

Can Social Performance Improve Financial Performance and Increase Customers' Trust?

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Abstract

Social concern is strongly emphasized in Islam. There are the concepts of *khalifah fil ard*, *hablum min nass*, *tawazun* in Islam which demonstrate the Islamic approach to concern for social issues. The purpose of this study is to obtain evidence pertaining to whether social concern in Islamic banks has an impact on improving their performance and the trust of customers. The research sample is 11 Islamic commercial banks in Indonesia. The observation period was from 2009 to 2017. The results of this study show that social activities carried out by banks in the form of *qardh* financing, and the distribution of *qardh al-hassan* and *zakah* funds, were able to increase customer trust in the banks. This increase in trust is evidenced by the positive influence of channeling social funds on increasing debt and temporary *syirkah* funds. However, the distribution of social funds does not have a positive impact on the amount of funding channeled by banks. As a result, the bank's income from the disbursement of finance cannot increase, and the impact of the bank's profitability does not increase. So, it has been proven empirically that the distribution of social funds does not have a positive impact on the amount of financing and profitability as measured by ROA and ROE.

Keywords: social performance, qard, zakah, qardh al-hassan financing

1. Introduction

Islamic banks are banks that use sharia law or principles in their operations. One of the sharia laws pertains to concern for the environment. The Qur'an, as a source of Islamic law, has more verses on the environment than verses about commandments and sacraments (R. Rizk, 2014). Another concept in Islam that emphasizes environmental concern is the concept of *khalifah fil ard*, which means that all humans have duties and responsibilities (in gaining the trust of God) in terms of preserving the planet Earth (R. Rizk, 2014). In line with the opinion of (R. Rizk, 2014), Jusoh, Ibrahim, & Napiyah (2015) have shown that social responsibility is part of fundamental Islamic teachings based on the concept of *khalifah*.

According to Dien (1997), Islamic teachings that emphasize concern for the preservation of nature are based on (1) the environment being God's creation; (2) the concern is a form of protection of God's creatures who praise and pray to Him; (3) the notion that the environment is a divine creation that deserves to be protected; (4) Islam is built based on the concept of goodness; (5) human relations in Islam must be based on the concept of justice, and goodness, and not on material or economic benefits. Thus, Islam strongly emphasizes that its adherents must be righteous in their social concern, and also in terms of social management, environment, and ethics, both individually and organizationally (Platonova, Asutay, Dixon, & Mohammad, 2016).

One way that the concern of an Islamic bank for its social environment can be measured is through the social disclosure in its annual report which is called the Islamic Social Responsibility (ISR) disclosure. ISR disclosure has been used by Sugianto & Harapan (2017), Sofyani, Ulum, Syam, & Wahjuni (2012), Santoso & Dhiyaul-haq (2017), Pratama (2018), Assegaf et al., (2012), Asriati, Ulfah, & Setyorini, (2016), and Sari (2018), who find that what is disclosed in the ISRs of Islamic banks in Indonesia is still low (Mukhibad, 2018).

Another indicator in measuring the concern of Islamic banks towards their social and natural environments is to use financial ratios. Fitrijanti & Alamanda (2013); Hameed, et al. (2004) and Mukhibad, Nurkhin, & Khafid (2016) use the performance of *zakah* (religious donations) and *qardh al-hassan* funds as indicators of the social performance of Islamic banks. In addition, Falikhatun, Assegaff, & Hasim (2016); Sa'ad & Ibrahim (2015) show that *qardh*

al-hassan financing is social financing. Thus, in addition to the performance of *zakah* and *qardh al-hassan* funds and the ratio of *qardh* financing (benevolent loans) can be used as a measure of the bank's social performance.

Data published by bank Indonesia show that the ratio of *qardh* financing as a measure of the social performance of Islamic banks in Indonesia remains small, with an average value of 1.80%. This fact is in line with the statement of Agus Martowardojo (Governor of Bank Indonesia) which contended that Islamic banks in Indonesia are still weak in channeling social financing (Hamidi, 2016).

Regarding research on social performance, many researchers have demonstrated empirically what the factors are that influence social performance in Islamic banks. In this study, the researchers have developed social performance as an independent variable that has an influence on improving bank financial performance. Research on the effect of CSR on financial performance has been discussed by many researchers, but the results still do not provide clarity as to whether CSR increases the economic performance (Francis, Harper, & Kumar, 2016). Researchers have noted that CSR enables companies to differentiate themselves in the marketplace for their products (Francis, Harper, & Kumar, 2016) while increasing the number of customers (Lev, Petrovits, & Radhakrishnan, 2012; Servaes & Tamayo, 2013; Mukhibad, 2018).

