Are the Social Concern Policies of Islamic Banks Caused by Economic Motives? Empirical Evidence on Islamic Banks in Indonesia

Hasan Mukhibad[1], Prabowo Yudo J[2]; Indah Anisykurlillah[3]
{hasanmukhibad@mail.unnes.ac.id [1], yudo@mail.unnes.ac.id [2], indah_anis@mail.unnes.ac.id}

Universitas Negeri Semarang, Indonesia[1]
Universitas Negeri Semarang, Indonesia [2]
Universitas Negeri Semarang, Indonesia [3]

Abstract. This research aims to demonstrate empirically whether banks' concern for society and the environment, as measured by the increase in social funds, is based on economic motives (changes in profit sharing, capital, funding, credit risk and profitability). The population is Islamic banks in Indonesia and a sample of 11 banks was determined using the purposive sampling method and with observations from the period 2014 to 2017. The data analysis uses the Structure Equation Model aided by the WarpPLS tool. The results demonstrate that there is no relationship between changes in the level of profit sharing, changes in Non-Performing Financing, and changes in profitability to the policy of channeling social funds. Changes in capital and funding received by banks have low significant influence on the policy of channeling social funds. These results indicate that there is no strong proof that the policy of channeling social funds is caused by economic motives.

Keywords: Social Fund Distribution Policy, Credit Risk, Profit Sharing Risk; Capital Risk.

1 Introduction

An Islamic Bank is a bank that uses Sharia principles as a basis for its operations. Indonesian Law No. 21 of 2008 concerning Islamic banks states that Sharia principles are *fatwas* issued by an authorized party, in this case the National Sharia Council (DSN). The main principle of Sharia is avoiding interest which is part of a bank's effort to support social justice and concern [1]. The social concern of Islamic banks is with regard to the impact of the task that is accepted by humans individually or collectively as *khalifah fil ardhi*. The concept of the *khalifah* refers to the task for himself and his duty to the *ummah* (Islamic community) as a whole to fulfill the rights and protect human welfare [1]. However, the social functions carried out by Islamic banks have diminished over time. Many reseacher, like Mallin, Farag and Ow-Yong [2]; El-halaby and Hussainey [3]; Farook, Hassan and Lanis [4]; Maali, Casson and Napier [5]; Sugianto and Harapan [6]; Santoso and Dhiyaul-haq [7]; Pratama [8] and Assegaf, Falikhatun and Wahyuni [9] found that the disclosure of Islamic bank's social activity was lack.

This low level of CSR disclosure is far from ideal in terms of current developments which now see CSR being used as one of the main factors behind the success of business entities that want to continue their existence with a good reputation while achieving maximum profit [9].

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CSR also functions as a strategic tool used by companies in facing international competition. However, a company having social concern is not in line with the thinking of neoclassical economists. They argue that companies that meet the social needs of their stakeholders will experience competitive losses resulting in reduced profits because these social costs can be avoided or borne by others (such as the government) [2].

The debate about this view has led many researchers to demonstrate empirically that, in fact, social concern is also able to increase profits [10][11]. Social concern enhances the company's branch image [12] which has an impact on customer loyalty [13]. The benefits of social concern in terms of performance also occur in Islamic banks. [13][14][2] demonstrated empirically that CSR disclosure had an impact on improving financial performance, both in the short and long term.

However, motivation to improve performance with CSR activities is not appropriate. Social performance in Islamic banks is its responsibility as a *khalifah*. This means that the motivation of Islamic bank to engage in social activities is different from conventional banks [15]. Thus, the implementation of social activities by Islamic banks is more done as part of worship through activities serving the community and the environment [3].

