



Empirical study: social and financial performance of Islamic rural bank in Indonesia

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ABSTRACT

Islamic Rural Bank (BPRS) in Indonesia have developed rapidly and reached the lower levels of society. As an Islamic institution, BPRS has both financial and social purpose. The effect of social performance on financial performance in BPRS has yet to be widely studied, especially using quantitative data over a long period. This research aims to determine the influence of social performance on financial performance at BPRS in Indonesia. This research uses internal factors (bank characteristics) and external factors (macroeconomic variables) as control variables. Generalized Method of Moments (GMM) parameter was used with Stata software to estimate selected BPRS panel data in the 2012-2021. The result shows that *zakat* has a positive and significant effect on financial performance at a significance level 0.01. The managerial implication of this study is to encourage Islamic rural banks to pay and report *zakat*.

Bank Perekonomian Rakyat Syariah (BPRS) di Indonesia mengalami pertumbuhan pesat dan telah melayani masyarakat kurang mampu. Sebagai institusi keuangan Islam, BPRS memiliki tujuan keuangan dan tujuan sosial. Penelitian ini bertujuan untuk menguji pengaruh kinerja sosial terhadap kinerja keuangan di BPRS yang jarang dilakukan dengan melibatkan waktu yang lama. Penelitian ini menggunakan faktor internal (karakteristik bank) dan faktor eksternal (variabel makroekonomi) sebagai variabel control. Pendekatan Generalized Method of Moments (GMM) dengan Stata digunakan untuk mengestimasi data panel BPRS tahun 2012-2021. Hasil penelitian menunjukkan *zakat* memiliki pengaruh positif signifikan pada level 0,01. Implikasi manajerial dari penelitian ini agar BPRS dapat membayar dan melaporkan *zakat*.

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1. Introduction

Islamic Rural Bank (BPRS) is an Islamic microfinance institution with a target market in the small and unbanked business community. BPRS plays a role in providing microcredit that can expand economic opportunities and financial markets for poor people. This is an effective solution for poverty reduction and other socio-economic benefits (Nomran & Haron, 2022). In addition, BPRS as part of Islamic banking, is expected to follow the objectives of Islamic economics by ensuring that wealth can circulate to as many parties as possible without harming other parties. BPRS activities have two functions: business (profit-oriented) and social (non-profit-oriented). Business function activities carried out by BPRS include commercial services in financial intermediation activities and other financial services. Meanwhile, its social function activities are in the form of collecting and distributing zakat funds.

The integration of business and social functions in BPRS should be maintained in continuity to achieve the Islamic economic goals attached to this institution. However, there is criticism from academic circles that there are deviations between Islamic economic theory and practice in Islamic financial institutions. Justice is the basis for Islamic financial institutions, which emphasize the importance of socio-economic commitments such as social justice and balance. On the other hand, practices in Islamic banking institutions aim to maximize profits and away from the goal of balance in this world and the hereafter (Abdul-Baki & Uthman, 2017). Research results (Zhao, 2014) show that the longer the age of microfinance, the more it will lead to mission drift, which has high financial performance but low social performance.

Based on criticism from academics, improving the social performance of BPRS needs special attention. Classical economists state that social and financial performance have a negative relationship, arguing that companies that meet the social needs of stakeholders will reduce profits. In contrast, social costs can be avoided or borne by other parties, such as the government (Simpson & Kohers, 2002). On the other hand, stakeholder theory assumes a positive relationship between social and financial performance is possible because the benefits of CSR outweigh the costs (Waddock & Graves, 1997).

BPRS as an Islamic financial institution, must emphasize a balance of social and economic activities. Zakat is an instrument that can be used as a motor for social performance in BPRS. Sources of zakat at BPRS can be obtained from internal banks (owners, employees, companies), external banks (customers), and sources of infaq-sadaqah according to the policies in each place. Using zakat in social and ethical activities can improve the reputation of BPRS and direct it to the expected financial performance.

The bank's financial performance can be measured using profitability ratios (Daly & Frikha, 2017; Gafrej & Boujelbéne, 2022). The higher the profitability of a bank, the better the bank's performance. The profitability of a bank can be influenced by two factors, namely internal and external. First, internal factors are all those related to bank management, such as asset management, liquidity, risk, operational efficiency, capital and debt. The second factor is external factors beyond bank management's control, such as macroeconomic conditions, inflation, and economic growth (Mohd Yusof et al., 2018).

