

Sharia Principle Compliance Model Between Islamic Financial Performance and Social Performance Evidence from Indonesia



Fitri Mansur, Afrizal, Achmad Hizazi, Sri Rahayu

Abstract: This study aims to explain the effect of compliance with sharia principles on sharia financial performance and its implications for Islamic social responsibility. This type of research is descriptive verification. The data used is the annual report of Islamic commercial banks in Indonesia. Data analysis using SEM PLS. The results of the study indicate that compliance with sharia principles has an effect on sharia financial performance and Islamic social responsibility. Through sharia financial performance, compliance with sharia principles has an effect on Islamic social responsibility. Islamic financial performance has an effect on Islamic social responsibility. The results of the study prove that Islamic commercial banks in carrying out their operational activities absolutely must be based on sharia because Islamic commercial banks are not only responsible to the owner but to Allah SWT. The compliance of sharia commercial banks with sharia principles fosters public trust in sharia commercial banks.

Keywords: Compliance with Sharia Principles, Islamic Financial Performance, Islamic Social Responsibility, Islamic Commercial Banks.

I. INTRODUCTION

The development of Islamic banking in recent times is quite slow when viewed from the Islamic/Sharia Financial System (Islamic Financing System/IFS) because it still has a very small market share. Until the end of 2019, Indonesia's Islamic finance market share only reached 9.01% of national financial assets, and the size of Islamic banking assets compared to the total national banking assets of 5.96%. This slowing growth movement of Islamic banking leads to a lower share of assets, third party funds, and financing of Islamic banks compared to the share of conventional banks (OJK, 2019). The Islamic banking system is substantially different from the conventional banking system. One of the fundamental aspects that distinguishes sharia and conventional banking is the fulfillment of compliance with sharia principles (sharia compliance). Non-compliance with

sharia affects public confidence in Islamic finance and exposes Islamic banking to the risk of distrust. [1] Hameed [2] in his research entitled Alternative Disclosure and Performance Measurement of Islamic Banks provides guidance on sharia indicators called the Islamic Performance Index (Islamicity Performance Index) providing an explanation of the indicators used for sharia compliance. Performance is one of the factors that must be considered by banks in order to survive. Performance measurement of Islamic commercial banks using financial ratios from conventional banks cannot be fully used for Islamic commercial banks, because Islamic commercial banks are different from conventional commercial banks. The Maqashid Syariah Index (MSI) is a model for measuring the performance of Islamic banking in accordance with sharia guidelines, namely the Al-Quran and Hadith. This model is widely known and implemented in several literature reviews to assess the performance of Islamic banks in several countries. [3] Mohamed, Oemar (2008) in his research has formulated a measurement of the financial performance of Islamic banking, which is called the Maqasid Sharia Index. Hudaefi and Noordin [4] developed MSI. The model developed in this study is called an integrated maqasid al-Sharīah-based performance measure. [4] Muhammad Syafii Antonio [5], measuring performance using the Maqashid Index approach with the SAW (Simple Additive The Weighting) method. Antonio's research results show that Islamic banking in Indonesia has better performance when compared to the performance of Islamic banking in Jordan. Companies are no longer required to only disclose their financial performance, but also their social and environmental performance. This refers to the principle of the triple bottom line, which is that in addition to focusing on maximizing profits, companies must also pay attention to the environmental and social impacts resulting from the company's operational activities. Companies can disclose information about CSR in the annual report or in the form of a stand-alone CSR or SR (Sustainability Report) report. [6]

The concept of Corporate Social Responsibility in sharia economics is based on the Qur'an, where humans are believed to be caliphs on earth, namely having the responsibility to maintain all of God's creation. This has been explained in the Qur'an surah Al-A'araf verse 74 which means ordering humans as caliphs on earth to protect all of God's creation. Islam also regulates the relationship between humans and the relationship with the natural surroundings. Islamic Social Responsibility was first initiated by Haniffa [7] and in 2013 was further developed by [8] [9] in Malaysia.

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The concept of Islamic Social Responsibility arises because of limitations in conventional social responsibility reporting, so that a conceptual framework of ISR is formed that is in accordance with the sharia concept. [10] Research on corporate social performance and corporate financial performance has often been debated (Chohran & Wood, 1984). In this case, whether the financial performance of a company that affects financial performance or social performance that affects the company's financial performance.

