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The Role of Corporate Social Responsibility Disclosure in Improving Financial Performance (Case study in Indonesian Islamic Bank)

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Abstract: *The influence of social care by business entities to their financial performance has been continuously debated in previous management reseearch. Nevertheless, studies about the influence of CSR on Islamic banks financial performance were rarely done. Therefore, this studyaims to examine the influence of Corporate Social Responsibility Disclosure (CSRD) on profitability as measured by Return On Assets (ROA), Return On Equity (ROE), Net Profit Margin (NPM) and Investment Account Holders (IAH) by debt and financing ratio. Data was obtained from Islamic banks in Indonesia through observation from 2012 to 2018 that analyzed by panel data regression and Fixed Effect Model (FEM). The results showed that the CSRD did not have a positive influence on ROA, ROE, NPM, IAH, Debt, and Financing Ratio. Therefore, the legitimacy theory was not proven in this study.*

Keywords: *Corporate social responsibility disclosure; Profitability; Investment account holders; Financing; Debt.*

Paper type: *Research paper*

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Abstrak: *Pengaruh kepedulian sosial oleh entitas bisnis terhadap kinerja keuangannya telah terus diperdebatkan dalam penelitian manajemen sebelumnya. Meskipun demikian, pengaruh CSR terhadap kinerja keuangan bank syariah jarang dilakukan. Oleh karena itu, penelitian ini bertujuan untuk menguji pengaruh PengungkapanTanggung Jawab Sosial Perusahaan (CSRD) terhadapprofitabilitas yang diukurdengan Return On Asset (ROA), Return On Equity (ROE), Margin LabaBersih (NPM) dan Pemegang Rekening Investasi (Investment Account Holders) oleh rasio hutang dan pembiayaan. Data diperoleh dari bank syariah di Indonesia melalui pengamatan dari 2012 hingga 2018 yang dianalisis dengan regresi data panel dan Fixed Effect Model (FEM). Hasil penelitian menunjukkan bahwa CSRD tidak memiliki pengaruh positif pada ROA, ROE, NPM, IAH, Debt, dan Financing Ratio. Oleh karena itu, teori legitimasi tidak terbukti dalam penelitian ini.*

Kata kunci: *Pengungkapan kinerja social; Profitabilitas; Investasi dana syirkah temporer; Pembiayaan; Hutang.*

INTRODUCTION

Islamic banks have experienced significant growth globally (Khan, 2010). In 2018, the Islamic Financial Services Board (IFSB) reported that the average asset growth of its banks in the world was 4.3% per year. A total of eight countries had growths above 10%, while those in the Middle East have lower growth due to a decrease in global oil prices (IFSB, 2018). Islamic banks become the largest sector, with a yearly contribution of 71%, or USD 1.72 trillion to industrialization (IFSB, 2018). According to the data obtained by Erns & Young in 2015, Islamic banks in nine countries have dominated the global market share, such as Saudi Arabia (31.70%), Malaysia (16.70%), UAE (14.60%), Kuwait (10.50%), Qatar (7.70%), Turkey (5.80%), Indonesia (3.80%), Bahrain (1.70%) and Pakistan (1.2%) (Hirst, 2015).

Islamic banks in Indonesia also experienced a significant increase in the number of annual average assets by 28.42% (Mukhibad, 2019). Nevertheless, based on its market share, the Islamic banks in Indonesia are less competitive than conventional banks (Hirst, 2015). This condition is very contrary to the Muslim population in Indonesia is the largest in the world. According to the Ministry of Cooperative and Small and Medium Entreprise data, the market share of Islamic banks in Indonesia is 5.3%, which is lower than marker share of Islamic bank iniMalaysia at 23.8%, market share in United Arab Emirates at 19.6 %, and market share in Saudi Arabia at 51.1 % (Republika, 19 May 2019). This fact showed that Indonesia is one of the largest Muslim countries in the world, based on Islamic financial fundamentals (Lusyana & Sherif, 2017).

