KnE Social Sciences
3rd JESICA
The 3rd Jakarta Economic Sustainability International Conference
Volume 2024

Research Article

Unlocking Profitability Potential: Investigating the Impact of Social Responsibility, Financial Disclosure, and Good Governance in Islamic Banking in Indonesia

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Abstract.
The corporation is primarily responsible for navigating profitability routes. This study looks at the impact of social responsibility, financial disclosure, and good governance on company profitability in Indonesian Islamic banking. The data includes financial statements and annual reports from 14 Islamic banks listed on the Indonesia Stock Exchange from 2018 to 2021. The 44 data points were chosen using a purposive sampling approach. The data were examined using the panel data regression technique. The best model was selected using the Hausman test. The findings of this study show that Islamic Bank Financial Reporting (IBFR) and Good Islamic Bank Governance (GIBG) have a favorable influence on Islamic Bank Profitability (IBP); however, Islamic Bank Social Responsibility (IBSR) impacts negatively. The outcomes of this study show that IBFR and GIBG are the most important drivers in boosting the profitability of Indonesian Islamic banks. Banks may attract depositors and investors by following IBFR and GIBG policies, which improve their financial performance and profitability. However, it is noteworthy that IBSR exhibits a contrasting influence, as the study reveals its negative impact on profitability. The findings suggest that higher levels of IBSR activity correspond to a decline in the performance of Islamic Commercial Banks. These insights shed light on the strategic considerations for Islamic banks, highlighting the significance of robust financial reporting practices and strong governance frameworks.

Keywords: Islamic bank social responsibility, Islamic bank financial reporting, good Islamic bank governance, Islamic bank profitability

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Published: 4 July 2024

Publishing services provided by Knowledge E

Selection and Peer-review under the responsibility of the 3rd JESICA Conference Committee.

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1. Introduction

The growth of Islamic banking in Indonesia has seen a constant increase in assets year after year, indicating Islamic banks' capacity to survive alongside traditional banks. In 2018, Islamic commercial banks had total assets of IDR 316.691 billion. This figure increased to IDR 350 billion in 2019, 397 billion in 2020, and 441 billion in 2021. However, the expansion of Islamic banking assets in Indonesia continues to lag behind conventional banks. According to Dihni [1], the Central Statistics Agency's data for 2021 showed that the ratio of Islamic bank assets to conventional banks was just

4.37 percent. This disparity emphasizes the necessity for Islamic banks to catch up to their conventional counterparts. Islamic banks presently have equity capital of IDR 47 trillion, which pales in comparison to conventional banks, which had IDR 1.360 trillion in 2020 [2]. These results highlight the significance of increasing Islamic bank growth in Indonesia in order to close the gap with conventional banks. Efforts should be geared at improving asset growth, boosting capital infusion, and closing the asset-to-conventional bank ratio gap. Islamic banks can nurture long-term growth and strengthen their position in the Indonesian banking market by focusing on these areas and providing more complete and competitive financial services based on Islamic principles.

When examining financial literacy and inclusion, a notable gap becomes evident. In 2019, financial literacy in Islamic banking stood at 8.93 percent, significantly lower than the 38 percent observed in conventional banks. Similarly, Islamic banking's inclusion rate reached only 9.1 percent, starkly contrasting the 76.2 percent achieved by conventional banking [3]. These figures highlight the considerable disparity that exists in this domain. The expansion of Islamic banks in Indonesia has not met its full potential. According to the Global Islamic Financial Report, Indonesia ranks seventh, following Malaysia and Iran. According to Supriani et al. [4], with an 87 percent Muslim majority population, Islamic banking should be able to favorably contribute to Indonesia's economic growth. This stance is consistent with that of Khan and Zahid [5], who argue that Islamic banks play an important role as key contributors to the global Islamic financial industry. Addressing financial literacy and inclusion gaps, as well as realizing Islamic banking's full potential, are critical imperatives. Efforts should be aimed at improving financial literacy programs, increasing access to Islamic banking services, and spreading the advantages and principles of Islamic finance to a larger audience. By fostering a supportive ecosystem and harnessing the untapped potential of Islamic banking, Indonesia can position itself as a leading player in the global Islamic finance landscape, driving inclusive economic growth and fostering financial well-being for all [6].