Research A B C D states that social performance affects financial performance, in contrast to the results of EF's research which states that social performance does not affect financial performance. Research conducted by Peng Yu-Shu [11] reveals that social media is shown as a mediation in linking CSR variables with the company's financial performance. The result of the research is that CSR has a positive impact on social performance and has a positive effect on the company's financial performance.

Falikhhatun & Assegaf in their research explains that sharia compliance using the Islamicity Performance Index which consists of Islamic investment ratios, profit-sharing financing ratios, and sharia income ratios has a significant positive effect on the health of Islamic banks in Indonesia [12]. Mehdi [13] examines the impact of the introduction of the Shariah-compliant Index (SI) on the performance and liquidity of the shares included in Bursa Malaysia, the results show that, overall, the Shariah-compliant Index (SI) has a positive impact on the financial performance of the shares included.

The results of the study above are different from the research conducted by Ananda Anugrah Nasution, et al [14] which explains that sharia compliance with the Islamic income ratio indicator has no effect on financial performance, while the profit sharing ratio indicator has a positive effect and the zakat performance ratio has a negative effect. on financial performance.

Nisa and Asrori's research [15] concludes that only the risk of musyarakah financing affects the performance of sharia compliance and each mudharabah, musyarakah and murabahah financing risk affects profitability performance.

Muhammad Azam, Muhammed Usman Khalid and Syeda Zinnaira Zia [16][17], conducted a study of sharia principles compliance on social performance (ISR) whose results concluded that sharia compliance affects social performance (ISR), these results are not in line with research by Roshima Said [18] which concludes that sharia compliance has no effect on Islamic social responsibility.

II. LITERATURE REVIEW

A. The Influence of Compliance with Sharia Principles on Financial Performance

Islamic banking in carrying out its activities must comply with sharia principles, or it can be said that Islamic banks must comply with sharia law and principles. Sharia compliance can be collected in the application of sharia principles in raising funds and distributing funds and services in sharia banking.[19]

With the theory of sharia companies, where sharia commercial banks must be based on sharia principles in operational management and sharia banking businesses are in line, because sharia commercial banks are not only

responsible to the owner but to stakeholders and Allah SWT. Bank compliance in carrying out its operations according to sharia principles is one way to maintain public trust in choosing Sharia Commercial Banks. In addition, compliance with sharia principles in Islamic commercial banks will make the bank's performance healthier. The higher the sharia compliance in applying these principles, the more likely the bank is categorized as a healthy bank.

H1: Compliance with Sharia Principles Affects Performance Sharia Finance.

B. The Effect of Sharia Compliance on Disclosure of Islamic Social Reporting

Sharia Compliance is the obedience of sharia banks to sharia principles. Islamic banks are financial institutions that operate in accordance with Islamic sharia principles, meaning that banks in their operations follow the provisions of Islamic sharia, especially regarding the procedures for converting in Islam. [20]

Disclosure of Islamic Social Responsibility is a form of trust and responsibility to stakeholders and Allah SWT. The high level of sharia compliance of an Islamic bank affects the extent of disclosure of Islamic Social Reporting. The purpose of Islamic Social Reporting is to increase the transparency of business activities by presenting relevant information by taking into account the spiritual needs of Muslim investors or sharia compliance in decision making.

H2: Compliance with Sharia Principles has an effect on Islamic Social Responsibility for Islamic Commercial Banks in Indonesia.

H3: Compliance with Sharia Principles has an effect on Islamic Social Responsibility through Sharia Financial Performance in Commercial Banks Sharia in Indonesia.

C. The Effect of Financial Performance on Islamic Social Responsibility

The theoretical basis can be used to explain the impact of the company's financial performance on the social performance of the company [21]. Resource-based theory states that companies with good financial performance will have available financial resources to improve corporate social performance [22]. Good performance is one of the assets that can be capital for a company to differentiate itself from the competition. The success of a company in carrying out Islamic social actions can gain support from stakeholders, which can increase access to resources and increase company productivity. Some researchers argue that the company's performance affects the company's financial performance, for example the research of Mio and Fasan [23] which shows that the company's social benefits affect the company's financial performance. A study by Reddy & Gordon [24] also found a positive impact of sustainability reporting on abnormal returns for companies listed in Australia. Other studies also support this view and show that corporate social performance affects corporate earnings, namely: McWilliams & Siegel [25]

H4: Islamic Financial Performance has an effect on Islamic Social Responsibility for Islamic Commercial Banks in Indonesia.

