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The Effectiveness of Zakat, Islamic Corporate Social Responsibility, and Sharia Supervisory Board in Driving the Financial Performance of Islamic Banks: Case Study in Indonesia

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Abstract: *This research aims to examine the influence of zakat, Islamic corporate social responsibility, and the Sharia supervisory board on financial performance, as appraised by return on assets (ROA), in Islamic commercial banks in Indonesia during the period 2018-2023. This study employs a causal research design with a quantitative approach. The sampling method used is purposive sampling. The samples consist of 42 banks listed with the Financial Services Authority. Secondary data sourced from the annual reports of each Islamic commercial bank in Indonesia are utilized in this study. Panel data regression analysis is used as the analytical technique. The study's findings reveal that zakat positively impacts financial performance, whereas Islamic corporate social responsibility and the Sharia supervisory board do not. This research confirms that zakat plays an important role as a strategy for reputation and public trust. Meanwhile, the effectiveness of ICSR and DPS needs to be improved thru strengthening the quality of social programs, independent supervision, and regulations that are not merely formalities.*

Keywords: *Financial Performance; Islamic Corporate Social Responsibility; Sharia Supervisory Board; Zakat.*

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INTRODUCTION

An Islamic bank is a banking institution that operates within the Islamic economic system. Initially, Islamic banks emerged in response to a group of banking practitioners and Muslim economic groups seeking to provide financial services in accordance with the principles and moral values of Islamic Sharia. Islamic commercial banks are one of the three types that offer payment services. During its operation, Islamic commercial banking has grown so rapidly that it is certainly not immune to problems. During its operation, BUS faced several challenges in maintaining good performance and improving its position compared to conventional banks (Ida Puspitarini, 2022).

In 2020, the number of Islamic Commercial Banks (BUS) qualified with the Financial Services Authority (OJK) There were 14 institutions. In 2021, this number increased to 15 Islamic Commercial Banks (BUS). However, in 2022, the number of BUS decreased from 15 to 13 institutions due to the mergers of state-owned Islamic banks, namely Bank BNI Syariah, Bank Syariah Mandiri (BSM), and BRI Syariah, which merged to form Bank Syariah Indonesia (PT BSI) (Financial Services Authority OJK RI, 2022).

The growth of Islamic banks today fosters competition between Islamic and conventional banks. This influences each bank's growth and performance. The performance of Islamic banking in Indonesia is closely related to the escalation in the number of banks. This is because Islamic banking is expected to have good company performance, not only based on the development of its office. The bank's financial statements can serve as a basis for assessing its economic performance. One indicator is the return on assets *(*ROA), this ratio measures a company's ability to generate profits from assets funded by public funds (Zuliana & Aliamin, 2019).

Islamic banking has expanded not only in countries with predominantly Muslim populations, like Indonesia but also in countries where Muslims are a minority for example the United Kingdom, especially London, which has become the focus of Islamic business and finance in the European region. The practice of Islamic finance in the UK is already very prevalent. In 2021, the Bank of England, the UK central bank launched a unique Sharia-based liquidity instrument. This is an alternative liquidity facility for UK banks, enabling UK Islamic financial institutions to access it in accordance with Sharia principles from the central bank (Bank Of England, 2021).

Globally, the Islamic banking sector has witnessed significant expansion. Based on information from the Islamic Financial Services Board (IFSB), the universal Islamic finance industry's total assets amounted to $3.25 trillion in 2022 (IFSB, 2023) and increased to $3.25 trillion in 2023 (IFSB, 2024). In addition, according to Refinitiv and ICB reports, global Islamic financial assets continue to increase annually. In 2019, global Islamic financial assets were recorded at US$2.88 trillion and are projected to grow to US$3.69 trillion by 2024 (Julita, 2021).

