The association between islamic bank perfomance and islamic social responsibility in supporting SDGs: the different between Indonesia and Malaysia

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Abstract. This study examines the association between Islamic banks' financial performance and the level of Islamic Social Responsibility (ISR) in supporting SDGs. The financial performance is measured by Islamic specific financial performance, including profit sharing financing ratio, zakat performance ratio, equitable distribution ratio, and director employee welfare ratio. The ISR disclosure is measured based on the Accounting and Auditing Organization for Islamic financial (AAOIFI) Governance Standard (GS) 1 and GS 7, consisting of 75 components of exposure in Islamic banks from Indonesia and Malaysia for the 2014- 2018 period. This study uses regression analysis. From the analysis of the 90 annual reports, it was found that the level of ISR disclosure in Indonesia and Malaysia had diversity and superiority respectively over the dimensions of ISR disclosure. The content analysis results show that Indonesian Islamic banks have an average total superior exposure of 54% compared to Malaysian state Islamic banks of 47%. Regression tests prove a positive association between profit-sharing financial ratio and zakat performance ratio and the level of ISR disclosure. While the association between the equitable distribution ratio and director employee welfare ratio and the level of ISR disclosure is not proven.

1. Introduction

Corporate social responsibility and social reporting are important issues for many companies due to public awareness of its impact on society and the environment, as well as the SDGs. This encourages more companies to be involved in reporting responsibilities to avoid activities that do not have a social license [1]. G250 (250 largest companies globally) shows how important information related to social responsibility is through their annual financial reports for 2011-2017 [2]. In 2017, around 78% of these companies made disclosures related to CSR reports. This is unbelievable considering that social responsibility, as outlined in the annual report, plays an essential role in global business through increasing corporate transparency, developing the corporate image, and providing useful information for investors [3][4][5].

Islamic banks represent a new wave of corporations whose social goals are at least as important as making a profit [6]. The Islamic banking sector is a financial institution that dominates the Islamic financial industry [7]. Because Islamic banks' objectives also include profit-seeking and social goals, it is essential to disclose CSR based on sharia principles in the annual report of Islamic banking. For this reason, social responsibility reporting is needed that explains the company's operations in sharia.

Sustainable industrialization, especially for companies and banks, supported by innovation and accountability for all company operational activities will be able to increase the trust of stakeholders so as to create dynamic and competitive economic strength for sustainability development and the world economy. In addition, with the existence of a form of accountability carried out by the company to stakeholders, enabling them to facilitate optimal service and enabling efficient use of resources, of course, adjusted to sharia principles.

The social responsibility carried out by the company for all operational activities to stakeholders is also part of the realization of sustainable development goal 9 concerning Industrial Innovation and infrastructure. This is because the progress of a company's innovation is the key to responding to economic and environmental challenges, as well as encouraging energy efficiency. Companies that promote a sustainable industry, are an important way to facilitate sustainable development.

Social reporting carried out by conventional institutions still does not cover spiritual and moral aspects. This then motivates to explore CSR from other points of view, such as the Islamic paradigm as an alternative to understanding social responsibility [8]. In the Islamic context, a form of corporate social responsibility that uses sharia principles is known as Islamic social responsibility (ISR). Management that discloses accountability in the form of an entity's performance, which contains Islamic values, will undoubtedly increase the public's desire to transact using Islamic banks [9]. Several previous studies revealed the importance of disclosing social responsibility based on an Islamic perspective [10][11][12].

CSR (Corporate Social Responsibility) cannot be separated from supporting the performance of a company. The company is said to be successful in carrying out its operational activities, and it can be seen from its financial performance. Financial Performance is an analysis carried out to see the company's success in managing the organization as a whole, adjusted to the proper and correct financial implementation rules [13]. Several empirical studies reveal that higher financial performance is indicated by the level of company profitability, giving them the freedom to express their social responsibility both to shareholders and to the general public [14][15][16].

