

## Zakah as Intervening Variable in Enhancing Sharia Bank in Indonesia

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### ABSTRACT

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The purpose of this study aims to reveal confidence in Islamic financial institutions as an institution that operates based on sharia principles to provide public welfare with four disclosure indicators, namely Islamic corporate social responsibility, Islamic corporate governance, zakah funds, and financial performance. This study elaborated path analysis calculations to gain a deep understanding on the provided issues. The population in this study included data on the publication of annual financial reports on Islamic banks in Indonesia which are registered with the Financial Services Authority (OJK) with a total of 14 Islamic banks, while the samples were selected according to the provisions of the purposive sampling method. The findings of this study indicate that partially Islamic, corporate social responsibility, Islamic corporate governance, and zakah funds have a positive and significant effect on financial performance. Also, Islamic corporate social responsibility and Islamic corporate governance have a positive and significant effect on financial performance through zakah funds.

**Keywords:** Islamic corporate social responsibility, Islamic corporate governance, zakah funds, financial performance.

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### INTRODUCTION

The existence of Islamic financial institutions, in reality, is not based on mere profit considerations, but there is a strong desire of Muslims to determine financial services according to sharia principles, namely financial institutions that are free from usury, *maysir*, and *gharar*. The motive for this research framework is the presence of sharia finance which is growing rapidly in various countries. This study exclusively examines one of the instruments of Islamic financial institutions, namely Islamic corporate social responsibility and Islamic corporate governance.

Islamic corporate social responsibility is a concept of corporate social responsibility that is based on an Islamic economy which is the basis for disclosing Islamic financial institutions in increasing public trust and being more oriented as the responsibility to Allah (Aracil, 2019). Islamic corporate governance in the principles of sharia is manifested through a sharia framework in conducting business regarding justice and equality for the benefit and orientation of Allah as the sole authority and authority in the world, which is supervised by the Sharia Supervisory Board as the sharia supervisory and supervisory board.

The principle of Islamic corporate social responsibility is closely related to Islamic corporate governance. Like two sides of a coin, advantages have a strong ranking in world business Murwaningsari (2009). One side of the interest in the interests of the shareholders (shareholder) and the other hand emphasizes the interests of stakeholders, including the community and the environment. Both of them have important roles and cannot be separated Yusuf (2017). This is supported by the development of the Islamic finance industry globally showing a positive trend. Shown by The Islamic Finance Development Report 2018 issued by Thomson Reuters states the Islamic financial institution industry grows from year to year by 11 percent to US \$ 2.4 Trillion, from total assets of US \$ 2.4 Trillion in 2017. As much as 71 percent or amounting to the US \$ 1721 billion is an asset of Islamic Banking.

Thus, researchers need to dissect the factors of social responsibility and governance that affect the financial performance of Islamic banks. The mass formulation of this study is as follows: (1) how does corporate social responsibility influence the financial performance of Islamic banks? (2) How is the influence of Islamic corporate governance on the financial performance of Islamic banks?; (3) How is the effect of zakah funds on the financial performance of Islamic banks?; (4) How is the influence of Islamic corporate social responsibility on the financial performance of Islamic banks through zakah funds?; (5) How does Islamic corporate governance affect the financial performance of Islamic banks through zakah funds?

## LITERATURE REVIEW

According to Hendratmoko and Muid (2017) Islamic corporate social responsibility emphasizes a spiritual approach as the basis for the company's obligation to have a social responsibility to the surrounding environment, both the natural environment and the community. Meanwhile, according to Arifin and Wardani (2016) Islamic corporate social responsibility is the concept of social responsibility that does not only include corporate responsibility to society. Financial institutions that are established based on sharia principles are required to be accountable for their business activities to Allah. Bonn and Fisher (2005) stated that corporate social responsibility is a point of every company that cannot be ignored and is an important part of corporate strategy.

Additionally, Hasan (2011) explained that the concept of Islamic corporate governance in Islamic financial institutions refers to relevant Islamic principles and ethics such as the prohibition of *usury*, *maysir*, *gharar*, implementing behavior that upholds justice, openness, confidentiality, healthy competition, and fair wages. Effendi (2009) also states that the existence of the sharia board as a sharia advisory and supervisory board is the key to implementing good corporate governance to improve financial performance in sharia financial institutions. Meanwhile, Syukron (2013) stated that the implementation of corporate governance in Islamic banking is an obligation. This obligation is a mandate of the Indonesian Article 34 of Law No. 21 of 2008 concerning Islamic Banking, which requires Islamic banking to implement corporate governance.

Ali (2006) defines zakah as one of the pillars of Islam which is a religious obligation that is imposed on one's assets according to certain rules. Wahyudi (2015) states that the higher the zakah funds issued by the company, the greater the profit the company gets. Meanwhile, Qardhawi (2002) explains that zakah is one of the umpteenth Islamic social teachings that is oriented towards the benefit of humanity, the role of zakah to alleviate poverty and help the poor. Therefore, professional management of zakah funds is the main requirement.