The phenomenon of low market share of Islamic banks followed the legitimacy theory, that brand, image, and loyalty are raised or enhanced through environmental and social disclosure (Alotaibi & Hussainey, 2016), and profitability (Gololo, 2019;Ta & Bui, 2018;Beck, Frost, & Jones, 2018;Vázquez, Méndez, Moreno, & Meca, 2019). Besides, Isnalita & Narsa (2017) stated that CSR disclosure had a positive influence on consumer loyalty and firm value, as measured by Tobin Q.

The positive impact of CSR disclosure on performance also occurs in Islamic banks. Platonova, Asutay, Dixon, & Mohammad (2016) examined Islamic banks at the Gulf Cooperation Council (GCC) as a sample of research. Their result found that CSR Disclosure had a positive impact on ROAA and ROAAt+1. Moreover, using different indicators with 90 Islamic banks sample in 13 countries, Farag, Mallin, & Ow-Yong (2014) found that CSR Disclosure had a positive influence on increasing ROA and ROE.

Based on previous research, it was concluded that CSR Disclosure could increase public trust in Islamic banks. Therefore, legitimacy theory suggested that companies need to conduct disclosure management to build good relationships with consumers (Magness, 2006). Moreover, Suto & Takehara (2016) and Kuo & Chen (2013) said that environmental disclosure or CSR is a strategic tool, due to its ability to build a company's reputation, public trust and create entity's added value for its stakeholders.

There were limited studies about the influence of CSR disclosure on performance in Islamic banks. For example, Farag et al. (2014), and Platonova et al. (2016). The various study more focuses on factors that influenced CSR disclosure on Islamic banks (Bukair & Abdul-Rahman, 2013; Garas & ElMassah, 2018; Razak, 2015; El-Halaby & Hussainey (2016); Farook, & Lanis, 2011).

From the analysis, it was concluded that the profitability indicators such as ROA, ROE, and bank market performance (Tobin Q) were commonly utilized in previous studies. However, this study expanded financial performance indicators such as the ratio of temporary syirkah funds, debt, and financing to assets. This study uses the ratio of temporary syirkah funds, debt, and financing to assets in order to know the influence of CSR in increasing customer loyalty and reputation. These proxies we use based on Aramburu & Pescador (2017); Gürlek, Düzgün, & Uygur (2017); Lee, Chang, & Lee (2017); Sindhu & Arif (2017); and Arli & Tjiptono (2014) was found that CSR had an impact on debtors loyalty and banks' reputation. According to Lee et al. (2017), CSR can be used by a company to form a corporate brand image that was used as a marketing tool to support business continuity.

Besides, this research is needed because there are still inconsistencies in the influence of CSR on profitability (Deswanto & Siregar, 2018; Perrini, Russo, Tencati, & Vurro, 2011; Saha, 2018; Shahzad & Sharfman, 2015; Soana, 2011; Wang, Dou, & Jia, 2015). The inconsistency of these results might be due to a complex relationship between CSR and performance (Jizi, Dixon, & Stratling, 2013). Janamrung & Issarawornrawanich (2015), in their research in Thailand, stated that corporate investment administered in the form of CSR had an impact on increasing ROA, but no relationship between CSR with ROE and Tobin Q. The results of this study were supported by the studies conducted by Platonova et al. (2016) on Islamic banks in the Gulf state, which found that CSR can increase current ROA and future profits. Sabri & Sweis (2016) reported that the amount of donations issued by companies increases profitability as measured by ROA and ROE. The same research results were also found byKanwal, Khanam, Nasreen, & Hameed (2013). However, Mukhibad, Anisykurlillah, Nurkhin, & Jayanto (2019) stated that CSR did not influence ROA and ROE.

Hypothesis Development

Legitimacy theory views that companies are bound by social contracts with the general public in their operationalizations. The existence of these social contracts is due to the dependency relationship between the company and the community. For instance, people need products produced by companies and vice versa. These two dependency relationships tend to fade, assuming the social contract cannot be carried out by the company.

The fulfillment of corporate social contracts for the community is realized with the company's concern for environmental issues. Therefore, documents presented on a company's care for social problems are evidence that shows its fulfillment towards social contracts. According to Deegan (2002), the legitimacy theory views that accounting documents are used as corporate social, political, and economic materials.