It is hoped that this research will contribute to previous research in several ways. First, in terms of the research scope, it focuses on Indonesia and Malaysia's regions, which are considered to have good sharia financial stability [7]. Second, this study contributes to conducting specific research using the ISR disclosure level based on AAOIFI (2015). This study will also use Islamic financial performance as measured by the course's Islamicity performance index [17]. Third, explore the comparison of disclosures made by Malaysia and Indonesia. Thus, this study aims to analyze the differences in the level of exposure of Islamic Social Responsibility and Islamic banking performance in Indonesia and Malaysia. This study also wants to test empirically the relationship between the Islamicity Performance Index and the ISR disclosure of Islamic banking in Indonesia and Malaysia.

2. Method

The sample selection method in this study was purposive sampling. The criteria used in determining the sample of this study are Islamic banking, which is a BUS (Islamic Commercial Bank) which is included in the list of Bank Negara Malaysia and the Indonesian Financial Services Authority (Otorita Jasa Keuangan/OJK) for the 2014-2018 period and publishes complete annual reports and/or financial reports fot the bank entity during the observation period on the site.

2.1. Dependent variable

This study develops several components obtained from the research of El-Halaby & Hussainey (2016) Maulana, (2018), and Brahim & Arab (2020). The development of the ISR index is based on AAOIFI, and then the overall index is obtained, which contains 75 components. The ISR disclosure index consists of 2 core components: the Sharia Disclosure Index component, which is a component of information disclosure that ensures that all transactions carried out by the company are by sharia rules

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and principles. This study uses an approach based on Governance Standards 1 (GS 1), which measures the disclosure of (1) SSB reports and (2) disclosure of SSB profile, duties, and responsibilities. The Social Disclosure Index component is a disclosure component related to information on corporate social responsibility activities. This standard ensures that CSR activities and company compliance are communicated in a uniform, honest, transparent, and easily understood manner by stakeholders. This study uses an approach based on Governance Standards 7 (GS 7). This component consists of 4 dimensions of disclosure, namely social responsibility to internal organizations, social responsibility to customers and clients, social responsibility in investment screening, and social responsibility to the general public.

Content analysis is used to measure and compare the quantity and quality of CSR disclosures in Islamic financial institutions [18]. The assignment of value to the analysis content is calculated by at least one ISR disclosure according to the criteria for the components of the sharia disclosure index and the social disclosure index. If a Sharia bank's annual report finds a disclosure component that matches the requirements, then a score of 1 is given. Conversely, it is given a value (score) of 0 if the Islamic bank does not provide a disclosure component. The overall score is calculated according to the following formula.

$$DICSit = \frac{\Sigma_t^n = XIjt}{N} \tag{1}$$

The level of disclosure of Islamic bank *i* in year *t* is determined by the exposure of each *Xijt* component, namely the revelation of component *X*, in sharia *i,* in dimension *j*, and at time *t*.

2.2. Independent Variable

The selection of financial performance based on research by [17] is a performance measurement tool that can reveal the worldly and spiritual values in Islamic banks. The Islamicity performance index developed by [17] can be used as an additional alternative to measuring Islamic banking performance. The following is an explanation of these variables:

1) *Profit Sharing Financing Ratio*

The principle of profit-sharing is al-ghunm bi'l-ghurm or al-kharj bi'l-daman, which means there is no share of profits without taking part in risk or loss [19]. While [17] develop profit-sharing ratios and identify how Islamic banks can achieve these goals. The profit sharing financing ratio formula is as follows:

$$PSR = \frac{Mudarabah + Musyarakah}{Total\ Financing} \tag{2}$$

2) *Zakat Perfomance Ratio*

The performance of Islamic banks should be based on the zakat obligation that is paid. This is because Islamic banks' performance indicators are different from conventional banks that use earnings per share (EPS) in their operations. The zakat performance ratio formula is as follows:

$$EZR = \frac{Zakat}{Net\ Asset} \tag{3}$$

3) *Equitable Distribution Ratio*

Islamic banking activities are not only focused on profit sharing. Islamic Bank also implements a fair distribution for its stakeholders. Also, [17] attempted to determine how the income of Islamic banks is distributed among its stakeholders. The equitable distribution ratio formula is as follows:

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$$\begin{gathered}\frac{Qard}{Income-(Zakat+Tax)}\\ \frac{Employee\ Expense}{Income-(Zakat+Tax)}\\ \frac{Dividen}{Income-(Zakat+Tax)}\\ \frac{Net\ Profit}{Income-(Zakat+Tax)}\end{gathered} \tag{4}$$

4) *Directors – Employees Welfare Ratio*

It is essential to identify how much money has been spent on directors' remuneration compared to money spent on employee welfare. Welfare here includes salary, training, etc. The formula for directors - employees welfare ratio is as follows:

$$DEWR = \frac{Average\ directors\ remuneration}{Average\ Employees\ Welfare} \tag{5}$$

2.3. Control variable

This study also includes some control variables. Following previous research, this study uses the CAR (Capital Adequacy Ratio) control variable [20][21]. We also use ROA (Return on Assets) as a control variable [14][16] and company size [22][16][23][12].