Islamic banks strive to optimize profitability through market expansion, thereby ensuring the sustainability of their business entities. This profitability is typically measured by the Return on Asset (ROA). However, the ROA of Islamic banking has exhibited fluctuations from 2018 to 2021, indicating that Islamic banks have yet to achieve optimal profitability. The limited capacity to generate capital for financing expansion contributes to their reduced competitiveness, potentially eroding depositor confidence. Despite the growth of Islamic banks, there remains a need to raise public awareness regarding other Islamic financial institutions. Regulatory bodies have introduced rules aligned with Islamic principles to meet corporate reporting requirements of Sharia-based social responsibility. This reporting framework is known as IBSR. It aims to uphold Islamic principles while encouraging improved performance within the Islamic banking sector. It has been suggested that the quality of IBSR is inseparable from the Concept of the GIBG. This concept is efforts to enhance profitability and competitiveness in Islamic banking necessitate a comprehensive approach considering market expansion, capital cultivation, regulatory frameworks, and adherence to Islamic principles. By addressing these aspects and strengthening Good Islamic Bank Governance, Islamic banks can work towards achieving sustained profitability and fostering public trust in their operations.

Implementing GIBG in Islamic banks presents significant differences compared to conventional banks. One notable feature is the presence of the Sharia Supervisory Board (SSB), which serves as an Islamic compliance oversight body. The SSB ensures that all procedures, transactions, and supplied goods adhere to Islamic law. Additionally, the supervisory function within Islamic banking aims to operate more effectively while upholding ethical management principles [7]. Empirical evidence indicates that, despite the growth of the Indonesian Islamic banking industry, the level of IBSR disclosure remains relatively low; only two of Indonesia's general sharia banks achieve a disclosure index exceeding 50 percent [8].

It has been suggested that the quality of disclosure increases in tandem with the corporate's performance in social responsibility initiatives. They argue that as the company's commitment to social responsibility improves, the transparency and quality of its disclosure practices also tend to enhance. In summary, implementing GIBG in Islamic banks, accompanied by the presence of the SSB, plays a vital role in ensuring adherence to Islamic principles. However, there is room for improvement in the level of IBSR disclosure within the Indonesian Islamic banking industry. Enhancing the commitment to social responsibility initiatives and improving the disclosure quality will strengthen Islamic banks' overall corporate governance and social impact [9].

One essential technique Islamic banking employs is the disclosure of IBSR. It entails providing clear and concise information about the bank's operations, investment activities, and newly recognized goods, as endorsed by the SSB. By prioritizing the pleasure of Allah SWT and aligning their operations with the principles of the Al-Qur'an and Sunnah, Islamic banking companies implement IBSR practices [10]. The disclosure of IBSR by Islamic commercial banks optimizes their financial performance, particularly in profitability. Undertaking IBSR activities and making corresponding disclosures requires significant capital. However, the outcomes achieved by the company through these efforts also yield substantial impact [11]. The expansion and development of Islamic banking are contingent upon the bank's ability to generate profits. The commitment to IBSR activities may require substantial capital, but the resultant impact on the company is noteworthy. It is crucial to address the factors influencing profitability and undertake measures to overcome challenges within and outside the industry [12]. Another significant factor that can impact profitability is IBSR. It represents a company's commitment to balancing its social, environmental, and economic responsibilities. Within an Islamic framework, this commitment is manifested through the disclosure of IBSR. The concept of IBSR combines components of Islamic economics, Islamic legal concepts, Islamic ethics, and Islamic charity, all based on Qur'anic and hadith values [13].

Furthermore, the GIBG is another important aspect that might impact profitability. The adoption of GIBG in Islamic banks began with the issue of Law on Bank Indonesia of 2009 Number 8, notably Article 49, which focuses on adopting GIBG for Commercial Banks. GIBG refers to a set of mechanisms that impact management decision-making. The actions and methods followed by a company's management are frequently the determining factors of its success or failure. To recap, two critical criteria that might affect profitability in Islamic banking are IBSR and GIBG. IBSR emphasizes the company's commitment to balancing social, environmental, and economic aspects in an Islamic manner. On the other hand, GIBG emphasizes the importance of sound governance practices and effective decision-making. By effectively implementing IBSR and adhering to GIBG principles, Islamic banks can enhance their financial performance and contribute to sustainable profitability.