It is essential to fulfilling the corporate social contract to avoid the community from revoking it through purchase reduction, eliminating labor supply, etc (Deegan, 2002). It means that the survival of the entity is determined by the community (Magness, 2006).

One of the indicators of bank business continuity is profitability. Some researchers stated that there was a relationship between CSRD and profitability (Farag et al., 2014; Suto & Takehara, 2017; Syed & Butt, 2017; Kanwal et al., 2013; Sabri & Sweis, 2016). However, many researchers failed to prove that CSRD is an independent variable in explaining financial performance. Mukhibad et al. (2019) were unable to verify that bank social care that measured by the amount of zakat, qardul hasan, and qard financing funds have positive influence on ROA, ROE and Net Profit Margin (NPM). Farag et al. (2014) also stated that CSR was not able to increase ROA and ROE in the following year.

According to the legitimacy theory, a bank's social care is evidence that it has fulfilled its social contract. Therefore, the community tends to provide positive values. This condition tends to allow an increase in its performance, as shown by Platonova et al. (2016) and Famiyeh (2017). Based on legitimacy theory, the hypotheses were developed as follows:

H1a: CSR Disclosure has a positive impact on ROA in the following year.

H1b: CSR Disclosure has a positive impact on the ROE in the following year.

H1c: CSR Disclosure has a positive impact on the NPM in the following year.

Consumers' trust and loyalty were used to prove that CSR can increase satisfaction, company's reputation and support the banking business (Lee et al., 2017; Chung, Yu, Choi, & Shin, 2015; Pérez & Bosque, 2015; Raman, Lim, & Nair, 2012; Doorn, Onrust, Verhoef, & Bügel, 2017). Moreover, public trust in banks is a critical factor for banks to maintain their operations. Pérez & Bosque (2015) stated that the CSR issued by banks influences customers' satisfaction, recommendations, and behaviors of interest to re-transact. Therefore, CSR issued by banks has a positive impact on increasing customer satisfaction and loyalty (Aramburu & Pescador, 2017; Chung et al., 2015).

In this study, two measurements were used to increase customer loyalty, namely the number of third-party funds on depositors and financing. Customers interested in bank services tend to maintain savings, mortgage loans, and utilize other products (Chochoľáková, Gabčová, Belás, & Sipko, 2015). According to this study, when a bank's brand image is improved, customer demand for its products and services increases. Also,Marin, Ruiz, & Rubio (2009) stated that CSR initiatives lead to customer loyalty due to the company's positive evaluation.

Three indicators were used to analyze customer loyalty and satisfaction, namely third party-funds (current accounts, savings, and deposits), the amount of financing disbursed, and the amount of debt received (savings and deposits). Therefore, the hypotheses were developed as follows:

H2a: CSR Disclosure has a positive impact on Investment Account Holders (IAH) received by banks in the following year.

H2b: CSR Disclosure has a positive impact on financing channeled by banks in the following year.

H2c: CSR Disclosure has a positive impact on debt received by banks in the following year.

RESEARCH METHODS

Data were obtained from Islamic banks in Indonesia using observations from 2009 to 2018and analyzed it through the panel data regression method with the fixed-effect model (FEM).

Corporate social responsibility disclosure (CSRD) was measured using the content analysis approach by identifying the indicators. A value of 1 is given when the bank provides information (disclosure) on the indicators and zero when the reverse is the case. CSRD was calculated by the percentage of the total value obtained by the bank against the total items used by Farook et al. (2011) and El-Halaby & Hussainey (2016).

The bank profitability performance was measured by three instruments, ROA, ROE, and NPM. ROA was measured by the ratio of net income to total assets. ROE was calculated by the ratio of net income to total equity. At the same time, NPM was measured by the ratio of profit-sharing costs provided by banks to customers against its operating income.

Consumer satisfaction and loyalty were also measured by a ratio of temporary syirkah funds to total assets (syirkah fund ratio) as an indicator in mudharabah and musyarakah fund owners invested in banks. It was also used the ratio of total financing (equity-based financing) and receivables (fixed income-based financing) distributed to all assets (Financing Asset Ratio). This study also used company size measured by log assets as a control variable.

