 | Acceptable if ≤5, ideally ≤3.3 | Risk_CoE | 0.020 | |

Source: output Warlppls

From table 8 it is known that all GoF parameters meet the criteria, so the research model is fit. Likewise, how good the model produces the observation value (predictive relevance) shows a coefficient of >0.05. Thus, the predictive relevance of the model is good.

Mediation Test

Testing the mediation construct in this study uses a causal step approach (Baron and Kenny, 1986). The technical procedure for mediation testing based on the causal step approach includes sequential stages. **First**, the independent variable must significantly predict the dependent variable (resulting in a coefficient c); **Second**, the independent variable must significantly predict the mediating variable (resulting in a coefficient); **Third**, estimate the effect of the mediating variables and independent variables on the dependent variable. The estimation produces 2 (two) predicted values, namely the predicted value of the mediating variable on the dependent variable (resulting in coefficient b) and the predicted value of the independent variable on the dependent variable (resulting in coefficient c'). Based on this stage, it is called full mediation if the relationship between the dependent variable and the independent variable becomes insignificant after being controlled by the mediating variable. It is called partial mediation if the relationship between the independent variable and the dependent variable remains significant after being controlled by the mediating variable, and there is a decrease in the effect of the independent variable on the dependent variable.

From the empirical model, there are 3 (three) mediation effects, namely (1) reputation mediation in the SC and CoE relationship; (2) mediation of reputation in the relationship between SC and performance, and (3) mediation of performance in the relationship between SC and CoE. The results of the mediation effect test on each relationship between constructs based on the causal step approach technical procedure are as follows:

- a) The direct influence of SC on CoE and performance before the mediating variable (reputation) is included into the model, is illustrated in Figure 3 and Figure 4 below:

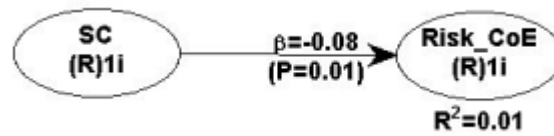


Figure 3. Direct Effect of SC on Risk (CoE)

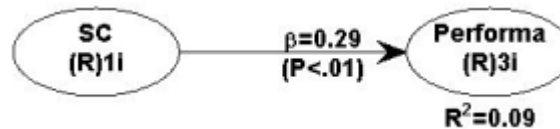


Figure 4. Direct Effect of SC on Performance

Figure 3 and Figure 4 show that the significance (*p*-value) of the influence of SC on risk (cost of equity) and performance is 0.01 and 0.001, respectively. This result indicates that the first condition of the causal step approach procedure is met.

- b) The influence of SC on mediation (reputation and performance) is illustrated in Figure 5 below:

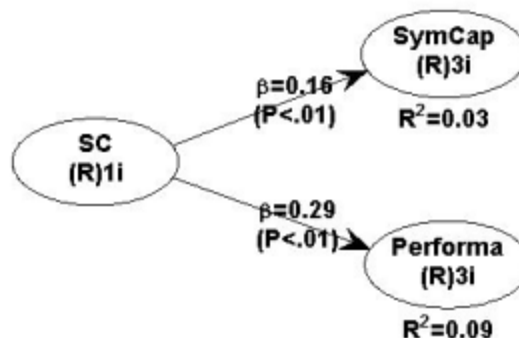


Figure 5. Direct Influence of SC on Mediation (Reputation and Performance)

From Figure 5, it is known that the significance (*p*-value) of the influence of SC on the mediation construct (reputation and performance) is < 0.001 . This result shows that the second condition of the causal step approach procedure is met.

- c) The estimated influence of the independent variable (SC) on the dependent variable (cost of equity) after being controlled by the mediation construct (figure 2) shows a coefficient of -0.050 and it is not significant ($p = 0.066$). Therefore, reputation and performance perfectly mediate the relationship between SC and the cost of equity (full mediation). However, in particular, the performance mediator acts as a suppressor variable because it produces a negative total effect. Therefore, it can be said that performance mediation in the SC and CoE relationship is an inconsistent mediation model because it produces a negative (total additional) effect. From Figure 2 it is also known that after being controlled by the mediation construct (reputation), the effect of SC on performance remains significant with a coefficient of 0.280 ($p < 0.001$) and there is a decrease in the

effect of SC on performance. Thus, reputation partially mediates the influence of SC on performance. Therefore, hypothesis 10 is accepted.