III. RESEARCH METHODS

A. Population and Sample

The population of this study are Islamic commercial banks registered with the Financial Services Authorization. The sampling technique used a purposive sampling technique with the following criteria:

(1) Islamic commercial banks operating in Indonesia: (2) Sharia Commercial Banks periodically submit annual reports issued for the 2015-2019 period on the official website of each bank. Based on the sample selection criteria, the sample Islamic banks in this study amounted to 11 Islamic banks.

B. Definition of Variable Operations

Compliance with Sharia Principles

Indicators of compliance with sharia principles in this study are: the ratio of revenue-sharing collection, the ratio of buying and selling financing, the ratio of profit-sharing financing, the ratio of halal income, the ratio of zakat, and the ratio of equity portfolio. Measured by the instrument built by Hameed, et.al (2004) provides guidelines on indicators of sharia compliance called the Islamic Performance Index (Islamicity Performance Index). And developed by Falikhathun & Assegaf (2012).

a. Profit-sharing fundraising ratio

The ratio of the calculation of profit sharing from the collection of public funds carried out by Islamic banks using mudharabah contracts includes mudharabah savings and mudharabah deposits.

Profit Sharing Ratio = $(\text{Profit Sharing Funds}) / (\text{Total Fundraising}) \times 100\%$

b. Buying and Selling Financing

The contracts used in financing with the principle of buying and selling are murabahah, salam, and istishna contracts. Financing with the principle of buying and selling is intended for customers who want to own goods.

Sale and Purchase Financing = $(\text{Pemb.Murabahah} + \text{Salam} + \text{Istishna}) / (\text{Total Financing}) \times 100\%$

c. Profit Sharing Financing

Profit sharing financing is financing based on sharia principles. The ratio for calculating profit sharing from financing carried out by Islamic banks includes mudharabah and musharaka. Profit sharing ratio can be calculated by the formula: 84

Profit Sharing Financing = $(\text{Mudharabah} + \text{Musyarakah Financing}) / (\text{Total Financing}) \times 100\%$

d. Islamic Income

The Islamic Income Ratio shows the percentage of how much halal income is earned compared to total income including total Islamic income plus non-halal income. Islamic income can be calculated by the formula: 83

Islamic Income = $(\text{Halal Income}) / (\text{Halal Income} + \text{Non-Halal Income}) \times 100\%$

e. Zakat

Zakat Sharing Ratio is an indicator of sharia compliance to measure the percentage of zakat paid by Islamic banks as evidence of compliance with sharia.

Zakat Ratio = $(\text{Zakat}) / (\text{Net Assets}) \times 100\%$

f. Sharia Financial Performance

To measure Islamic Finance by using the Maqasid Syariah Index (MSI). In this study, researchers developed MSI from

Mohammed, Dzulastri and Taib (28) by adding measuring the performance of sharia in this study using 4 indicators: individual education, creating justice, achieving prosperity and achieving efficiency.

g. Islamic Social Responsibility

In conducting the ISR assessment in this study using content analysis in accordance with the research of Qoyum et al. (2017) each item will be assigned an ordinal number to indicate items that are (disclosed) and not in the company report. To get the total value of the ISR index, it will be done by scoring, ie each item will be given a value of 1 if disclosed in the company report, and will be given a value of 0 otherwise. The value of each item is then added up and divided by the total item. After assigning a score to the ISR index, then determining the level of disclosure by using the following formula:

Disclosure level = $(\text{Number of Completed Disclosure Scores}) / (\text{Maximum Number of Scores}) \times 100\%$

C. Data Technique Analysis

The Descriptive statistical analysis was used to provide an overview of the variables in this study. The data analysis method used to prove the hypothesis in this study is structural equation modeling (SEM) based on component or variance known as Partial Least Square (PLS). After the data were collected, descriptive analysis, normality test, PLS regression, and hypothesis testing were carried out in the form of individual parameter significance tests (t test).