Issues related to the relationship between social and financial performance in BPRS are the focus of study in this research. As a sharia microfinance institution, the social performance of BPRS can

Be proxied through zakat (Nomran & Haron, 2022). Zakat paid by the company shows that it is transparent in managing its activities (Septian et al., 2022). Reports on the source and use of zakat funds must also be issued by the BPRS as stated in the Statement of Financial Accounting Standards (PSAK) No. 101.

2. Literature Review (optional)

Zakat

Islam teaches the obligation of zakat for humans and companies as a form of social responsibility, aiming to achieve harmonization between the rich and the poor (Kashif et al., 2018). Zakat is a form of worship both materially and spiritually. Zakat has a dual function of clearing wealth and a form of obedience to Allah (spiritual) (Poon et al., 2021). Meanwhile, At-Taubah (9:60) explains who is entitled to receive zakat, namely fuqara, masakin, amilin, converts, riqab, al-gharimin, fiisabilillah, and ibn sabil.

Zakat is a form of redistribution of wealth from the rich to the poor (8 asnaf). For a Muslim, paying zakat is a form of obedience to Allah. Apart from zakat, Islam encourages people to set aside some of their wealth for charitable purposes such as infaq and sadaqah. Zakat, infaq and sadaqa have the same form of tabarru. However, in terms of the nature and distribution targets, there are differences. Zakat payments are mandatory for rich people and the distribution target is set at 8 asnaf. At the same time, infaq and sadaqah are voluntary and the distribution targets are for various community interests by fulfilling Islamic law.

Zakat in Islamic Financial Institution

Zakat payments are mandatory for rich people and the distribution target is set at 8 asnaf. At the same time, infaq and sadaqah are voluntary and the distribution targets are for various community interests by fulfilling Islamic law. Islamic finance refers to a financial institution system that complies with sharia law. Islam emphasizes ethical, moral, social, and religious factors to promote equality and justice for the good of society. Principles that encourage risk sharing, individual rights and obligations, property rights, and the sanctity of contracts are part of the Islamic ethics that underlie the financial system. Islamic microfinance also identifies the poorest of the poor as the main criterion for eligibility to receive zakat. As an institution under sharia law, Islamic microfinance is also required to pay zakat from their employee and receive zakat from the customer. In some country for instance Indonesia, islamic rural bank (BPRS) should report the activity of collecting and distributing zakat, along with other financial report.

The Relationship between Zakat and Financial Performance

BPRS is a form of sharia microfinance institution with two objectives: financial and social. Financial goals can be reflected in the institution's financial performance through ROA, and ROE. Social goals can be seen from the performance of BPRS in reducing poverty and income inequality. The social goal is to enable BPRS to receive and distribute ZIS (zakat, infaq and sadaqah) to those in need. (Tuan Ibrahim et al., 2020) tested the influence of ethical values in sharia banking as seen through the

zakat index and charity index on financial performance using the return on assets ratio. Several studies on the influence of zakat on financial institutions have been conducted by (Purwati et al., 2022). However, no research has included macroeconomic conditions and bank characteristics into a regression analysis with zakat on financial performance.

So far, studies related to the social and financial performance of BPRS in Indonesia are still rare. Several previous studies examined the relationship between zakat and financial performance in Islamic commercial banks, including (Bukair & Abdul Rahman, 2015; Purwati et al., 2022; Septian et al., 2022; Syurmita & Fircarina, 2020).

3. Research Method

Research Design

The research method operated multiple linear regression with data analysis techniques using the Generalized Method of Moments (GMM) with Stata software. This analysis technique can explain the influence between the variables investigated. The advantage of the GMM method is that it can overcome data conditions with violations of assumptions in regression analysis.

Sample and Data

The population in this study is all 165 BPRS in Indonesia. A purposive sampling technique was used to determine the number of BPRS. The BPRS in the sample were selected based on two criteria: 1) actively operating for ten years (2012-2021) and 2) collecting and distributing zakat, which can be seen through their financial reports.