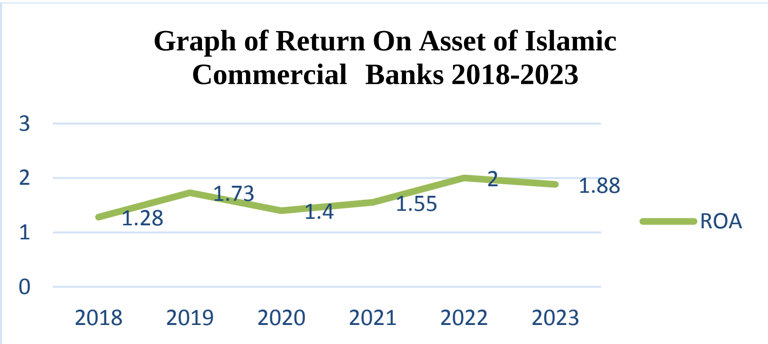

Figure 1. Financial Ratios of Islamic Commercial Banks in Indonesia
Source: Islamic Banking Statistics, December 2018-2023.

As shown in the graph above, the ROA of Islamic Commercial Banks has fluctuated from 2018 to 2023. It can be seen that in 2018, ROA reached 1.28%, then in 2019, ROA increased by 1.73%; in 2020, ROA decreased by 1.4%; in 2021, ROA increased by 1.55%, then in 2022, ROA experienced a significant increase with ROA of 2.00% and decreased in 2023 with ROA of 1.88%. From this information, it can be seen that the ROA of Islamic commercial banks increased and then decreased from 2018 to 2023. This certainly requires further research to determine whether there is an impact of zakat, ICSR, and the Sharia supervisory board on bank performance, given that banks that implement zakat, ICSR, and have a Sharia supervisory board should be able to enhance bank performance, as reflected in ROA.

The process of identifying specific indicators to assess a company's profitability is known as financial performance analysis (Retnaningsih, Susi, widi Hariyanti, 2019). Every company, including those in the Islamic banking industry, aims to achieve significant profit in line with its function and purpose as a Sharia-compliant business entity. On the other hand, Islam has regulated how profit can be the goal of operational activities without violating the principles of Islamic law, one of which is avoiding the use of usury. Islamic banks are institutions that provide financial services in accordance with Sharia principles. A bank's good or bad financial performance reflects its ability to allocate and manage its resources. Therefore, banks need to measure their economic performance. The better the financial performance of the bank, the better its values in the eyes of investors (Agustin, 2020).

One of the determinants that affects financial performance in this study is zakat. Zakat is a way for companies to help reduce poverty in the economy. Based on Law No. 23 of 2011 on zakat management, zakat is an obligation for Muslims or companies to allocate a portion of their assets and distribute them to eligible recipients in accordance with Islamic law (Government Regulation of the Republic of Indonesia, 2011). Zakat is intended to improve the company's reputation as a socially responsible one by providing information about CSR, thereby strengthening its business transactions. Zakat will also help generate profits. Investors generally seek high returns, so this profitability information is essential. Therefore, corporate zakat is received from the company based on all its profits (Ahmad, 2019). Banks that issue zakat regularly will try to make their company more straightforward to increase confidence, if this will help the performance of Islamic banks (Wardiwiyono & Arty Fitria Jayanti, 2021).

In addition to zakat, Islamic Corporate Social Responsibility (ICSR) is another determinant affecting financial performance. The company demonstrates social responsibility in its environment, for example through ICSR by conducting social activities and operating its business. ICSR is the Islamic Corporate Social Responsibility (CSR) notion that develops from conventional CSR concepts. ICSR arises because CSR is a concept from the West and is not rooted in Islamic values. Thus, Islamic banking must reflect a social responsibility derived from Islamic teachings (Yususf, 2017). This ICSR program will attract investors to participating companies because they can realize greater profits, thereby impacting financial performance (Mahanani et al., 2017). Because of the existence of ICSR, People are generally more likely to trust companies that practice ICSR compared to those that do not. This contributes significantly to business practices in Muslim-majority areas, where environmental management is seen as part of moral and religious responsibility (Sisdianto et al., 2024). The company's success can be partly measured by ICSR disclosure. Investors can assess the company's state at a particular time by examining its performance, which will help with decision-making (Septian et al., 2022).