RESULTS AND DISCUSSION

The descriptive analysis of all variables used in Table 1 showed that the CSRD of Islamic banks in Indonesia was impressive, with an average disclosureabout 66.26%.The lowest CSRD disclosure was 38%, and the highest was 84%.Meanwhile, the standard deviation is 0.1183 which means that the CSRD of Islamic banks in Indonesia was relatively evenly distributed, with an average Net Profit Margin (NPM) of 49.53% with quite different data distribution. Some banks had an NPM of 15.19% and 74.49%.

When bank performance was measured using ROA and ROE, the sample results showed an average value of 0.78% and 5.28%, respectively. The standard deviation was quite small for ROA, and the distribution was less in ROE because some banks had -94.01%. The distribution of bank assets also tends to be evenly distributed assets because it has a standard deviation of 2.5. Our sample has the smallest asset of IDR 661,912,000,000 and the highest asset is IDR 98,341,116,000,000.

Table 1: Descriptive Statistics

	CSRD	**NPM_{t+1}**	**ROA_{t+1}**	**ROE_{t+1}**	**$Size_{t+1}$**	**Debt $Ratio_{t+1}$**
Min	38.00	7.12019	-10.77	-94.01	6.61912E+11	7.57908
Max	84.00	74.4914	4.08	29.7933	9.83411E+13	93.2624
Mean	66.26	49.5339	0.78172	5.27712	2.27955E+13	20.2179
St Dev	11.84	15.1881	1.70551	14.0165	2.55454E+13	14.5396

Regarding the funding structure, Islamic banks were in the quite well category with an average debt of 20.22% and a temporary syirkah ratio of 66.57%. However, when the bank funding only came from debt and equity, it had no syirkah funds. Table 1 also shows that there are banks that have a small debt ratio (7.58%), but there are banks that a large debt ratio, which is 93.26%. These results indicate that the sample has a debt ratio that tends to be heterogeneous. The conclusion of these two ratios (debt and IAH ratio) provides evidence that Islamic banks in Indonesia have sufficienttrust from customers.

Funding disbursed by Islamic banks was high because it had an average of 87.71%, with a standard deviation of 102,224. There were also some banks with a financing ratio of 37.31%. Meanwhile, other banks have a significant financing ratio of 99.65%. This figure shows the diversity of our sample in providing financing. There were also some banks with a financing ratio of 37.31%. The descriptive data concerning CSRD are as follows

Table 2: Corporate Social Responsibility Disclosure

		Investment and Finance	**Products and Services**	**Labor**	**Social**	**Environment**	**All**
Min	0	50	50	0	0	66.6667	0.3800
Max	50	100	100	100	57.1429	100	0.8400
Mean	33.5979	84.9206	69.5767	69.8413	23.1293	94.0741	0.6626
St Dev	9.69613	13.8684	18.5833	20.16	17.4829	9.36026	0.1184

Table 2 above showed that the disclosure ratio by Islamic banks in Indonesia was a governance indicator with an average value of 94.07%. The smallest CSRD indicators were environmental and financial at 23.13% and 33.60%, respectively.

In the next stage, after testing the classical assumptions - normality and heteroscedasticity, a hypothesis test was performed. The results are shown in the following table.

Table 3: Test Results using Fixed Effect

Dependent Var.	**ROAt+1**	**ROE t+1**	**NPM t+1**	**IAH t+1**	**Debt Ratio t+1**	**Financing Ratio t+1**
CSRD	154.1052	0.952749	222.3273	-0.017249	0.006253	-2.098987
	117.7468	0.807033	222.5842	1.174046	0.654991	1.943185
Size t+1	13.21990***	-0.03988**	2.393720	0.014137*	0.002745	0.110864**
	2.294823	0.015729	4.338049	0.007612	0.012765	0.037872

Table 3 showed the coefficient and standard error
*** Sig. at 1%, ** Sig. at 5%; and * Sig. at 10%