This research data was obtained from the Sharia Rural Bank Financial Report published by the Indonesian Financial Services Authority. This data is the latest, accessed via the website www.ojk.go.id. The data type used in this research is panel data obtained from BPRS quarterly. The collected data is processed based on the financial ratios needed as internal factors determining financial performance. Besides banking data, this research uses macroeconomic data to determine BPRS's financial performance. The macroeconomic data we use are inflation and economic growth. We obtained this data from the Indonesian Central Statistics Agency via the site www.bps.go.id.

Based on the criteria above, the sample in this study can be seen in the table 1:

Table 1 List of Samples

No	Province	District/City (Kab/Kota)	Name of BPRS
1	West Sumatera	Kab. Agam	PT BPRS Ampek Angkek Candung
2	West Java	Kab. Bogor	PT BPRS Amanah Ummah
3	West Java	Kab. Bandung	PT BPRS Amanah Rabbaniah
4	West Java	Kab. Bandung	PT BPRS Harta Insan Karimah Parahyangan

5	West Java	Kab. Bekasi	PT BPRS Artha Madani
6	West Java	Kota Bekasi	PT BPRS Harta Insan Karimah Bekasi
7	Central Java	Kab. Klaten	PT BPRS Al Maburr Babadan
8	East Java	Kab. Kediri	PTBPRS Artha Pamenang
9	East Java	Kab. Malang	PT BPRS Bumi Rinjani Kepanjen
10	Yogyakarta	Kab. Sleman	BPRS Mitra Amal Mulia
11	Central Java	Kab. Pati	PT BPRS Artha Mas Abadi
12	Central Java	Kab. Kendal	PT BPRS Asad Alif
13	CentralaJva	Kab. Magelang	PT BPRS MERU SANKARA
14	East Java	Kab. Sidoarjo	PT BPRS Bakti Makmur Indah
15	Banten	Kota Tangerang	PT BPRS Harta Insan Karimah
16	West Nusa Tenggara	Kota Mataram	PT BPRS Dinar Ashri
17	West Java	Kab. Bandung	PT BPRS Harta Insan Kaarhim Cibitung

Operational Variables

This study consists of three types variables: dependent, independent and control variables. Control variables using both bank's characteristic and macroeconomic condition. A detail explanation about variables used in this research are as follows:

Table 2 Operational Variables

Type of variables	Name of variables	Description
Dependent	Return on Asset (ROA)	Earning after tax divided by total assets
	Return on Equity (ROE)	Earning after tax divided by total equity
Independet	Zakat	Total zakat divided by total assets
	Bank's characteristics	
	Size	Log of total assets

Control	∂ Capital adequacy	Total equity divided by total assets
	∂ Efficiency	Operational expense divided by operational income
	∂ Financial risk	Provision for loan losses divided by total assets
	Macroeconomic Condition	
	∂ Inflation	Inflation rate
	∂ GDRP (Gross Domestic Regional Product)	Reel GDRP in specific region

Model and Data Technique Analysis

Previous literature shows inconsistent result about the impact of zakat on financial performance (Bukair & Abdul Rahman, 2015; Purwati et al., 2022; Septian et al., 2022; Syurmita & Fircarina, 2020). By adding bank's characteristic and macroeconomic condition to the model, the regression model is given as follows:

$$ROE_{it} = \alpha + \beta_1 ROE_{it-1} + \beta_2 ZAKAH_{it} + \beta_3 SIZE_{it} + \beta_4 CA_{it} + \beta_5 EFF_{it} + \beta_6 RISK_{it} + \beta_7 INF_{it} + \beta_8 GDRP_{it} + \epsilon_{it} \dots \dots \dots (1)$$

$$ROA_{it} = \alpha + \beta_1 ROA_{it-1} + \beta_2 ZAKAH_{it} + \beta_3 SIZE_{it} + \beta_4 CA_{it} + \beta_5 EFF_{it} + \beta_6 RISK_{it} + \beta_7 INF_{it} + \beta_8 GDRP_{it} + \epsilon_{it} \dots \dots \dots (2)$$

At model above, i and t denote bank and time. ROA and ROE are proxies for bank performance, each has similarities. ROE_{it-1} and $\beta_1 ROA_{it-1}$ reflect the previous term as well as to overcome the dynamic nature of bank performance. ZAKAH is notation for zakat, SIZE (bank size), CA (capital adequacy), EFF (management efficiency), RISK (financial risk). INF (inflation) and GDRP (gross domestic regional product). We performed transformations using the first difference method to remove individual effects, before analysis using GMM, the Pearson correlation test was carried out to assess collinearity between independent variables. Testing shows no collinearity between variables, so the results are robust, then the panel data analysis can be executed.