Full mediation of reputation can be interpreted that there is no direct relationship between SC adoption and the cost of equity capital and conversely SC and the cost of equity capital have an indirect effect through reputation. The indirect relationship between SC and the cost of equity capital means that SC can only influence the cost of capital with a good reputation. These empirical results are not in line with previous empirical studies which show SC has a direct effect on the cost of equity capital (Karimov *et al.*, 2020) but confirm previous empirical studies which argue that findings in developed countries do not always prove to be the same in developing countries (Kamal, 2011). Thus, hypotheses 8 and 9 are accepted. Thus, hypothesis 8 is accepted. On the other hand, the result of this study show that performance mediates the influence of SC and the cost of equity capital but is inconsistent because it produces a negative (total additional) effect. This research also shows that reputation partially mediates the relationship between SC and performance. Partial mediation means that SC can influence the cost of equity capital without involving performance. This result validate previous empirical studies showing the mediating role of reputation in the relationship between business ethics and performance (Fombrun, 1996; Greening and Turban, 2000; Lai *et al.*, 2010; Galbreath and Shum, 2012; Saeidi *et al.*, 2015; Pham and Tran, 2020).

Both full and partial mediation were found to prove the main objective of this research, namely that risk can be managed or cost of equity can be reduced through at least 2 (two) factors by building reputation and improving performance.

Conclusions

This research is focused on empirical testing of extra variables in the relationship model of Islamic Ethical Practice dimensions (SC adoption) and risk, which is proxied by the cost of equity capital. The rationality of testing contingent factors in the relationship between SC and the cost of equity capital is based on several research gaps: (1) the knowledge gap in the relationship model between SC and the cost of equity. As far as being observed, investigating the relationship between SC and the cost of equity in developing countries is scarce, especially Indonesia. Therefore, whether and how the influence of SC and the cost of equity capital is still ambiguous; (2) evidence gap. Indonesian Sharia quantitative screening is more liberal and simple than developed countries, so the influence of SC and the cost of equity can produce a dual effect and different significance. Therefore, it is necessary to build a more comprehensive system to explain the influence of SC on the cost of equity capital by formulating mediating variables. Based on the research gap, this study implements symbolic capital (reputation) and performance as mediation in the relationship between SC and the cost of equity.

The results reveal that the link between SC and cost of equity is fully mediated relationship, which indicates that SC can only affect the cost of equity with good reputation and by improving performance. These results provide several contributions to the Islamic finance, both theoretically and practically. Theoretically, this study contributes to accommodating the ambiguity of the role of SC in explaining the cost of equity. It expands the Islamic finance literature by investigating how SC effects the cost of equity capital. Practically, these findings provide several contributions to companies, including (1) Full mediation of reputation and performance in the relationship between SC and the cost of equity shows that building reputation and improving performance are important aspects for companies in efforts to manage risk or reduce the cost of equity; (2) The significance of testing hypotheses 2 and 3 provides input to company management that consistently applying Islamic principles in business activities can improve reputation and performance; (3) The significance of testing

hypotheses 4 and 7 provides input to company management to strive to improve reputation and performance by increasing PER (Price Earning Ratio) and operational profit or operational cost efficiency.

The findings of this research also provide several contributions to investors, including (1) Full mediation of reputation in the relationship between SC and the cost of equity and partial mediation of reputation in the relationship between SC and performance indicating that the company can produce intangible assets. Therefore, investors can consider to invest in SC companies; (2) The significance of hypothesis 5 indicates that the higher the reputation, the higher the performance. Based on these empirical results, investors can choose securities from companies with a high reputation with several alternatives such as those that have a high PER or securities that are already well established.

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