The novelty of this study is that the test relates to the impact of social performance on all stakeholders and not only the shareholders of the Islamic banks which are the object of study. The reason for this is that existing research has rarely discussed the effect of CSR on bank performance (Francis et al., 2016), especially Islamic banks. Another reason is that banks take large risks in their operations (Francis et al., 2016), and this is even more the case with Islamic banks (Lassoued, 2018; Boumediene, 2010; Ahmed & Tariqullah, 2007). The risks faced by Islamic banks concern credit risk, interest-rate risk, and liquidity risk (How, Karim, & Verhoeven, 2005). Ahmed & Tariqullah (2007) which shows that the risks faced by Islamic banks are more diverse than conventional banks.

Research that demonstrates empirically the influence of social performance on the profitability of Islamic banks has been conducted by Mukhibad (2018); Platonova et al. (2016); Mallin, Farag, & Ow-yong (2014) who find that social performance affects the performance in the subsequent year. The difference between this research and previous research by Mukhibad (2018); Platonova et al. (2016); Mallin et al. (2014) is the measurement of social performance uses financial ratios, not based on the extent of both CSR or ISR disclosure. The measurement of social performance in this study uses *qardh* financing ratios, and the performance of *zakah* and *qardh al-hassan* funds. The performance of *zakah* and *qardh al-hassan* uses the amount of *zakah* funds and *qardh al-hassan* funds distributed. This is because the expenditure on *zakah* and *qardh al-hassan* is from funds collected and channeled in the form of social activities of Islamic bank.

Islamic banks are banks whose operations are based on sharia principles. Law No.21 of 2008, pertaining to Sharia Banks, limits sharia principles used by Islamic banks to the *fatwa* (rulings) of the National Sharia Council (DSN). That is to say, compliance with Islamic banks in terms of sharia principles is limited to the use of covenants issued by the National Sharia Council (Dewan Syariah Nasional).

However, many parties consider that compliance with sharia principles also involves social concerns and environmental concerns. Humans are tasked with becoming caliphs on Earth (Beekun & Badawi, 2005; R. R. Rizk, 2014). God created the Earth and humans have the task of managing it and they will be held to account by God. In the management concept, humans must maintain and care for the Earth, so that it can continue to be used in accordance with the purpose of its creation.

The Qur'an, as a source of Islamic law, strongly emphasizes that its adherents have to be concerned for the environment. Analysis by Helfaya, Kotb, & Hanafi (2018) has identified 675 verses in 84 chapters throughout 30 parts of the Qur'an that have environmental content related to the core components of the natural world, namely humans, water, air, soil, plants, animals, and other natural resources. Aside from this, in Islam there are the concepts of *Hablum Minallah* and *Hablum Minannas* which posit that humans must have good vertical relations (humans with god) and good horizontal relations (humans with humans and nature). Thus, the environment is part of the teachings that are emphasized in Islam (Kamla, Gallhofer, & Haslam, 2006). Helfaya et al., (2018) consider that Islamic social and environmental concern are motivated by the goals of *duniya* (temporal world) and *akhirah* (afterlife).

According to these concepts, social concern is an integral part of sharia law. That is to say, Islamic banks which have special characteristics, namely making sharia the basis for their operations, must include social concern activities in their operations (Hassan, Abul; Latiff, 2009). The concern of Islamic banks is demonstrated by good social performance. Islamic banks' social performance can be demonstrated by their ISR disclosure (Farook, Hassan, & Lanis, 2011; Mallin et al., 2014; Rahman & Bukair, 2013), *qardh* financing (Falikhatun et al., 2016), *zakah*

performance, and *qardh al-hassan* performance (Mukhibad, Kiswanto, & Jayanto, 2017).

Mukhibad (2018), using Islamic banks in Indonesia as a research sample, demonstrates that ISR disclosure has a positive influence on profitability in the subsequent year. The results of the study by Mukhibad (2018) corroborate the findings of Platonova et al., (2016) who examine Islamic banks in Gulf Cooperation Council (GCC) countries and Mallin et al., (2014) who use 90 Islamic banks in 13 countries around the world and find that CSR disclosure has a positive influence on the profitability of the subsequent year. Siregar & Bachtiar (2010) also find that CSR disclosure positively affects profitability.

Unlike previous research, social performance in this study uses financial ratios that can be used throughout the year. Expenditures in the course of the year can provide the benefits of increasing profitability in the same year. In ISR and CSR disclosures, companies are only able to carry these out at the end of the year when publishing annual reports, so, logically, the benefits for profitability can only be felt in the subsequent year. In this study, measurement of profitability is carried out in the same year, not in the subsequent year.