Table 3 showed that CSRD did not have a positive influence on bank profitability in the coming year, as measured by ROA and NPM. These results indicated that the bank's concern for the environment did not respond positively to the public and was unable to increase its ROE, ROA, and NPM. The results of this study showed that the obtained data are in line with the theory of legitimacy. This theory stated that the fulfillment of social contracts by banks leads to an increase in community policies with the banks concerned and subsequently increases their legitimacy. This finding supports the previous research conducted by Farag et al. (2014), and Mukhibad et al. (2019) but rejected the findings of Mukhibad (2018), Platonova et al. (2016), and Famiyeh (2017), which stated that CSRD had a positive impact on profitability. Mukhibad (2018) used different the data analysis method with this study. Mukhibad (2018) used Ordinary Least Square (OLS), while this study utilized the *Fixed Effect Model* (FEM). Furthermore, Mukhibad (2018) used simultaneous tests (ROA and ROE), while this study used ROA, ROE, and NPM individually to determine the impact of CSRD on profitability performance.

However, the test results of profitability measurements based on ROE showed a negative influence, which showed that CSRD could reduce bank ROE in the following year. This finding was undoubtedly interesting because, since 1990, there was a real debate on the need for companies to have social care and determine a negative relationship between CSRD and ROE that supported neoclassical economic theory, have not provided significant influence profits (Farag et al., 2014). However, Mukhibad et al. (2019) stated that social activities in Islamic banks were a form of duties known as *Khalifah fil ard* (Caliph of God on earth). It indicated that the social activity motivation of Islamic banks was different from conventional (Aracil, 2019). Social activities were part of worship through activities to serve the community and the environment.

It was also found that CSRD did not have a positive impact on customer confidence, with the temporary syirkah fund used for its measurement. This proxy was used to measure the trust of mudharabah and musyarakah fund holders invested in Islamic banks. The results indicated that CSRD did not have a positive influence on the number of temporary syirkah funds obtained by banks in the coming year. It also rejected the hypothesis that was developed and indicated that CSRD was not one of the reasons for customers to invest funds in Islamic banks on the principle of profit-sharing.

Besides, it was also found that the extent of CSRD reported by banks did not have a positive impact on the amount of debt obtained by banks in the following year. This finding did not support the hypothesis developed in this study, which divided the Islamic bank liability into three types, namely investment receipts sourced from equity, temporary syirkah funds, and debt. However, two of the three sources came from non-owners, which were temporary syirkah funds and debt. This study also explained the influence of CSRD on Islamic bank debtor customers' trust. It was used as a measurement of the amount of financing, with fixed income and equity schemes to determine the trust of debtors. The results showed that CSRD did not have a positive influence on the amount of funding disbursed by banks and rejected the developed hypothesis. It means that irrespective of the fulfillment of the social contract customer did not consider the bank before applying for credit.

The overall test results found that CSRD did not influence customer trust in Islamic banks. Therefore, it was concluded that social and environmental care did not have a positive influence on customer trust. These findings found a correlation between CSR and customer demand for bank products, services, and customer loyalty. However, this was in line with the research conducted by Chochoľáková et al. (2015) and Marin et al. (2009) on loyalty based on respondents' perceptions between statements and attitudes, which differed.

CONCLUSION

The results of this study showed that CSRD did not have a positive impact on profitability as measured by ROA, ROE, NPM, temporary syirkah funds (IAH), debt ratio, and the amount of funding disbursed by banks. This finding indicated that the extent of CSRD conducted by Islamic banks was not a reason for customers to invest or conduct other transactions. There were also allegations that social and environmental care was part of the task as the *Khalifah fil ard* carried by the Islamic bank.Islamic banking social activities were a form of worship and considered a political document using the legitimacy theory to improve customer performance and trust.Therefore, the customer's response was to add transactions with banks because it had fulfilled social contracts as proposed by the legitimacy theory.

This study examined the impact of CSRD on profitability and customer trust based on financial ratios owned by banks with the perspective used to prove this relationship. The limitation of this study lies on its sample, Islamic banks in Indonesia, which can't generalize the influence of CSRD on customer loyalty and reputation of all banks industry sector while bank consumers also have relatively less environmental awareness compared to those of consume products, such as fashion or food and beverages consumers. Moreover, further studies are needed to expand the sample and incorporate demographics or community culture as an indicator in explaining the legitimacy theory on Islamic banks.

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