2.4. Research model

This study uses regression analysis to test whether Islamic banks' performance factors have a relationship with the level of ISR disclosure. The research model used is similar to several studies related to CSR disclosure based on previous sharia principles [24][25][26][12]. The model specifications are shown as follows :

$$\boldsymbol{ISR_n} = \alpha + \beta_1 PSF_{it} + \beta_2 ZPR_{it} + \beta_3 EDR_t + \beta_4 DEWR_{it} + \beta_5 CAR_{it} + \beta_6 ROA_{it} + \beta_7 LNSIZE_{it} + \varepsilon$$

Where:

ISR_n	= ISR disclosure level i in period t
α	= Constant coefficient
β_{1-4}	= Independent Variable Regression Coefficient
PSF_t	= *Profit sharing financing Ratio* for company i in period t
ZPR_{it}	= *Zakat Perfomance Ratio* for company i in period t
EDR_{it}	= *Equitable distribution Ratio* for company i in period t
$DEWR_{it}$	= *Directors-Employees Welfare Ratio* for company i in period t
CAR_{it}	= *Capital Adequacy Ratio* for company i in period t
ROA_{it}	= *Return on Assets* for for company i in period t
$LNSIZE_{it}$	= Company size for company i in period t
ε	= Error

Meanwhile, to compare whether there are differences in the level of ISR disclosure made by the state sharia banks of Indonesia and Malaysia, and to see whether the performance of Islamic banks measured by the Islamicity performance index is the same or different between the two countries, the Mann-Whitney U test is used. This difference test is similar to previous research that conducted a comparison of CSR disclosure [18][12].

3. Results and discussion

Industrial development will encourage added value and increase the application of technology and innovation which will encourage greater investment that will in turn, increase the SDGs. This also applies to Islamic banking that pays attention to product and service innovation, including reporting the accountability of its operational activities to stakeholders.

3.1. The difference between Indonesian and Malaysia Islamic banks

Indonesia and Malaysia are two countries that have substantially promoted the Islamic banking system in their country. Both are also in the same area, so their culture is not much different. Therefore, it is not surprising that Islamic banks' ISR reporting practices in Indonesia and Malaysia are similar. However, after analyzing the content of the 90 annual reports of Islamic banks during the 2014-2018 period, several differences were found regarding the two countries' dimensions. The following is a comparison trend of ISR disclosures during the 2014-2018 period.

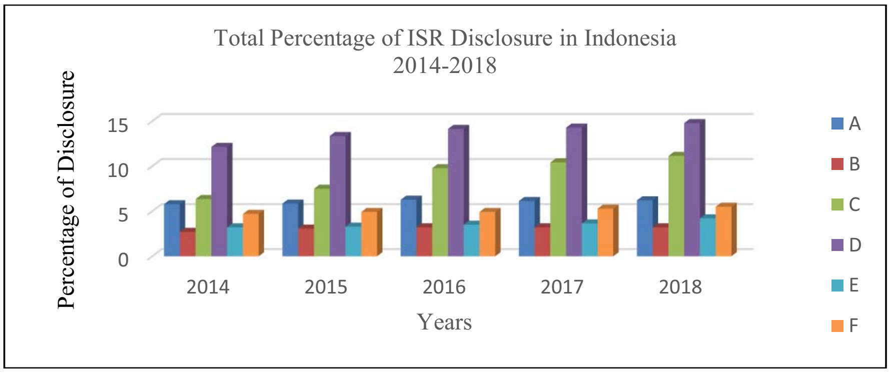

Figure 1. Trends in Total ISR Disclosure in Indonesia by dimension.
Source: Scoring index by Author (2020).