Previous research on the profitability of Islamic banks has yielded varying results, creating research gaps in this area. Mahfudz et al. [14] research in Turkey and Indonesia reveals that IBSR does not significantly impact profitability in Turkish Islamic banking, as stakeholder behaviour is more influential in shaping IBSR practices. However, IBSR has a more pronounced influence on profitability in Indonesian Islamic banking, mainly when measured using ROA. On the other hand, Alfakhri et al. [15] suggest that IBSR does not affect profitability. Hussain et al. [16]'s study on banking in Pakistan demonstrates that IBFR influences profitability.

Agustina [17] demonstrate that IBFR, profitability, and liquidity all have a positive and considerable impact on company value. However, the influence of the Islamic Social Reporting variable on business value is positive but not significant. Good corporate profitability demonstrates good financial performance, which improves investor perceptions and raises firm value. Khan et al. [18]'s study on Islamic banking in Bangladesh, the Maldives, Pakistan, and Sri Lanka found that GIBG procedures had no impact on firm value. Khan and Zahid [5]'s research supports this conclusion, concluding that GIBG has no effect on corporate performance. However, other research [19, 20] indicate that GIBG has a considerable impact on profitability.

Given the disparities in findings, the purpose of this study is to investigate and identify the determining elements that influence the profitability of Islamic banks, with an emphasis on IBFR, GIBG, and IBSR. By investigating these characteristics, this study helps to better understand the dynamics and determinants of profitability in the Islamic banking market. Investigate and evaluate the links and dynamics between the chosen variables in Indonesia's Islamic banking setting. The findings of this study will add to the current body of information and give useful insights into the elements that influence Islamic bank performance and profitability.

2. Material and Methods

2.1. Material

2.1.1. Stakeholder theory

Stakeholders refer to companies and interest owners such as residents, employees, suppliers, government, and the capital market, among others, who have the potential to influence or be affected by a company's actions. The support extended by stakeholders significantly impacts a company's survival and success [21]. Stakeholder theory forms the foundation of corporate social responsibility, where stakeholders are individuals or groups who contribute, voluntarily or involuntarily, to the development of capabilities and actions that promote prosperity while assuming risks associated with organizational activities. Therefore, stakeholders encompass those who conduct business on behalf of the organization and those who benefit from the organization's activities, including the surrounding community [22]../../../../../../01 NIA/01 CAPA/2024/03/09 CJ4349-JESICA NL/CJ4349-JESICA-1 REV/JESICA 01_TURNITIN REVISION.docx - bookmark=id.4d34og8.

In this study, stakeholder theory elucidates the responsibility of Islamic banking through implementing IBFR, which extends beyond the board of directors' expectations and encompasses the public's perception of the company's role in the economic sphere. Additionally, it fulfills a spiritual perspective for Muslim users of financial reports. By meeting stakeholders' expectations, companies can achieve exceptional financial performance. Disclosing IBSR in annual reports can enhance financial performance. In summary, stakeholder theory highlights the importance of engaging with various stakeholders in Islamic banking. Implementing IBFR is an extension of social reporting, addressing economic aspects and fulfilling spiritual perspectives for Muslim stakeholders. By fulfilling stakeholder expectations and disclosing IBSR, companies can enhance their financial performance and contribute to sustainable growth.

2.1.2. Islamic bank financial reporting (IBFR)

IBFR is a reporting system that holds Muslims accountable to Allah and promotes transparency in business activities by providing relevant information for their spiritual well-being [23]. It aims to enhance commercial transparency by disseminating information that aligns with Muslim investors' Sharia compliance and spiritual demands. IBFR is a guideline for implementing Sharia financial work and corporate responsibility towards stakeholders, including clients, suppliers, employees, competitors, the general public, and the government [24].