Another determinant of financial performance is the Shariah Supervisory Board (DPS). Sharia Supervisory Boards an independent body of Sharia and banking experts for Islamic financial institutions. Its task is to examine and implement the rulings of the National Shariah Council within Islamic banking and financial institutions (Ilyas, 2021). The Sharia Supervisory Board is tasked with advising and consulting the board of directors and overseeing the bank's operations to ensure compliance with Sharia law and values and to improve the bank's overall performance (Intia & Azizah, 2021). The supervisory mechanism of the Sharia Board is responsible for analyzing the Islamic bank's operations and assessing its activities and products. The Sharia Supervisory Board can ultimately use this mechanism to ensure that the Islamic bank's operations align with the guidelines set by the national Sharia council's fatwa and to provide insights into the bank's Sharia compliance, as disclosed in the bank's public reports (Hasibuan, et al., 2020).

Building on previous research, it can be seen that there is a gap between the research results and the researchers' results. The results of the study (Septian et al.,2022) demonstrate that zakat has a significant influence on financial performance. Several international studies support the research results on zakat's impact on economic performance. The research findings in Abd Samad et al. (2018) discovered that zakat has no impact on financial performance. In research belonging to Ibrahim et al. (2020) found that zakat affects financial performance.

Research by Arshad et al. (2012) and Permatasari et al. (2023) shows that Islamic corporate social responsibility affects financial performance. Syurmita & Miranda (2020) and Al-Malkawi (2018) show that zakat and ICSR positively affect economic performance. Research conducted by Marjuki (2023) shows that zakat and ICSR do not influence financial performance, whereas the Sharia supervisory board does.

Some international research journals related to ICSR show that Islamic Corporate Social Responsibility (ICSR) influenced financial performance. This is consistent with the study by Mallin et al. (2014) and aligns with the findings of Zafar et al. (2022), which show that ICSR affects the financial performance of Islamic banks. Similar results were also found in the study of Emad M. Hashem Otri et al (2024)

In the research journal belonging to (Mallin et al., 2014) the findings revealed that the Sharia Supervisory Board (DPS) had an impact on financial performance. This is consistent with the study by (Abdallah & Bahloul, 2021), (Kok et al., 2022) and (Tashkandi, 2023) This has affected DPS's financial performance.

This study is designed to bridge the research gap by analyzing in depth the effects of Zakat, ICSR, and Sharia Supervisory Boards on the financial performance of Islamic commercial banks in Indonesia. This study focuses its analysis on the impact of these variables on company profitability as measured by the ROA ratio.

RESEARCH METHODS

This study employs a causal research design that aims to explain causal relationships among multiple concepts or variables by examining the correlation between independent variables and the dependent variable (Duryadi, 2021). A quantitative approach is used in this research. Quantitative research generates findings through statistical procedures or other quantification methods (Sujarweni, 2015). The data used in this study are secondary, sourced from the annual reports of Islamic Commercial Banks, which are available on each bank's official website.

This research uses purposive sampling, which involves selecting samples based on specific criteria or considerations. It targets all Islamic commercial banks in Indonesia from 2018 to 2023, totaling 80 banks (Sujarweni, 2015). The sampling criteria for this study require that the company be an Islamic commercial bank registered with the Financial Services Authority for the period 2018-2023; banks that cannot be accessed to obtain the relevant annual report data are available on the official website of the Islamic Commercial Bank, and Companies that do not display the data needed by the author to determine the year variable. 42 samples meet the predetermined criteria as follows:

Table 1. Criteria of Samples

No.	Criteria	Total
1.	Islamic Commercial Banks registered with OJK during the period 2018-2023	80
2.	Companies that cannot be accessed publish annual financial reports in the period 2018-2023	(17)
3.	Companies that do not display the data needed by the author to determine the variables for 2018-2023	(21)
Number of samples used		42

Source: Data processed by researchers, 2024

This study uses financial performance (Y) as the dependent variable, while Zakat, Islamic Corporate Social Responsibility, and the Shariah Supervisory Board (X) are the independent variables. Financial performance (Y) is measured by the profitability ratio ROA. ROA measures a company's efficiency in using its assets to generate profits. Profit serves as an indicator of a company's performance, meaning that the higher the profit achieved, the better the company's performance (Andryani & Kunti, 2012). ROA is a ratio that measures the extent to which a company's assets generate profits. The following is the formula for calculating Return on Assets:

$$ROA = \frac{\text{Profit before tax}}{\text{Average total assets}} \times 100\% \qquad (1)$$