Janamrung & Issarawornrawanich (2015), in their research in Thailand, find that corporate investment given in the form of CSR has an impact on increasing ROA. The results of this research are also corroborated by the research of Kanwal, Khanam, Nasreen, & Hameed (2013) who find that there is a link between CSR and financial performance. Bahjat, Sabri, Mohammad, & Sweis (2016) find that the amount of donations issued by companies can increase profitability as measured by ROA and ROE. However, Fadma El & Boutti (2012) find that the CSR disclosure index does not affect ROA and ROE.

H1: The social performance (*qardh al-hassan* financing ratio, expenditure on *zakah* funds and *qardh al-hassan* funds) has a positive influence on profitability (ROA, ROE and NPM).

Social costs incurred by banks have the potential to be an effort to attract customers and prospective customers to use bank services, both directly and indirectly. For customers, CSR activities can strengthen their loyalty to companies (Arli & Tjiptono, 2014; Gürlek, Düzgün, & Meydan Uygur, 2017). In addition, Lee, Chang, & Lee (2017) show that CSR can be used by a company to shape its brand image which is used as a marketing tool to support the company's business continuity.

In this study, customer satisfaction is measured by the amount of third party funds collected by banks in the form of deposits savings and current accounts. The reason for this increase in third party funds collected by banks is shown in the higher customer trust in the bank. The research of Pérez & Bosque (2015) finds that CSR issued by banks will influence the image of banks, satisfaction, recommendations, and interest in repurchase behavior on the part of bank customers. Aramburu & Pescador (2017) and Chung, Yu, Choi, & Shin (2015) add that CSR issued by banks has a positive impact on increasing customer satisfaction and loyalty. More specifically, Sindhu & Arif, (2017) find that *zakah* issued by Islamic banks can improve the reputation of the bank and subsequently have a positive impact on performance. In this study, satisfaction and interest in returning to using bank services is measured by debt ratios and the ratio of third party funds collected by banks.

H2: The social performance (*qardh al-hassan* financing ratio, expenditure on *zakah* funds and *qardh al-hassan* funds) has a positive influence on debt.

H3: The social performance (*qardh al-hassan* financing ratio, expenditure on *zakah* funds and *qardh al-hassan* funds) has a positive influence on third party funds.

Increased loyalty due to social expenditure has the potential to increase the loyalty of customers who are beneficiaries of funds channeled by banks. The findings of Pérez & Bosque (2015) demonstrate empirically that CSR is able to increase customer interest in using more products provided by the bank. The improved brand image of Islamic banks caused by an increase in the bank's social performance is able to increase customer interest in applying for loans or transfers of credit from conventional banks to Islamic banks. Another measure of customer satisfaction is the amount of financing channeled by banks. The assumption is that, if the finance channeled is large, then the satisfaction of the customer is high and vice versa; if the finance channeled is low then customer satisfaction is low.

H4: The social performance (*qardh al-hassan* financing ratio, expenditure on *zakah* funds and *qardh al-hassan* funds) has a positive influence on financing channeled by banks.

2. Method

The sample in this study comprises Islamic commercial banks in Indonesia with a period of observation from 2009 to 2017. Determination of the sample uses the purposive sampling method. The criteria for the sample selection are the issuing of certain reports, namely financial and Good Corporate Governance reports and presentation of *zakah* funds

and *qardh al-hassan* funds channeled by the bank during the observation period. The variables used are measured by the following methods: (1) *qardh al-hassan* financing is measured by its ratio to all financing; (2) the expenditure of *zakah* funds is measured by the amount of *zakah* funds distributed by Islamic banks; (3) *qardh al-hassan* funds are measured by the amount of *qardh al-hassan* funds that has been distributed by banks; (4) Return on Assets (ROA) is measured by the ratio of net income to assets, (5) Return on Equity (ROE) is measured by the ratio of net income to equity; (6) Net Profit Margin (NPM) is measured by the ratio of the cost of profit sharing to the income from financing; (7) Third Party Funds are measured by the ratio of third party funds to assets; and (8) the amount of financing is measured by the ratio of financing to assets.

The data analysis uses the Structural Equation Model using the WarpPLS analysis tool. Test the validity of the model to use APC, ARS, AARS, AVIF and VIF score.

3. Results

The results of the descriptive analysis show that the distribution of *zakah* has a very large standard deviation. The magnitude of this standard deviation shows that the variety of Islamic banks in distributing *zakah* is very heterogeneous. Islamic banks in Indonesia, namely Bank Syariah Mandiri, distributed *zakah* amounting to IDR 50,794,078,580 in 2014, while, in other banks, the distribution of *zakah* funds was IDR 392,800.