IBFR is a framework for Sharia social performance and corporate responsibility towards various stakeholders. Its significance is evident in the stock market, where companies implementing Business Social Responsibility are included in specific stock categories. Previous research has shown that IBFR goes beyond providing reports or disclosing the position of business units in the economy to satisfy stakeholder expectations. It also incorporates a spiritual perspective by offering insights that meet the spiritual criteria of Muslim business reports.

Studies examining the relationship between Islamic bank profitability, called IBP and IBFR disclosure, have found that profitability significantly and positively depends on IBFR disclosure in Indonesian Islamic banks but not Malaysian ones [25]. Furthermore, research by Affandi and Nursita [26] supports the positive effect of Islamic Bank Financial Reporting on profitability. Santika [22] studied Islamic commercial banks from 2013 to 2017 and found that IBFR positively affected IBP partially and simultaneously. Based on these findings, we propose the following hypothesis:

Hypothesis 1: IBFR has a positive effect on IBP.

2.1.3. Good Islamic bank governance (GIBG)

GIBG encompasses principles companies adopt to optimize corporate value, enhance performance, and contribute to long-term sustainability. It is a robust corporate governance framework and the mechanism that governs corporate control, ultimately generating sustainable financial returns for shareholders and stakeholders. The fundamental principles of GIBG encompass transparency, accountability, independence, fairness, and responsibility [27]. Transparency ensures that the company's operations provide all stakeholders with essential information. It involves timely disclosure and sharing relevant knowledge with stakeholders and the wider public. Accountability entails the business unit's ability to assume direct and open responsibility for its actions and capabilities. Independence emphasizes the importance of individual management of business units to prevent overpowering and promote access to external parties. Fairness underscores the principles of justice and equality, ensuring that every decision and action considers the interests of consumers, suppliers, shareholders, investors, and citizens. Responsibility highlights the company's commitment to upholding the law and fulfilling its social duties as a responsible corporate citizen [28].

By adhering to GIBG principles, companies can effectively address challenges, enhance control effectiveness and efficiency, and ultimately improve profitability is called IBP. Research regularly shows that corporate governance improves profitability. Previous study on the association between GIBG and profitability, such as Ariandhini [29]'s findings, confirms GIBG's favorable and substantial influence on profitability. Thus, we suggest the following hypothesis:

Hypothesis 2: GIBG has a positive effect on IBP

2.1.4. Islamic bank social responsibility (IBSR)

IBSR encompasses the Concept of social responsibility that goes beyond corporate responsibility to society and extends to corporate responsibility to Allah SWT. It represents the application of Islamic principles to the broader framework of corporate social responsibility. The principles of charity and philanthropy in Islam align with conventional philanthropy, evident in practices such as tithe, infaq, alms, non-harming, and lending to those in need without expecting anything in return. Islamic banks commonly articulate their social responsibility in their financial statements.

The IBSR index is an assessment tool to evaluate how effectively Islamic banks articulate their social responsibility initiatives [30]. The disclosure of IBSR by Islamic banks can contribute to improved financial performance and profitability. While IBSR initiatives and disclosures require significant resources, their impact on the company's outcomes can be substantial. Institutions adopting IBSR should focus on engaging natural, direct, and indirect stakeholders as their targets [31]. However, according to Cahyaningtiyas and Canggih [32], if IBSR has a negative effect on profitability, it may be influenced by various factors that exert a negative impact. For instance, Islamic banks' operational focus prioritizes a sense of purpose over maximizing profits.

By embracing IBSR and aligning their practices with Islamic values, Islamic banks can fulfill their social responsibilities and contribute to the betterment of society. This approach acknowledges the multifaceted nature of corporate social responsibility, integrating it with the principles of Islamic finance. A successful IBSR can result in enhanced financial performance, long-term sustainability, and positive societal impact. Thus, the hypothesis can be proposed:

Hypothesis 3: IBSR Has a negative effect on IBP

2.2. Methods

This study's analytical technique makes use of a quantitative data panel. The dataset includes financial statements and annual reports from 14 Islamic banks listed on the Indonesian Stock Exchange (IDX). The sample was selected using a purposive sampling approach, resulting in a sample size of 44 data points. The sample selection method was based on the following criteria: (i) Islamic banks must be registered with the Financial Services Authority; (ii) they must have published annual and financial reports for four years running from 2018 to 2021; and (iii) the data given must include all of the proxies utilized in this study. The data analysis involves conducting panel data regression analysis using the collected data from the 14 selected Islamic banks in Indonesia over the four years from 2018 to 2021. Criteria for Sharia commercial banks can be seen in Table 1.