The variable (X_1) Zakat is measured using data on zakat payments made by the company, which, for Islamic Commercial Banks is typically disclosed in the income statement (Syurmita, 2020). Zakat is calculated at a rate of 2.5% using the following formula :

$$\text{Zakat} = 2{,}5\% \times \text{Profit before tax} \qquad (2)$$

Variable (X_2) Islamic Corporate Social Responsibility (ICSR) is measured using the Islamic Social Reporting (ISR) index. The ISR index used is chosen because the company studied is an Islamic commercial bank, so the measurement of the ISR index is more appropriate, as it is believed to align with the Islamic perspective. There are six themes of ICSR disclosure in the ISR framework: investment and finance, products and services, labor, community, work environment, and corporate governance. An ISR value is assigned as one if an item is disclosed and zero if it is not disclosed (Arshad et al., 2012). The ICSR disclosure index is calculated as follows:

$$\text{ICSR} = \frac{\text{Disclosed item}}{\text{Total number of disclosed items}} \qquad (3)$$

The variable (X_3) Sharia Supervisory Board is responsible for monitoring the bank's activities to ensure compliance with Sharia principles and offering guidance and recommendations to the board of directors. The total number of members on the Sharia Supervisory Board measures this (Marjuki, 2023). The following is the formulation of the Shariai Supervisory Board:

$$\text{DPS} = \sum \text{Number of members of the Sharia Supervisory Board} \qquad (4)$$

This inquiry employs panel data regression analysis as its analytical technique. Data processing was conducted using the E-Views application, a user friendly Windows based software (Sugiyanto, 2022). This study uses the panel data method, which integrates time-series data (time-series data) with cross-sectional data (cross-sectional data), meaning the data cover several objects and several periods, making it complex (Sugiyanto et al., 2022).

RESULTS AND DISCUSSION

The Effect of Zakat on the Financial Performance of Islamic Commercial Banks in Indonesia for 2018-2023

In the Islamic banking framework, zakat is both a religious practice and a tabarū (social responsibility) that business actors must uphold to keep their operations balanced. Zakat is considered one of the corporate social features that can increase a company's value by spreading awareness of social responsibility and encouraging business transactions (Ridwan, 2004) .

Based on the results of hypothesis testing in this study, the t-value is 3.021043 > t-table (2.02107539), and the p-value is 0.0045 <0.05. Therefore, the hypothesis is accepted, which means that the zakat variable affects the financial performance of Return on Asset (ROA). It has been proven that banks make regular zakat payments every year. Thus, it can be concluded that paying zakat will not hurt the assets of Islamic commercial banks, otherwise it will increase assets and improve financial performance. In line with the Shariah Enterprise Theory, Muslims must pay zakat as proof of a servant's commitment to his principles and as a means of meeting the needs of his stakeholders.

This research is in line with research conducted by Nabillah & Ulfi (2022) This states that the zakat program can increase public trust in Islamic commercial banks, which impacts financial performance. This research is also in line with the research of Septian et al. (2022), Anggraeni & Mitra (2024), Ibrahim et al. (2020), and Putrie & Siti (2019).

The Effect of Islamic Corporate Social Responsibility (ICSR) Financial Performance (ROA) Islamic Commercial Banks 2018-2023

Islamic Corporate Social Responsibility (ICSR), originated from conventional CSR and refers to a business's obligation to consider the interests of its users, communities, shareholders, employees, and the surrounding environment across all aspects of its operations, extending beyond legal obligations (Yusuf, 2017). Based on the results of hypothesis testing in this study, the t value of 1.816910 < t table, namely 2.02107539, and the sig value 0.0771 > 0.05, then the hypothesis is rejected, which means that the Islamic Corporate Social Responsibility (ICSR) variable does not affect the financial performance of Return on Asset (ROA).

This shows that the increased ICSR disclosures do not affect the company's efforts to maximize income from its assets. Theoretically, the disclosure of ICSR is a form of fulfilling investors' expectations and desires for more information about all company activities, in this case, the activities of Islamic commercial banks. However, when a company faces financial instability, it usually improves its economic performance first until it is fully stable, and then fulfills its social responsibility (Pratama, 2022).