4. Result and Discussion

Table 3 shows a descriptive analysis of the data collected. The total n value in the observation column shows different values, this is because the time series and cross-section data do not have the same amount (strong balanced panel data). Descriptive statistical analysis is an analysis that compares the minimum value, maximum value, average value (mean), and standard deviation of research carried out systematically without drawing conclusions. The mean value shows the average value of the data.

The maximum and minimum values indicate the largest and smallest values of the data. The standard deviation value shows the standard measure of data deviation.

Table 3 Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max	Observations
ROE	.270034	.2463089	-.5028226	1.430.625	N = 539
ROA	.0208924	.0253141	-.033496	.2395071	N = 538
CA	.0865213	.0456914	.0278056	.5288155	N = 542
RISK	.0190687	.0105018	.0010029	.0502916	N = 542
EFF	.5344189	.4557805	.0494901	8.308.397	N = 543
SIZE	1.802.263	1.243.385	155.808	2.095.889	N = 542
ZAKAH	.0049612	.024632	0	.2395071	N = 538
INF	1.664.699	2.177.919	-1.43	9.24	N = 680
GDRP	238854.9	124298.2	16147.31	425191.7	N = 680

The mean zakat shows a value of 0.0049, this indicates that the amount of zakat paid by BPRS in Indonesia is 0.49% of the total profit earned. The mean ROE (0.27) is higher than ROA (0.02). ROE and ROA show the bank's ability to generate profits using the capital and assets owned. RISK shows the ratio of Allowance for Productive Asset Losses (PPAP) to total assets. The mean RISK value shows 0.019, meaning that 1.9% of productive assets distributed in the form of financing are allocated to the allowance for asset losses. EFF is a measure of efficiency obtained from the comparison between Operational Costs and Operational Income. An EFF value of 0.53 means that the profit obtained by the bank consists of 53% of the costs incurred. The smaller the efficiency value, the more efficient the bank is in carrying out service provision activities. A bank is called inefficient if the efficiency value is >80%. The SIZE variable is obtained from the natural logarithm of total assets. The mean SIZE value is 1,802,263, with a maximum value of 2,095,889. Macroeconomic variables that act as control variables are inflation and GDRP. The mean inflation is 1.66, while the mean GDRP is 238,554.9.

Regression Analysis

Before testing the hypothesis, the researcher conducted a multicollinearity test to determine whether there was a strong relationship between the independent variables using the Variance Inflation Factor (VIF) calculation. If the VIF value is < 10, there is no multicollinearity problem; if the VIF value is > 10, then there is no multicollinearity problem. VIF test results are as follows:

Table 4 VIF Result

Variable	VIF	1/VIF
ZAKAH	5.07	0.197077
ROA	4.77	0.209477
SIZE	2.69	0.372023
RISK	2.66	0.375340
CA	1.48	0.676033
INF	1.39	0.719417
GDRP	1.29	0.778044
EFF	1.09	0.920864
Mean VIF	2.56	

Based on the Variance Inflation Factor (VIF), it shows that each equation has an average value of less than 10. Thus, the model used is free from multicollinearity problems or does not reveal any violations to execute regression. The data analysis technique in this research uses the Generalized Method of Moments (GMM) with Stata software. Hypothesis test results can be seen in the table below:

Table 5 Hypothesis Test Result

VARIABLES	(1) ROA	(2) ROE
L.ROA	-	
	0.081***	
	(0.03)	
ROA_lag1	0.036	
	(0.03)	
ZAKAH	1.034***	6.552***
	(0.04)	(0.71)
SIZE	-0.002	0.051
	(0.00)	(0.04)
CA	-0.016	-1.946***
	(0.02)	(0.38)
EFF	-0.001	-0.010
	(0.00)	(0.01)
RISK	-0.254**	-2.739
	(0.12)	(1.85)
INF	0.000	0.009
	(0.00)	(0.01)
GDRP	-0.000	-0.000*
	(0.00)	(0.00)
L.ROE		-0.133***
		(0.04)
ROE_lag1		0.094**
		(0.04)
Observations	302	302
Number of	17	17
SandiBank		