3. Results and Discussion

The results in Table 2 provide major conclusions about the variables under inquiry. The average Islamic Bank Profitability (IBP) is 0.0347727, suggesting that Islamic banks make profits. The standard deviation for IBP is 0.2015114, indicating that profitability varies across the studied Islamic banks. The smallest IBP value is 0.057, and the maximum is 1.338, demonstrating the profitability range. Moving on to Islamic Bank Financial Reporting (IBFR), the average value is 0.449363, with a standard deviation of 0.080832. These results suggest that Islamic banks' reporting processes generally fulfill IBFR criteria. The least IBFR value recorded is 0.227, while the largest value is 0.591, demonstrating the wide variety of IBFR values across the analyzed Islamic banks.

Table 1: Criteria for Sharia commercial banks.

No.	Criteria for Sharia Commercial Banks	Amount
1.	Sharia commercial banks registered with the OJK during the 2018-2021 period.	15
2.	The number of Sharia commercial banks in Indonesia that have not published annual reports for 4 consecutive years from 2018 to 2021. Banks that have not published Annual Reports in a row are: 1. Bank Syariah Indonesia (BSI)	(1)
3.	Sharia commercial banks in Indonesia whose data do not match the completeness of researchers are: PT. Bank Aceh Syariah (BAS) PT. Maybank Syariah Indonesia (MSI) PT. Bank Tabungan Pensiun Nasional Syariah (BTPNS)	(3)
	Total companies sampled	11
	Total data for the 4-year research period	44

Source: Author's own work

Regarding Good Islamic Bank Governance (GIBG), the mean score is 4.75, indicating a positive assessment of governance practices within Islamic banks. The standard deviation for GIBG is 1.893993, reflecting some variation in governance scores across the sample. Lastly, the mean value of Islamic Bank Social Responsibility (IBSR) is 0.4822727, suggesting a good level of social responsibility among Islamic banks. The standard deviation for IBSR is 0.0867121, with a minimum value of 0.244 and a high value of 0.634, illustrating the range of IBSR values among the banks examined. These statistical indicators provide light on the average levels and variability of IBP, IBFR, GIBG, and IBSR across the sample of Islamic banks. The findings give insight on financial performance, reporting procedures, governance standards, and social responsibility activities, therefore improving our understanding of these critical issues.

Table 2: Descriptive statistical analysis test.

Variables	Obs	Mean	Stdev	Min	Max
IBP	44	.0347727	.2015114	.057	1.338
IBFR	44	.4493636	.080832	.227	.591
GIBG	44	4.75	1.893993	3.00	10.00
IBSR	44	.4822727	.0867121	.244	.634

Source: Author's own work (2023)

3.1. Panel data model test

This study employed various test models to analyze the panel data and identify the most suitable models for the research objectives. These models were carefully selected based on their statistical properties and ability to capture the underlying patterns in the data. The results of these model tests are presented in Table 3, which provides insights into the model specifications and their corresponding statistical outcomes.

TABLE 3: Model selection test.

Chow Test		Breusch Pagan LM Test		Hausman Test	
Probability value	.1733	Probability value	1.000	Probability value	.0710
Alpha value (α)	.05	Alpha value (α)	.05	Alpha value (α)	.05
Selected Model	Fixed Effect Model	Selected Model	Random Effect Model	Selected Model	Random Effect Model

Source: Author's own work (2023)

The first stage in the model selection procedure is to perform the Chow Test to decide whether the Fixed Effect Model (FEM) or the Random Effect Model (REM) should be used. Based on the data shown in Table 3, the probability value for the FEM is 0.1733, which is larger than the alpha threshold of 0.05. As a result, the Fixed Effect Model (FEM) is chosen as the recommended model for further investigation. The second step is to do the Breusch Pagan Lagrange Multiplier test to determine the appropriateness of the selected Model (FEM) vs the Random Effect Model (REM). The test results show that the probability value for the REM is 1.0000, which is much more than the alpha value of 0.05. As a consequence, the Random Effect Model (REM) is determined to be the best fit for the analysis.