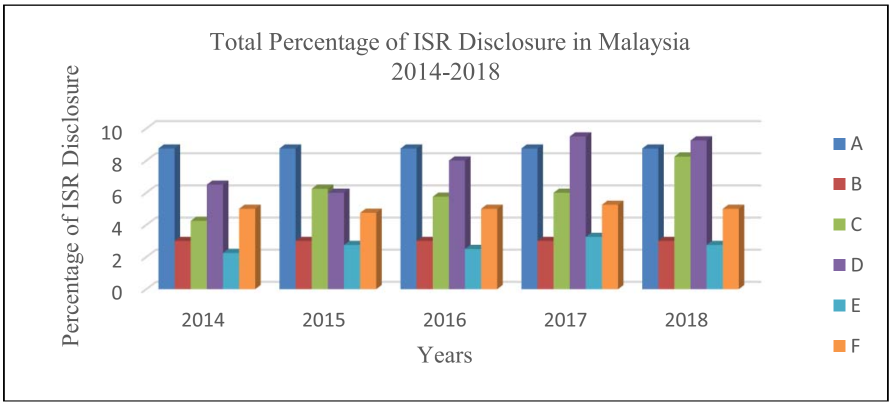

Figure 2. Trends in Total ISR Disclosure in Malaysia by Dimension.
Source: Scoring index by Author (2020).

Information :
A : Dimensions of the report of the Sharia Supervisory Board (SSB)
B : Dimensions of Information for Members of SSB (Shariah Supervisory Board)
C : Dimensions of Social Responsibility to Internal Organizations
D : Dimensions of Social Responsibility to Customers and Clients
E : Dimensions of Social Responsibility for Investment Screening
F : Dimensions of Social Responsibility to the General Public

Figures 1 and 2 show the trend of total ISR disclosures by Islamic banks in Indonesia and Malaysia over the five years (2014-2018). It can be seen in the figure that the dimension of social responsibility towards customers and clients is the area most expressed by Islamic banks in Indonesia and Malaysia. The SSB report's measurement is also the area most disclosed by Islamic banks from Malaysia.

Interestingly, however, the two countries increased their disclosure rates over the past five years. Both countries had the lowest disclosure levels on the dimensions of information related to SSB members and investment screening. Nonetheless, both countries have sought to increase their ISR disclosure during the 2014-2018 period.

3.2. Result of the ISR disclosure different test

The difference test in this study is used to see the difference in the value of the dependent variable used in the research or the difference in the ISR disclosure value. The following are the results of the different test results for the ISR disclosure of Islamic banks in Indonesia and Malaysia for the 2014- 2018 period using the Mann-Whitney U Test.

Tabel 1. Results Of The Disclosure Different Test.

Dimension	**Country**		**Different Test Results (*p-value*)**
	Indonesia	**Malaysia**	
1. Komponen Shariah Disclosure Index			
1.1 Dimensions of SSB Report (10 components)	61%	88%	**0,1318**
1.2 Dimensions of SSB member information (4 components)	78%	75%	**0,1391**
Average disclosure	**70%**	**82%**	
2. Komponen Social Diclosure Index			
2.1 Dimensions Social Responsibility Within the Organizatio			
2.1.1 Employee welfare (12 components)	48%	22%	**0,0020****
2.1.2 Internal environmental preservation policy (4 components	41%	39%	**0,3836**
2.1.3 Earnings and expenditure prohibited by the Shariah (5 components)	34%	38%	**0,9166**
Average disclosure	**41%**	**33%**	
2.2 Dimensions of Social Responsibility in its Relationsip with Customers and Clients			
2.2.1 Par excellence customer service (3 components)	58%	42%	**0,0495****
2.2.2 Late repayments and insolvent clients and avoiding onerous terms (9 components)	48%	28%	**0,0740**
2.2.3 Qard Hasan (6 components)	60%	18%	**0,1050**
2.2.4 Special Features (6 components)	68%	49%	**0,0039****
Average disclosure	**59%**	**34%**	
2.3 Dimensions of social Social Responsibility in Screening Its Investments			
2.3.1 Screening of clients for compliance with Islamic principles and social responsibilities (2 components)	41%	18%	**1,000**
2.3.2 Investment quotas based on industry, social impact and environmental impact (5 compenents)	55%	47%	**0,1172**
Average disclosure	**48%**	**33%**	
2.4 Dimensions of Social Responsibility in Its Relationship with Greater Society			
2.4.1 Zakat (3 components)	86%	68%	**0,0463****
2.4.2 Charitable activities (4 components)	53%	59%	**0,1913**
2.4.3 Waqf management (2 components)	16%	30%	**0,6831**
Average disclosure	**52%**	**52%**	
Total average disclosure	**54%**	**47%**	