In several previous studies, researchers have focused on institutional factors affecting bank social performance as measured by CSR disclosure [3][2][14][4] and [13] have still been limited in demonstrating the motivation of Islamic banks to in terms of its social performance. In addition, the above studies measure social performance based on disclosure and have not measured it based on social costs channeled by banks. This method of measuring social performance based on CSR disclosures does not accommodate Islamic banks that channel a lot of their social funds but have limitations in disclosing them in their annual reports. For this reason, in this study the measurement of social performance is not measured based on CSR disclosure, but based on bank social expenditure.

2 Theory and Development of Hypotheses

The risks faced by banks include capital risk, credit risk and profitability risk. Islamic banks forbid the practice of charging interest (usury) and replace it with a profit sharing system. With this profit sharing system, Islamic banks face more complex risks than conventional banks. One of the risks is low profit sharing given to third party fund owners.

In contrast to conventional banks that provide a predetermined amount of interest, Islamic banks provide profit sharing, the amount of which depends on the bank's monthly performance. Islamic banks that have good performance provide high returns to the owners of savings and deposits, and vice versa; if the performance is low, the profit sharing provided is also low. Low profit sharing makes investing in Islamic banks less attractive. The subsequent impact is that there will be a transfer of savings and deposits to conventional banks. This is even more the case in Indonesia, which applies a dual banking system that allows customers to change banks. This condition is exacerbated by the fact that there are more rational customers of Islamic banks in Indonesia who have economic reasons to invest their funds in Islamic banks.

The second risk is capital risk. The bank has the function of collecting funds and channeling it to deficit funds. There is a consequence of this role if the amount of funds raised is greater than the capital they have. Capital has a function as a risk bearer if the bank goes bankrupt. Thus, banks having limited capital causes them to face high risk, namely the risk that the banks have limited ability to guarantee the return of customer funds that they have collected.

The third type of risk is funding risk. The large amount of customer funds collected by the bank has consequences for channeling it in the form of financing. Unproductive customer funds will cause the income received by the bank to stagnate and cause the profit sharing provided to customers to decrease. This means that Islamic banks are increasingly at risk if the funds received by third parties exceed the bank's ability to pay.

The fourth risk is credit risk. The bank's function as an intermediary institution has the consequence that funds raised should be channeled in the form of credit. However, lending must also be done carefully. The amount of credit channeled will increase the bank's income; however, credit disbursement that is not based on a good feasibility analysis will lead to bad credit, and no return of capital in the form of profit sharing for the credit channeled.

As with other entities, Islamic banks—which are religious business entities—the level of profitability is a very important performance measure. In addition to measuring the owner's returns, profitability is important information for the customer in assessing the health of the bank. Customers will choose a healthy bank because the level of health will affect the ability of banks to pay their debts and refund customers' funds.

The aforementioned business risks faced by Islamic banks are a challenge for them to control or even avoid. It is important for these risks to be controlled so that banks are able to maintain business continuity and stabilize and even improve their performance [16]. One effort to control risk is to increase customer loyalty by maintaining customer trust, bank image and performance. One was that can be done is through social performance. [16] found that one activity that can reduce risk is CSR. According to instrumental theory, CSR must be considered by an institution's risk management system and also as a tool to increase business volume [17].

This hypothesis is based on empirical evidence presented by [2]; [18]; [19]; [20]; [20]; and [10] who found that CSR can improve company performance. This idea of performance being improved by CSR is very reasonable because CSR is able to increase loyalty, customer satisfaction, and the reputation and brand of the entity [21][22][23][24][25]. Based on this explanation, the following hypothesis has been developed:

H: Third party fund sharing rate, Capital Adequacy Ratio (CAR), funding, Non Performance Financing (NPF), and profitability have an impact on social fund distribution policies.

3 Method

For its sample, this study uses eleven Islamic commercial banks in Indonesia with observations from the period 2014 to 2017. The research samples were determined by the purposive sampling method and this produced 40 units of analysis.