IV. RESULT AND DISCUSSION

A. Inferential Statistical Analysis Results

This test includes construct validity testing (convergence validity and discriminant validity) and construct reliability testing. This research was conducted using 3 research latent variables, namely: Compliance with Sharia principles, Sharia Financial Performance and Islamic Social Responsibility.

Measurement Model Test Results (Outer Model)

The validity test is carried out by using the evaluation measurement (outer) model, namely by using convergent validity. To test convergent validity, the outer loading value is used. The following are the results of the calculation of the initial model of the study (PLS Algorithm) using the SmartPLS software as shown in the table below:

From table 5.2. shows that all indicators of the latent variables of this study already have a loading factor above 0.5. Thus, these indicators are valid and reliable indicators as indicators that reflect the variables of this study.

Validity Test Results with Discriminant Validity

The next evaluation is to see and compare the discriminant validity and the square root of the extracted mean variance (AVE). The following are the measurement results with AVE on each indicator:

Based on the data presented in table 1 above, it is known that validity testing with convergent validity obtained valid indicators to measure latent variables.

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Reliability Test with Composite Reliability

Composite Reliability is the part that is used to test the reliability value of indicators on a variable.

Based on the data presented in table 1 above, it can be seen that the composite reliability value of all research variables is > 0.6 .

These results indicate that each variable has met composite reliability so that it can be concluded that all independent latent variables are appropriate and feasible to be tested variables to determine their effect on the independent latent variables.

Reliability Test with Cronbach Alpha

The reliability test with the composite reliability above can be strengthened by using the Cronbach alpha value. Cronbach alpha is said to be good if > 0.6 .

Based on the data presented above in table 1, it can be seen that the Cronbach alpha value of each research variable is > 0.6 . Thus these results can indicate that each research variable has met the requirements of the Cronbach alpha value, so it can be concluded that all variables have a high level of reliability.

Structural Model Testing Results (Inner Model)

Inner model or structural equation model to test the significance of independent latent variables. This examination includes the significance of the path relationship and the R-square value. The results of the measurement of the inner model with PLS are as follows:

From table 1 above, this R Square result can be explained that the influence of the sharia principle compliance variable gives a value of 0.726 which can be interpreted that the dependent latent variable can be explained by the independent latent variable of 72.6%, while 27.4% is explained by the independent variable. others outside of research.

B. Hypothesis Test Results

This study has 7 (seven) hypotheses which are divided into 5 (five) hypotheses to see the direct effect and 2 (two) hypotheses to see the indirect effect. To see the direct and indirect effects, then the hypothesis testing is done by using Bootstrapping on the second model of this study.

Test Results Significance Direct Effect (Direct Effect)

Table 1. presents the path coefficient value and P-Values value for testing the significance of the direct effect (total effect).

Table 1 Bootstrapping-PLS Output Direct Effect

	(O)	(M)	(STD EV)	T Statistics O/STDEV	P Values
Sharia compliance -> Sharia financial performance	0,89 2	0,87 8	0,099	9,217	0,000
Sharia compliance -> ISR	-0,34 5	-0,35 5	0,103	3,443	0,001
Sharia Financial performance -> ISR	0,24 9	0,26 0	0,055	4,636	0,000

To find out the magnitude of the influence between variables, it can be seen from the original sample estimate column and to see the level of significance it can be seen from

the P Value column. The results of hypothesis testing based on the table above are as follows:

1. Hypothesis Testing 1

The first hypothesis in this study is "the influence of sharia principle compliance on financial performance", Testing the first hypothesis produces a path coefficient value of 0.892 (positive) with a t-stat value of 9.217 > 1.96 and a P-Value value of 0.000 $< sig$ 0.005. then H_0 is accepted

2. Hypothesis Testing 2

The second hypothesis in this study is "the effect of compliance with sharia principles on Islamic Social Responsibility", Testing the second hypothesis produces a path coefficient value of -0.345 (negative) with a t-stat value of 3.443 > 1.96 and a P-Value value of 0.001 $< sig$ 0.005. then H_0 is accepted

3. Hypothesis Testing 3

The third hypothesis in this study is "the influence of Islamic financial performance on Islamic social responsibility", Testing the fifth hypothesis produces a path coefficient value of 0.249 (positive) with a t-stat value of 4.636 > 1.96 and a P-Value value of 0.000 $< sig$ 0.005 then H_0 is accepted

Test Results Significance Indirect Effect (Indirect Effect)

The next inner model evaluation test carried out in this study is the indirect effect significance test, namely: testing whether Islamic financial performance affects the relationship between compliance with sharia principles and Islamic social responsibility.