Table 1 shows the results of the different test results for the ISR disclosure of Islamic banks in Indonesia and Malaysia for the 2014-2018 period. It can be seen in the table that several sub- dimensions have an average difference, such as employee welfare, customer service, special features, and Zakat. This is indicated by the sub-dimensional *p*-value < alpha 0.05. There is a difference in the sub-dimensional average value disclosed by Indonesia and Malaysia's state Islamic banks. Meanwhile, there were no other differences in diversity.

3.3. Results of different test of shariah bank perfomance

Different test results for independent variables are used to see the average value of the difference in Islamic banks' performance in Indonesia and Malaysia for the 2014-2018 period. The Mann-Whitney U test was used to see the diversity of each variable. The following is a table of results of different tests of the performance of Islamic banks in Indonesia and Malaysia.

Tabel 2. Result of different test of shariah bank perfomance.

Shariah Bank Perfomance	**Country**		
	Indonesia	**Malaysia**	***P-value***
Profit sharing financing ratio	33,87%	24,72%	**0,0058****
Zakat Perfomance Ratio	0,02%	0,17%	**0,0000****
Equitable Distribution Ratio	7,56%	15,90%	**0,6907**
Director – Employee Welfare Ratio	18,26 times	5,37 times	**0,0000****

It can be seen in the table, and several ratios have diversity values between one another. This is indicated by the p-value of each variable less than alpha 0.05, so there is a significant difference between the three independent variables. The difference in the average value of the PSF can occur due to the lack of financing channeled by the Malaysian state Islamic banks, especially mudharabah and musyarakah funding, to calculate funding profit-sharing. It is said that Malaysian Islamic state banks use more debt-based funding [27]. Then, there is a difference in the diversity of the average ZPR value of the Indonesian and Malaysian Islamic banks. Malaysian state sharia banks are better at issuing zakat with an average of 0.17%, the average zakat payment made by Indonesian Islamic banks is only 0.02%. And finally, the test results of the director's employees' welfare ratio show that there is a difference in the average difference in the DEWR variable. The smaller this ratio, the more money is used for employee welfare. The average DEWR value of Malaysian Islamic banks is 5.36 times, while Indonesian Islamic banks are 18.26 times so that Malaysian Islamic banks are better at allocating benefits for directors and employees.

3.4. Hypothesis testing results

Tabel 3. Results of The Regession of The research Model.

Variabel	**Predicted Sign**	**Coefficients**	**t-*statistic***	**p- *value***
Cons		-0,8497247	-0,82	0,421
PSF	+	0,1162773	2,78	0,013**
ZPR	+	23,10397	1,98	0,064*
EDR	+	-0,0101845	-1,28	0,219
DEWR	-	0,00097	1,30	0,210
CAR	+	0,1266127	2,35	0,031**
ROA	+	0,0551598	0,97	0,345
LNSIZE	+	0,0421952	1,24	0,231

Based on the summary of the regression model in table 3, the t-statistic value obtained from the variable profit-sharing financing ratio in this study is 2.78 with a probability value (p-value) of 0.013, which means that it is significant positive below 5 percent α. the profit-sharing financing ratio is positively associated or has a relationship with the level of ISR disclosure of Islamic banks in Indonesia and Malaysia. The results of this positive relationship are consistent with previous research disclosed by [28]. The higher the profit sharing financing you have, the more Muslim investors will channel funds to Islamic banks. Thus, Islamic banks with high-profit sharing ratios will provide more detailed information regarding their social responsibility disclosures.