A circumstance similar to the distribution of *zakah* is the distribution of *qardh al-hassan* funds. The largest amount of *qardh al-hassan* funds distributed was carried out by BSM which was IDR 36,990,032,769 in 2016. The lowest amount of *qardh al-hassan* funds was IDR 2,000,000 which were channeled by Bank Jabar Banten in 2015. The large difference in distribution was due to the main source of *qardh al-hassan* funding being fines. Other sources of *qardh al-hassan* funds, such as *infaq/shodaqah* and *waqf* funds, have not been effectively utilized by banks. Similar to the distribution of *zakah* and *qardh al-hassan* funds, *qardh* financing also shows a high level of standard deviation.

Table 1. Description of variables

Variables	Maximum	Minimum	Mean	St. dev.
<i>Zakah</i>	2.52049E+12	392.800	1.78322E+11	6.37141E+11
QH	3.7E+10	2.000.000	2.17E+09	5.47E+09
<i>Qardh</i>	6.53E+12	26.566.666	9.2E+11	1.44E+12
ROA	0.022646	-0.03869	0.007357	0.007897
ROE	0.297933	-3.60468	0.022287	0.484553
NPM	1.12258	0.002373	0.453487	0.172728
Third Party Funds	7.79E+13	5.08E+09	1.87E+13	2.03E+13
Accounts Receivable	1.95E+14	9.08E+11	2E+13	2.84E+13
Loans	1.35E+13	1.9E+11	3.98E+12	3.71E+12

The results of hypothesis testing with the Structural Equation Modeling (SEM) can be summarized and presented in the following figure and table:

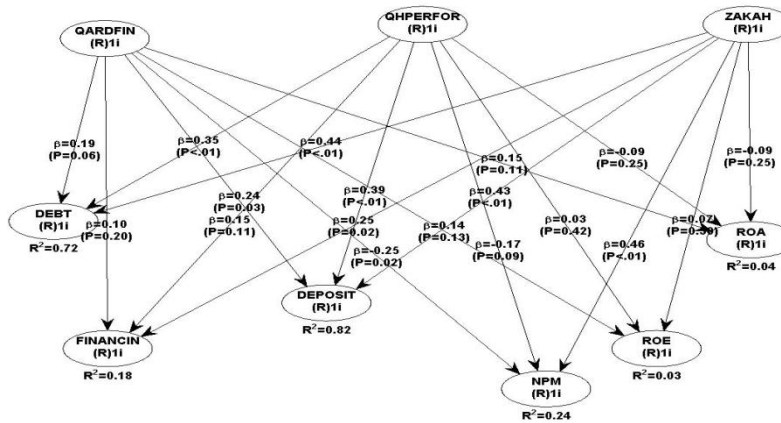


Figure 1. Results of model testing

Based on Figure 1, the results are summarized in the following table:

Table 2. Results of hypothesis testing

Independ. Var.	Debt Ratio		Financing Ratio		Third-Party Funds		Net Profit Margin (NPM)		Return On Equity (ROE)		Return On Asset (ROA)	
	B	Sign.	B	Sign.	B	Sign.	B	Sign.	β	Sign.	β	Sign.
Qardh Financing	0.195	0.057**	0.104	0.205	0.238	0.026*	-0.253	0.019*	0.143	0.127	0.152	0.111
Qardh al-hassan	0.349	0.002***	0.152	0.112	0.395	<0.001***	-0.168	0.088	0.026	0.422	-0.087	0.245
Zakah	0.444	<0.001***	0.248	0.021*	0.428	<0.001***	0.463	<0.001***	0.026	0.299	-0.087	0.248
R ²	0.72		0.18		0.82		0.24		0.03		0.03	

*** Sig. at 1%; ** Sig. at 5%; * sig. at 10%

4. Discussion

The results show that bank expenditures on social activities, in the form of distribution of both zakah funds and qardh financing, has a positive impact on the debt received by banks. That is to say, there is the potential for social funds to increase investor confidence in providing debt to Islamic banks. Zakah is a social fund collected from employees' professional zakah, customers' zakah and the company's zakah which is distributed to parties entitled to receive zakah or, as they often referred to, the eight asnaf. The eight parties who are entitled to receive zakah are the destitute, poor, muallaf (converts), fi sabilillah (religious community activists), people who are heavily in debt, slaves, musyafir (stranded travelers), and amil (appointed collectors).