Finally, the Hausman test compares the FEM and REM to select the better-fitting model. The test produces a probability value of 0.0710, which is more significant than the alpha value of 0.05. As a result, the Random Effect Model (REM) is finally chosen as the optimal model for the investigation. Following these model selection processes guarantees that this study uses a strong and appropriate model to evaluate the data and draw relevant results. The chosen Model will give useful insights into the relationship between the variables under inquiry while also adding to the field's current body of knowledge.

3.2. Partial regression test

In this test, the significance level of each variable is compared by examining the t-count and t-table values. If the probability significance value is less than 0.10 and the t-count is greater than the t-table value, the independent variable significantly influences the dependent variable.

Table 4: Regression random effect model test results.

Variables	Probability value
Cons.	.038
IBFR	.054
GIBG	.038
IBSR	.616
Number of Obs	44
Adjusted R-Squared	

Source: Author’s own work (2023)

The t-table value is 1.687, according to the data, with a significance level of 10%. Table 4 summarizes the test findings. First, for IBFR, the t-count value is 1.72, which is higher than the t-table value of 1.687. As a result, we may infer that hypothesis 1 is correct, demonstrating a relationship between IBFR and IBP. The probability level is.054, which is below than the 10% significance level (t-table value), supporting the significant relationship between IBFR and IBP. Second, for GIBG, the t-count value is 1.8, which exceeds the t-table value of 1.687. Thus, hypothesis 2 is accepted, demonstrating a link between GIBG and IBP. The probability value is .384, which is less than the 10% significance level, demonstrating the substantial relationship between GIBG and IBP.

Finally, for IBSR, the t-count value is -.15, which is less than the t-table value of 1.687. As a result, hypothesis 3 is rejected, showing that there is no association between IBSR and IBP. The probability value is.616, which is greater than the 10% significance level, demonstrating the lack of a meaningful relationship between IBSR and IBP. Finally, the data demonstrate that IBFR has a considerable impact on IBP, as does GIBG, but there is no significant affect on IBSR.

4. Conclusion

In Indonesia’s Islamic banking sector, social transparency and good governance trends have a clear beneficial impact on firm profitability. Establishing a strong governance structure allows organizations to create an integrated ecosystem that successfully handles the rights and duties of shareholders, management, creditors, government agencies, workers, and other stakeholders. This holistic approach to governance aims to enhance managerial effectiveness and efficiency, ultimately leading to increased company profits. The research findings carry substantial implications, particularly for investors who seek a comprehensive assessment of business financial performance beyond the traditional financial aspects. Investors gain a broader range of information to make informed decisions by considering the broader scope of sustainable social aspects. Islamic banks must embrace social disclosure to demonstrate their corporate responsibility to the Islamic business community, who entrust their funds and rely on Islamic banking services.

However, an unexpected finding emerges as the study sheds light on the possible negative consequences of excessive social disclosure. While social disclosure promotes openness and accountability, its widespread application may unintentionally undermine firm profits. This negative effect results from an increase in operating expenses within Islamic banking, which reduces total profit margins. By combining social transparency and financial performance, Islamic banks may negotiate the tricky terrain of corporate responsibility while maintaining profitability. The journey toward profitability within Islamic banking in Indonesia requires careful consideration of both financial and social aspects, harnessing the power of social disclosure and good governance to drive long-term success and stakeholder satisfaction.

The present study acknowledges a limitation regarding its relatively short observation period, focusing on annual reports from 2018 to 2021. Future research is encouraged to extend the observation period, encompassing a more comprehensive range of annual reports. Furthermore, to give a more comprehensive knowledge of the factors driving firm profitability, future research should include a larger range of independent variables. These may include cost efficiency, company size, and company age, which have demonstrated significant impacts on profitability in previous research. Expanding the scope of independent variables will enrich the analysis and offer a deeper insight into the dynamics of company profitability within the context of Islamic banking in Indonesia.

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