4. Hypothesis Testing 4

Testing the fourth hypothesis resulted in a path coefficient value of 0.222 (positive) with a t-stat value of 4.347 > 1.96 and a P-Value value of 0.000 $< sig$ 0.005 quality of ISR disclosure.

C. Discussion

The first hypothesis in this study states that compliance with sharia principles affects the performance of Islamic finance in Islamic commercial banks in Indonesia. This can be seen from the path coefficient value of 0.892 (positive), the results of statistical tests show a P value of 0.000, so the first hypothesis is accepted. The results of this study prove that compliance with sharia principles has an influence on Islamic financial performance in Islamic commercial banks in Indonesia, this is because Islamic commercial banks in Indonesia carry out their operational activities based on sharia principles and do not use interest in collecting funds from the public or provide financing to third parties. The collection of funds in Islamic banks is different from that found in conventional banking. This is in line with the theory of stewardship because Islamic banking in its operational and business management is based on sharia principles according to the mandate given, thereby increasing public trust, and eliminating people's fears of losing the privileges they seek in Islamic banking. So that it affects the decision to choose or continue to use the services offered by Islamic banks. Supported by research by Falikhatun and Assegaf [12], Andespa[26], and Afridawati and Gampito [27].



The second hypothesis in this study states that compliance with sharia principles has an effect on Islamic Social Responsibility in Islamic commercial banks in Indonesia. This can be seen from the path coefficient value of -0.345 (negative) with a P value of 0.001. The results of these tests are quite interesting findings, because the implementation of good sharia principles does not guarantee high social disclosure as well.

This is due to the fact that Islamic commercial banks in Indonesia assume that the implementation of banking operational activities in accordance with sharia principles will increase public trust so that there is no need to pay attention to social responsibility reports, but on the contrary if public trust begins to decrease towards Islamic commercial banks, it is necessary to report disclosures that have been made. good. So that people will trust and be interested in investing again. This is not in accordance with research conducted by Khasanah & Yulianto, [28]

The third hypothesis in this study states that Islamic financial performance has an effect on Islamic Social Responsibility in Islamic commercial banks in Indonesia. This can be seen from the path coefficient value of 0.249 (negative) with a P value of 0.000. companies with social responsibility disclosures. The better the company's financial performance, the more widely the company discloses social responsibility. The results of this study support the agency theory that when the company makes a profit, the company's management will give a signal to investors by disclosing its financial statements as soon as possible and will provide additional information about the company's activities, while when the company's performance is poor, the management may prefer to limit access to accounting information. . The results of this study are also supported by research by Nasution (2018), (Lako, 2014), Arshad (2012)

The fourth hypothesis in this study states that compliance with sharia principles has an effect on Islamic Social Responsibility through Islamic financial performance at Islamic commercial banks in Indonesia. This can be seen from the path coefficient value of 0.222 (positive) with a P value of 0.000. Islamic commercial banks will disclose their social responsibilities sufficiently to gain public trust. Disclosure of good social responsibility carried out by Islamic commercial banks cannot be separated from the performance of these Islamic commercial banks. This performance shows the condition of the company regarding the goals to be achieved. One of the objectives of sharia banking performance is to pay attention to the benefit of the people, which must be carried out in accordance with sharia concepts that are in accordance with the Qur'an and Hadith. Maqasid sharia is the goal of Allah and His Prophet in formulating Islamic laws (Sakirman, 2012). The results of this study are in accordance with research conducted by Oktarina (2015) and Sunarwan (2015), Arifin and Wardani (2016) and Sidik and Reskino (2016). However, the results of this study contradict the research conducted by Kartika (2014) and Fauzi (2016).

V. CONCLUSIONS

Based on the results of the tests that have been carried out, it can be concluded that shariah compliance has an effect on sharia financial performance, shariah compliance and shariah

financial performance also affect ISR. Through sharia financial performance, compliance with sharia principles also has an effect on ISR. Islamic banking must be able to account for resources in accordance with sharia principles to gain the trust of stakeholders, because the better the company's financial performance, the more widely the company discloses social responsibility.

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