The t-statistic value obtained from the zakat performance ratio variable in this study is 1.98 with a probability value (p-value) of 0.064, which means that it is significantly positive below 10 percent α. Statistically, the zakat performance ratio is positively associated or has a relationship with ISR disclosure of Islamic banks in Indonesia and Malaysia. In other words, Islamic banks tend to make zakat payments as a form of the company's obligations towards sharia by distributing zakat to the public. Zakat is an effective strategy in poverty and equality [29][30][31][32]. Zakat can be stated as a win-win strategy to maximize returns and improve performance while considering society as a whole [33]. The greater the ratio of Zakat paid, making the Islamic banks are more motivated to express what they have done. Therefore, paying Zakat and will help companies fulfill their responsibilities well to Allah SWT. as well as to the community [34].

The t-statistic value obtained from the equitable distribution ratio (EDR) variable in this study was -1.28 with a probability (p-value) of 0.219, which means negative but insignificant. The inconsistency of the results found in this study may be due to the distribution of income distribution of the state Islamic banks in Indonesia and Malaysia to the public (through qard and donations), shareholders (dividend distribution), employees (labor load incurred), and the company itself. (net income generated). The insignificant relationship between fair distribution ratios and ISR disclosures may also occur because Islamic banks are more concerned about competition between Islamic banks and more established conventional banks. Islamic bank managers set a high level of concern for commercial purposes such as maximizing usage, utilizing operating costs, offering products and services that are feasible, and quality with care for other stakeholders [35]. However, it does not mean that Islamic banks do not care about social welfare. However, banks are more concerned about their ability to compete, especially Islamic banks, which struggle to position themselves among the more established conventional banking [35].

The t-statistic value obtained from the directors-employee welfare ratio (DEWR) variable in this study was 1.30 with a probability (p-value) of 0.210, which means positive but insignificant. The insignificance of the DEWR variable in the ISR disclosure in this study may be due to differences in the distribution of benefits made by Islamic banks in Indonesia and Malaysia to affect the exposure of ISR or corporate social responsibility. The difference in the average DEWR variable between the two countries can also be seen through the Mann-Whitney U Test difference in Table 2, which shows a significant difference in the average value between the Islamic banks of the two countries.

The t-statistic value obtained from the capital adequacy ratio variable in this study was 2.35 with a probability value (p-value) of 0.031, which means that it is significantly positive below 5 percent α. Statistically, the capital adequacy ratio has a significant effect on ISR disclosure of Islamic banks in Indonesia and Malaysia. The results of this substantial effect are consistent with the results of previous studies, which prove that the capital adequacy of Islamic banks has a significant positive impact on the level of ISR disclosure [20][21]. This indicates that banks with large CAR ratios are an essential factor to consider in ISR disclosure because with sufficiently large capital, Islamic banks have the ability and more flexibility to carry out ISR disclosures in their annual reports.

The t-statistic value obtained from the return on assets (ROA) variable in this study is 0.97 with a probability (p-value) of 0.345, which means positive but not significant. This shows that statistically, return on assets does not affect the level of ISR disclosure of Islamic Islamic banks in Indonesia and Malaysia. The results of this study cannot prove the effect of ROA on the level of ISR disclosure as

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evidenced by [14] and [16]. However, the results of this study are following previous research conducted by [21] and [37] which states that profitability does not affect ISR disclosure. Islamic banks view that ISR disclosure activities must be carried out as a form of corporate transparency to increase stakeholder confidence.

The t-statistic value obtained from the Company Size variable in this study is 1.24 with a probability (p-value) of 0.231, which means positive but not significant. This shows that statistically, the company size does not affect ISR disclosure of Islamic Islamic banks in Indonesia and Malaysia. The results of this study are not in line with research conducted by [15], [24], and [12] which revealed that company size has a significant influence on the level of social responsibility disclosure. However, this study's results follow previous research, which showed that the company size does not affect social exposure [25][36]. Firm size does not affect the extent of ISR (Islamic Social Responsibility) disclosure.

4. Conclusion

From the overall empirical tests that have been carried out, it can be concluded that the level of ISR disclosure of Islamic banks in Indonesia and Malaysia has increased during the 2014-2018 period. It is expected that it support the increase of SDGs in these two countries. The analysis content results show that both have the advantage of exposure in social responsibility dimensions to customers and clients. Meanwhile, if viewed from the average total disclosure, the sharia disclosure index is most disclosed compared to the social disclosure index. On the other hand, the two countries also have differences in the average ISR disclosure and Islamic financial performance.

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