Jumingan (2014) defines that the financial performance of a bank is a description of the financial condition of a bank in a certain period, both regarding the aspects of raising funds and channeling funds which are usually measured by indicators of capital adequacy, liquidity, and bank profitability. In this study, financial performance is proxied by the financial ratio of return on assets as explained by Harahap (2015) in his study mentioned that return on assets is a ratio

engaged to measure the net profit obtained from the use of assets. Meanwhile, Pandia (2012) in the study remarked that return on assets is used to measure the ability of company management to gain overall benefits.

## METHOD

The population in this study includes data on the publication of annual financial reports on Islamic banks in Indonesia which are registered with the Financial Services Authority (OJK) with a total of 14 Islamic banks. The samples were selected according to the provisions of the purposive sampling method with the following criteria: (1) Islamic banks operating in Indonesia that are registered with the OJK; (2) Islamic banks that consistently present published annual financial reports from 2013 to 2017; (3) Islamic bank annual reports are available in Indonesian and English. To determine a sample of 12 Islamic banks consisting of Bank *Muamalat* Indonesia, Bank Rakyat Indonesia *Syariah*, Bank Negara Indonesia *Syariah*, Bank *Syariah Mandiri*, Bank Central Asia *Syariah*, Bank Mega *Syariah*, Bank *Syariah Bukopin*, Bank Panin *Syariah*, Maybank *Syariah* Indonesia, Bank Victoria *Syariah*, Bank Aceh *Syariah*, and Bank *Jabar Banten Syariah*.

This study uses the secondary data documentation method from the publication of annual Islamic bank financial reports in the period 2013 to 2017. Departing from the formulation of the problem, the research data analysis tool is regression analysis which will be followed by path analysis which integrates time series data using application assistance tools. SPSS software. 21.0.

## RESULTS AND DISCUSSION

### Hypothesis testing

Hypothesis testing is to determine the overall coefficient and is used to test the joint effect of ICSR, ICG, zakah funds on financial performance using ROA as a proxy. Using the t-table with a significance level of 0.05, the t-table value was obtained at 1.998.

**Table 1.** Hypothesis Test

Model	Standardized Coefficients Beta	t	Sig.
(Constant)		2.275	0.005
ICSR	0.361	3.319	0.000
ICG	0.571	5.195	0.003
Zakah	0.940	21.459	0.010

Based on the Table 1, it can be stated that:

- The ICSR  $t_{\text{count}}$  value is 3,319. The comparison of the two results in a value of t count greater than  $t_{\text{table}}$ , which is  $3.329 > 1.998$ . Thus, it can be concluded that ICSR has a positive and significant effect on financial performance by proxying ROA.
- The  $t_{\text{count}}$  value is 5,195. The comparison of the two results in  $t_{\text{count}}$  greater than  $t_{\text{table}}$ , namely  $5,195 > 1,998$ . Thus, it can be concluded that ICG has a positive and significant effect on financial performance proxied by ROA.
- The  $t_{\text{count}}$  of zakah funds is 21,456. The comparison of the two results in a value of  $t_{\text{count}}$  greater than  $t_{\text{table}}$ , namely  $21.456 > 1.998$ . Therefore, it can be concluded that zakah funds have a positive and significant effect on financial performance proxied by ROA.

Path analysis is used to determine the direct and indirect effects of the ICSR, ICG, zakah, and financial performance (ROA) variables. The results showed that ICSR affected financial performance (ROA), meaning that if the ICSR had an additional 1%, it would increase financial performance (ROA) by  $\beta = 0.361$  or 36.1%; (2) ICSR affects zakah funds, meaning that if the ICSR increases by 1%, it will increase zakah funds by  $\beta = 0.596$  or 59.6%; (3) and zakah funds affect

financial performance (ROA), meaning that if the zakah fund has an additional 1%, it will increase financial performance (ROA) by  $\beta = 0.940$  or 94.0%. Thus, ICSR has an indirect effect on financial performance (ROA) through zakah funds with  $\beta = 0.361 + (0.359 \times 0.940) = 0.698$ .