These findings demonstrate empirically that improving social performance will have an impact on the increasing debt received by banks. Companies with high CSR will have higher profitability, growth, and sales than companies with low CSR (Lins, Servaes, & Tamayo, 2017). In addition, companies that have high CSR will increase debts (Lins et al., 2017). Thus, investor confidence can be built with good social performance (Kim, 2011; Lins et al., 2017).

Another consequence of channeling social funds is a positive impact on customer trust. This increase in customer trust in banks is characterized by empirical evidence showing that social expenditure (spending on zakah funds, qardh al-hassan and qardh financing) has a positive impact on the amount of third party funds received by banks, in the form of current accounts, savings accounts and time deposits. This condition indicates that the higher the bank's social performance, the more reliable the bank's performance as a safe place to save funds as well as make

investments. The results of this study corroborate the findings of Aramburu & Pescador (2017), Chung, Yu, Choi, & Shin (2015), Kim (2011) along with Sindhu & Arif (2017). Companies that have a lot of CSR activities tend to offer satisfaction, relationship value, relationship commitment, dependence, cooperation, and good communication between companies and consumers, employees, and investors (Kim, 2011).

Social expenditures can also improve a bank's image and attract its investors to increase their investment but it does not have a positive impact on increasing bank profitability. Logically, an increase in funds collected from investors constitutes an additional resource that can be used by banks to obtain profits. But the results of this study demonstrate empirically that the expenditure of social funds does not affect the amount of ROA and ROE of the bank. Here, there is a possibility that an increase in investor confidence is not accompanied by an increase in debtors, so the increase in funds collected by banks is not accompanied by an increase in the funding that is channeled. Moreover, the results of this study demonstrate that expenditure on social funds has no positive influence on the distribution of bank financing. Only the release of *zakah* can increase financing. This finding indicates that banks have the potential to experience difficulties in channeling or managing their loans. On the other hand, Islamic banks must pay the cost of raising funds in the form of margins, profit sharing, or *ujroh* (fees). As a result, ROA and ROE do not increase in line with the increase in the distribution of social funds.

These findings are different from the findings of Platonova et al., (2016); Mallin et al., (2014); Siregar & Bachtiar (2010); and Mukhibad (2018) which show that bank social performance, as measured by ISR disclosure, has an impact on bank profitability. This difference between these and previous findings is due to how social performance is measured. In this study, social performance is measured by the amount of social expenditure, while the studies by Platonova et al., (2016); Mallin et al., (2014); Siregar & Bachtiar (2010); and Mukhibad (2018) measures it by ISR disclosure. That is, it makes it possible for there to be a difference between social expenditure and bank ISR disclosure.

Another interesting finding is that *qardh* financing has a negative impact on Net Profit Margin (NPM). *Qardh* financing is a type of financing that is channeled by a bank but it does not provide profit sharing or revenue. However, with *qardh* financing, banks are only entitled to be the recipients of the return of the principal from the funds disbursed. The negative relationship between *qardh* financing and NPM shows that this type of financing is unfavorable for banks. Sa'ad & Ibrahim (2015) explain that *Qardh* financing is a non-profit loan mechanism provided by banks to poor people to help them overcome certain financial difficulties or to grow small businesses for the welfare of their family. There is a possibility that the sources of this *qardh* financing are productive funds. On the other hand, banks must provide profit sharing for productive funds collected by banks. That is, the provision of *qardh* financing originating from productive funds will cause the ratio of income to profit sharing costs to be lower.

The results also show that the expenditure on *zakah* funds has an effect on increasing a bank's NPM. We suspect that the issuance of *zakah* can increase the confidence of investors and customers who own third party funds (see Sindhu & Arif, 2017). Trust in third party funds can remove the level of profit sharing from the things considered by customers before investing in Islamic banks. Increased third party funds are not followed by an increase in the amount of funding channeled. As a result, the income received by the bank is stagnant, and this causes the profit sharing with owners of third party funds to decrease.

According to Islamic concepts, the fulfilling obligations to all stakeholders is emphasized. The Islamic approach to stakeholders' perspectives can easily be seen in a company's relationships with key stakeholders (shareholders/owners and employees), and derivative stakeholders (suppliers, buyers/customers, debtors, competitors, and the natural environment) (Beekun & Badawi, 2005). The results of this study, which show that the absence of a relationship between social performance and ROA and ROE, give rise to a provisional conclusion that the distribution of social funds has no purpose with regard to obtaining profits. Social performance by channeling social funds (*zakah* and *qardh al-hassan*) and distribution of *qardh* financing are part of fulfilling Islamic banks obligations towards stakeholders.

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