The measurement method of each variable is adjusted for the purpose of the study in order to explain whether changes in bank risk are the basis for policy making for social distribution, so all variables are measured by changes in risk compared to the risk of the previous year. Operational variables are measured as follows:

a. The social funding policy (CSR policy) is measured by the percentage of changes in the distribution of social funds this year compared to the previous year's social funds distribution ($CSRP = \frac{CSR^t - CSR^{t-1}}{CSR^{t-1}}$)
b. Profit sharing risk is measured as a percentage of this year's changes in profit sharing of savings and deposit funds compared to the previous year's profit-sharing rate.
c. Capital risk is measured by the percentage of CAR changes compared to the previous year's CAR.

d. Funding risk is measured as a percentage of changes in the amount of third-party funds this year compared to the previous year.
e. Credit risk is measured by the percentage of this year's NPF changes compared to the previous year's NPF.
f. Profitability risk is measured by the percentage of changes in ROA and ROE this year compared to the previous year.

For data analysis, this study uses Stuctural Equation Model analysis with the assistance of the Warp PLS tool. Before the hypothesis is set, fit model tests are carried out by looking at the Average R-squared (ARS) values, Average path coefficient (APC), Average Block VIF (AVIF), Average Adjusted R-squares (AARS), and Average full collinearity VIF (AFVIF) [26].

4 Results And Discussion

The results of the descriptive test are presented in the following table:

Tabel 1. Descriptive Analysis

Indicator	Prof Sharing Cost	CAR	Funding	ROA	ROE	NPF	CSR
Average	0.150127	0.011781	0.241434	-0.32105	2.518983	0.355285	10.64108
Min	-0.89763	-0.39914	-0.402	-36.1338	-150.979	-1	-1
Max	7.055815	0.514151	1.815316	32.48392	345.7474	6	468.6651
St Dev.	0.894322	0.219942	0.315037	7.083355	45.65924	1.203165	59.61606

The table above shows a very diverse variation of data on CAR, ROA and CSR fund diversion. The profit-sharing rate for owners of savings and deposits shows different variations. This research sample provides profit sharing growth given to customers with an average growth rate of 15.12%. In addition to profit sharing growth, Islamic banks also have a positive CAR growth of 1.18%. CAR growth supports the growth of assets of Islamic banks which have annual average asset growth of 11.92% [27]. Bank growth is supported by the average growth of third-party funds by 24.14%. However, performance-lowering conditions occur at with a decreasing ROA of 32.10% and an increasing NPF of 35.53%. From this descriptive analysis, it can be seen that Islamic banks have declining financial performance. The results of the study are presented in the following table:

Table 2. Results of Hypothesis Testing

Independent Variables	Beta	Sig.	R^2
PLS Cost	-0.09	0.24	0.05
CAR	-0.10	0.10*	
Funding	-0.17	0.09*	
ROA	0.10	0.21	
ROE	-0.07	0.31	
NPF	0.13	0.14	

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

Table 3 shows that the rate of change in profit sharing with customers provided by banks does not affect the policy of channeling CSR funds. This fact implies that the low profit sharing provided to customers will cause a high risk of transferring savings and deposit funds to other banks. For creditors, entities that have a high degree of social concern have lower credit risk [28]. However, this risk does not cause Islamic banks to disburse more CSR funds.

Table 3 also shows that the high and low levels of CAR are the reason why banks provide additional funding for social funds. The negative beta value with a significance value of 0.10 indicates that the relationship between CAR and CSR is slightly significant and has a negative relationship. CAR is an indicator for measuring the ability of bank capital to guarantee the bank's business risk. When banks have a CAR that falls, they have a higher risk and this causes the amount of social funds channeled by banks to increase. In addition, the low CAR can to diminish corporate image due to the decreasing ability of banks to guarantee the funds raised. One effort that can improve the image is through CSR activities [12]. [17] found that banks that have low capital risk tend to provide more complete disclosure of CSR reports.