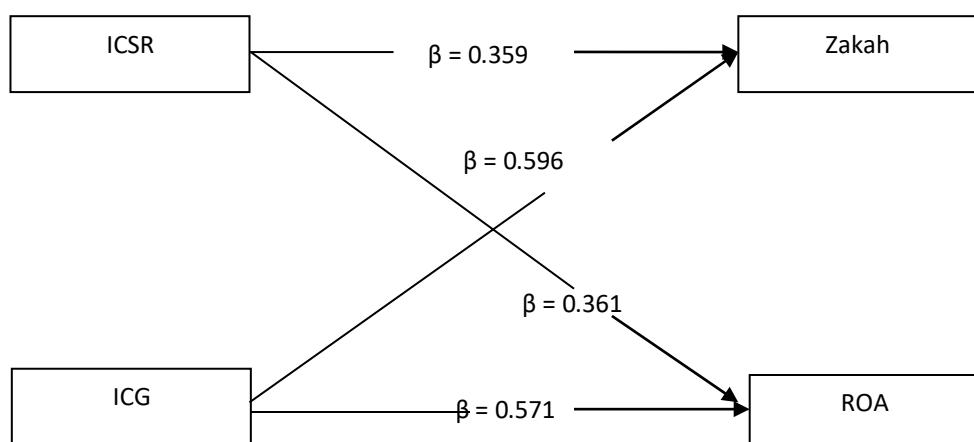


Figure 1. Path Analysis

Then it was explained that ICG affected financial performance (ROA), meaning that ICG had an increase of 1 percent, it would increase financial performance (ROA) by  $\beta = 0.571$  or 57.1 percent; (2) ICG affects zakah funds, meaning that if ICG increases by 1 percent, it will increase zakah funds by  $\beta = 0.596$  or 59.6%; (3) if the zakah fund has an additional 1 percent, it will increase financial performance (ROA) by  $\beta = 0.940$  or 94.0 percent. Thus, ICG has an indirect effect on financial performance (ROA) through zakah funds with  $\beta = 0.361 + (0.359 \times 0.940)$ .

## Discussion

Atmaja (2012) Islamic corporate social responsibility refers to business practices that have an ethical responsibility in Islam, companies incorporate Islamic religious norms which are marked by a commitment to sincerity in social contracts in their business. So that disclosure in Islamic banking will affect financial performance. This is reinforced by research by Thahirah et al. (2016) which states that the disclosure of ICSR is important for Islamic financial performance. Islamic financial institutions that disclose the ICSR properly will be seen as an entity that the Muslim community can trust in channeling their funds. This shows that the ICSR initiative can be used as a business strategy by companies in facing the demands of fierce business competition to improve the financial performance of Islamic financial institutions.

According to Effendi (2009), Islamic corporate governance can be defined as a set of systems that regulate and control a company to create value-added. This is because ICG can encourage the formation of a clean, transparent, and professional management work pattern. The existence of the Sharia Supervisory Board as a sharia advisory and supervisory board is a key aspect of implementing good corporate governance to improve the financial performance of Islamic banking as an Islamic financial institution.

It is reinforced by the theory of Nor (2014) which states that the existence of the Sharia Supervisory Board will make Islamic banks in operational activities and in launching products more compliant with sharia principles. Therefore, the Islamic community has the view that they will prefer investing in Islamic banks. Zakah fund is one of the concepts in a company that is very attached to sharia banking, wherein carrying out the company's operations it is not only to get profits targeted by management in the short or long term but all aspects both external and internal to the company need to be considered. Ali (2006) states in his theory that the

relationship between social and corporate financial performance is positive. The survey confirms that caring for the social environment will not cause the company to suffer losses.

Reinforced by Ilmi (2011) research, zakah funds can function as a motivator for obtaining company profits, so that basically if a company is oriented towards zakah, it is oriented to the financial performance of the company as a whole. This is because to increase the zakah capacity of companies, they must first improve their company's financial performance.

Islamic corporate social responsibility or ICSR does not only cover corporate responsibility towards society but also includes corporate responsibility towards Allah SWT. Companies are considered to have a responsibility to others, including society and the environment because they are entities that have a relationship with God, society, and stakeholders. Therefore, to obtain divine pleasure, companies must comply with Islamic rules and regulations.

Muhamad et al. (2012) revealed in their research that the stronger the influence of zakah funds on Islamic commercial banks in Indonesia, the stronger the relationship between Islamic corporate social responsibility and financial performance can develop so that people believe in Islamic banking through zakah funds distributed to the public. Larbsh (2015) Islamic corporate governance must refer to business ethics and Islamic economic and financial principles, including those related to the commandment of zakah, prohibition of usury, prohibition of speculation, and orders to develop an economic system based on profit and loss sharing.

This is reinforced by Indra (2017) saying that Islamic banking is required to work by the principles and ethics of sharia business by implementing transparent and accountable governance. The implementation of Islamic corporate governance in Islamic banks will provide an indication and impression to the public that Islamic financial institutions are protected from fraudulent practices. By distributing zakah funds, it will add positive value to Islamic banking companies.

## **CONCLUSION**

Some of the substantial extractions of the findings from the analysis are First, there is a positive and significant influence between Islamic corporate social responsibility on financial performance. These results indicate that Islamic corporate social responsibility can have a positive effect and provide attractiveness to financial performance so that it can improve the financial performance of Islamic banks. Second, there is a positive and significant influence between Islamic corporate governance on financial performance. With this, it can be concluded that Islamic corporate governance can improve the financial performance of Islamic banks. Third, there is a positive and significant influence between zakah funds on financial performance.

This illustrates that the more zakah funds are distributed, the more financial performance will increase. Fourth, there is a positive and significant influence between Islamic corporate social responsibility on financial performance through zakah funds. Fifth, there is a positive and significant influence between Islamic corporate governance on financial performance through zakah funds. Analysis in improving the financial performance of Islamic banking does not only use Islamic corporate social responsibility, Islamic corporate governance variables. Of course, many other factors affect financial performance, such as intellectual ethical identity, intellectual capital, and Islamic investment ratio. Therefore, researchers suggest that further researchers use other factors that have not been used in this study.

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