Standard errors in parentheses
 *** p<0.01, ** p<0.05, * p<0.1

From the table above, the results of data processing show that zakat has a significant effect at the 0.01 level on the financial performance of BPRS as shown through ROA and ROE. The higher the level of zakat payments, the bank's financial performance will increase. This research also includes bank characteristic variables and macroeconomic indicators as control variables. The data processing test results can be seen in the table below:

Table 6 Result Summary

No	Variable	Relationship Mode	Coefficient	Result
	Bank' characteristic			
1.	SIZE-> ROA	Negative	-0,002	Insignificant
2.	SIZE-> ROE	Positive	0,051	Insignificant
3.	CA-> ROA	Negative	-0,016	Insignificant
4.	CA-> ROE	Negative	-1,946	Significant at leve0l,01
5.	EFF-> ROA	Negative	-0,001	Insignificant
6.	EFF-> ROE	Negative	-0,010	Insignificant
7.	RISK-> ROA	Negative	-0,254	Insignificant
8.	RISK-> ROE	Negative	-0,2739	Insignificant

Macroeconomy Variable				
9.	INF-> ROA	Positive	0,000	Insignificant
10.	INF-> ROE	Positive	0,009	Insignificant
11.	GDRP-> ROA	Negative	-0,000	Insignificant
12.	GDRP-> ROE	Negative	-0,000	Significant

Discussion

The hypothesis test results show that zakat has a positive and significant effect on financial performance, as seen through ROA and ROE at the 0.01 level. An increase in the amount of zakat paid by BPRS will cause an increase in the company's financial performance. In table 3, the mean BPRS zakat in Indonesia is only 0.004, meaning zakat payments are only 0.4%. This finding is in line with stakeholder theory that social performance has a positive influence on company performance. This theory assumes that the benefits of CSR outweigh the costs (Waddock & Graves, 1997), in this study CSR is proxied by zakat.

Based on the results obtained during data collection, not all BPRS paid zakat in full in the observation period 2012 – 2021. Zakat data in this research was obtained from profit and loss reports, which show the amount of zakat paid by the Company. Furthermore, although many BPRS have paid zakat, they do not create reports of the source and use of zakat funds as on the OJK website. Reports on the source and use of zakat funds are one component of financial reports that sharia financial institutions must prepare in accordance with Statement of Financial Accounting Standards (PSAK) No. 101.

Several control variables in this research show different results regarding their influence on ROA and ROE. Size, efficiency and financial risk are proven to be insignificant in influencing financial performance, likewise capital adequacy does not have a significant effect on ROA, however, it has a significant impact on ROE which indicates that capital adequacy will improve the performance of capital owned by BPRS in generating profits. BPRS that have sufficient capital will be able to run a business more efficiently and increase profits. Banks that have high capital will also have lower financing risk. According to research, Size does not significantly affect ROA (Al-Nasser Mohammed & Muhammed, 2017). GDRP is not significant in influencing the financial performance of Islamic banks in several countries in the Middle East and Asia.

Zakat is proven to have a significant effect on financial performance. In that case, the practical implication that can be carried out is to encourage the relevant regulators to tighten up BPRS regarding reporting the source and use of zakat funds. Another implication is to consider zakat as an indicator of the performance of sharia financial institutions as per research results (Nomran & Haron, 2022). Zakat as an indicator of the performance of sharia financial institutions also differentiates it from conventional financial institutions.

5. Conclusions

This research aims to examine the influence of social performance seen through zakat payments on financial performance through ROA and ROE at BPRS in Indonesia. The research results show that zakat significantly affects ROA and ROE.

Practical implication of this study are; first, encourage the relevant regulators to tighten up BPRS regarding reporting the source and use of zakat funds, second, consider zakat as an indicator of .

the performance of sharia financial institutions as per research results (Nomran & Haron, 2022). Zakat as an indicator of the performance of sharia financial institutions also differentiates it from conventional counterparts. Future studies can be carried out by investigating the effect of zakat on financial performance using another panel data analysis other than GMM (generalized method of moment)

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