This study's results align with Stakeholder Theory, which underpins the research hypothesis. This theory holds that the company is concerned with personal interests and must consider its stakeholders, such as the community. Gaining benefits from CSR companies can create value, which takes time (Rahmawaty, 2021). According to Hill in research Sidik & Reskino (2018) it revealed that globally, companies involved in CSR did not experience a significant increase in stock prices over 3 to 5 years. However, over the past 10 years, companies' stock prices have risen substantially.

The results of this study are not consistent with the findings of research conducted by Emad M. Hashem Otri et al. (2024), Zafar et al. (2022) and Mallin et al. (2014), but the results of this study are in line with research conducted by Rizwanti et al. (2023), Ilmi et al. (2020) and Mais et al. (2023) States that Islamic Corporate Social Responsibility does not affect financial performance. The company's low disclosure of Islamic corporate social responsibility information cannot lead to positive changes for Islamic commercial banks. So, the more ICSR disclosure items are reported by Islamic commercial banks, the more CSR activities are disclosed and affect company profits, the lower the effect on ROA (Husna, 2020).

The Influence of the Sharia Supervisory Board on Financial Performance (ROA) at Islamic Commercial Banks 2018-2023

Based on the hypothesis research results, the t-value of 1.064258 is less than the t-table value of 2.02107539, and the significance value of 0.2939 is greater than 0.05. Therefore, the hypothesis is rejected, indicating that the Sharia supervisory board variable does not influence Return on Assets (ROA). This suggests that the number of members of the Sharia supervisory board does not affect the bank's economic performance. This is because the board's duties and responsibilities are limited to supervising and assessing the Sharia compliance of banking operations, products, and services.

Additionally, the Shariah supervisory board does not influence financial performance because an increasing number of board members can lead to unnecessary debates and delays in decision-making. Moreover, some members concurrently serve on the sharia supervisory boards of multiple banks, resulting in divided attention and reduced effectiveness in overseeing a bank's operations. This contributes to the Sharia supervisory board's perception of poor performance (Zuliana & Aliamin, 2019). Therefore, the Sharia supervisory board must pay close attention to its duties to ensure Sharia compliance in the banks it supervises.

The results of this study contradict previous research by Marjuki (2023), Tashkandi (2023), Umam & Yogi (2020), Abdallah & Bahloul (2021), Kok et al. (2022) and Mallin et al. (2014) This states that the Sharia supervisory board affects financial performance. However, the results of this study are in line with the research of Intia & Azizah (2021), Nugraha et al. (2023), and Bayu (2023) this states that the Sharia supervisory board does not affect financial performance (ROA).

CONCLUSION

Based on the test results and data analysis, it can be concluded that zakat affects the financial performance (ROA) of Islamic commercial banks from 2018 to 2023. This is evidenced by each bank consistently paying zakat every year. In contrast, Islamic corporate social responsibility did not influence the financial performance. (ROA) of Islamic commercial banks during the same period. This is because the more ICSR disclosure items disclosed by Islamic commercial banks, the more CSR activities disclosed will undoubtedly affect company profits and reduce company performance. Furthermore, the Sharia supervisory board did not affect the financial performance (ROA) of Islamic commercial banks from 2018 to 2023. This indicates that the number of Sharia supervisory board members does not impact the bank's financial performance, as their role is limited to overseeing operational activities to ensure compliance with Sharia principles.

The implications of this research indicate that zakat policies need to be strengthened as a strategy for reputation and public trust because they have been proven to contribute to the financial performance of Islamic banks. Islamic Corporate Social Responsibility (ICSR) must be transformed from a mere disclosure formality into an activity that has a real impact on society and investors, thereby improving financial performance. Additionally, the effectiveness of the Sharia Supervisory Board (DPS) oversight is determined more by the quality, independence, and capacity of its members than by mere numbers, so the focus of strengthening should be directed toward these aspects. This finding also underscores the importance of regulations that promote the standardization of ICSR disclosures and the evaluation of DPS performance, ensuring they are not only formally compliant but also capable of creating sustainable economic value. This study has limitations: the independent variable, profitability, relies only on ROA, so researchers recommend using additional profitability proxies or adding them.

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