In addition to the decline in CAR, the results of the study also show that changes in bank third party funds originating from savings and deposits have a slightly significant and negative effect on changes in the distribution of social funds. This evidence shows that the decrease in savings and time deposits collected by banks has the potential to create a rush to withdraw funds that have an impact on liquidity risk. The need to control risk due to a decrease in savings and time deposits causes banks to increase the distribution of social funds.

The results of the study also show that changes in bank financial performance do not have an impact on changes in the amount of social funds channeled by banks. The measure of performance in this study uses profitability ratios as measured by ROA and ROE, so the decrease in the level of ROA and ROE obtained by banks is not one of the conditions that causes banks to increase social funds given to the community to reduce the amount of poverty. The diminishing profits will indicate that the bank has a poor performance, because profits are the main indicator of the bank. This situation can also support the conclusion that the risk of investing in such a bank has a high risk and this causes a low level of public confidence in the bank. [18] argue that public trust in the entity can be improved through the distribution of CSR funds. CSR is clear evidence that the entity has concern for the community. This attitude of concern will be perceived by the community and form a "positive perception" of the company among the community and stakeholders.

The bank's risk level as measured by NPF also results in the finding that the changes in the NPF for Islamic banks do not cause them to increase their concern for social and environmental issues. High NPLs have diverse impacts, namely low income, and low liquidity, and low ability of banks to provide credit. These three conditions will have a direct impact by decreasing the profit sharing given to customers and causing the low profitability of the bank.

The various bank risk measurements above indicate that only liquidity risk and capital risk are factors that are slightly significant to changes in the distribution of bank social funds. Liquidity, profitability, credit, and profit sharing risks were demonstrated as having no impact on the bank's social concern. This result implies that the social and environmental concerns of Islamic banks are not caused by economic motives. This result rejects the findings of [17] which posited that banks that have low capital risk, high liquidity risk, and low profitability have a tendency to reveal more complete CSR reports.

There is the potential that the social awareness of Islamic banks is a consequence of banks that have a vision and mission to use Sharia rules as the basic concept of bank management. The consequence of Sharia law as the basis for bank operations is that banks must have responsibilities to stakeholders in terms of economic and social performance. Social and environmental concerns are the core teachings in Sharia [14][3][29][30][31][32].

Some evidence of Islam emphasizing that people should have social concerns is the concepts of *hablum min annas*, *khalifah fil ardh* [13]; “happiness in the hereafter” (*falah*) [33] and the verses regarding commandments and sacraments related to social and environmental concerns [31]. Aside from these, in Sharia transactions, there is the concept of *tawazun* (balance) which has consequences for banks related to them having a good and balanced performance in terms of financial and social concerns [34]. Social concern is also often equated with the command to carry out ritual teachings and prayer (*sholat*) as found in the Qur'an (Sura 13:22; 108: 2; 2: 177; 2: 43l; 2: 110; 5:55). In the concept of organization, balance is realized in meeting stakeholders' interests and achieving economic and social goals [31].

5 Conclusion

An entity's concern for business and the environment has recently been emphasized. The company's corporate policy of having concern for the social issues and the environment can be motivated by economic factors (increasing consumer loyalty, brand trust and loyalty) and non-economic motives (management awareness, coercion from regulators and religious motives). Based on its empirical testing, this research has demonstrated that economic factors (level of risk) are measured by changes to (1) profit sharing provided by banks to customers, (2) CAR, (3) third party funds, (4) ROA; (5) ROE; and (6) NPF and it shows that only CAR and third party funds have a significant effect (a level of 10%) on the bank's social concern policies. This result shows that there is minimal proof that the social concern policies of Islamic banks are caused by economic motives. There is potential that the banks the researchers sampled have a motive related to fulfilling Sharia principles and this is the basis for implementing social concern activities.

The economic motive used in this study is restricted to the risk control motive only. This measurement is still very limited because economic motives are very broad in nature. Therefore, further studies could use economic motives with other measures such as brand change, consumer loyalty, business competition, ‘go public’ policies, and other measures.

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