Empirical Investigation Of The Role Of Sharia's Corporate Social Responsibility On The Relationship Between Firm Size And Profitability

Ririn Irmadariyani, Isti Fadah, Diana Sulianti K. Tobing, Siti Maria Wardayati

Abstract: TThe aim of this research is to investigate the role of shari'ah corporate social responsibility on the relationship between firm size and profitability. This research uses explanatory research method. This research uses a sample of 78 firm-year observations from 13 firms listed on the Indonesian Stock Exchange (IDX) that entered the Jakarta Islamic Index from 2011 to 2016. Partial Least Square (PLS) has been used to analyze the data. This research finds that there is no effect of firm size on profitability both directly and indirectly through shari'ah corporate social responsibility. Furthermore, there is no evidence that shari'ah corporate social responsibility can increase profitability. However, the empirical result show that firm size has positive impact on shari'ah corporate social responsibility. For future research, that shari'ah corporate social responsibility as measured by Islamic Social Reporting (ISR) should be applied to companies that are purely Islamic. The application of shari'ah corporate social responsibility is expected to give shari'ah value added that is profitability and corporate non-financial performance. For future research is expected to investigate the effect shari'ah corporate social responsibility on corporate non-financial performance

Index Terms: Firm Size, Syariah Corporate Social responsibility, profitability

1 INTRODUCTION

IN implementing corporate social responsibility activities, the company has two contradictory goals, such as corporate social responsibility implemented as a social responsibility to the community, on the other hand the company is expected to continue to obtain maximum profits. One of the objectives of the company is to maximize profits to shareholders. The company will provide these profits if it as good financial performance.The firm size is the important determinant of its profitability. The firm size can be an important element in determining the efficiency of a company such as lower production costs which have an impact on the competitiveness of the company. Previous research examining the effect of firm size on profitability still provides inconsistent results. Some studies show the results that there is a positive influence between firm size and profitability, while others show a negative effect or no influence on the firm size on profitability. The studies which showed positive effect are Dogan (2013); John dan Adebayo (2013); Pervan dan Visic (2012); Babalola (2013). On the other hand, Kartikasari dan Merianti (2016); Niresh dan Velnampy (2014); Kumar dan Kaur (2016); Veltampy dan Nimalathasan (2010) have found that there is no relationship between firm size and profitability. This research is based on the existence of research gap and the importance of shari'ah corporate social responsibility. In a conventional perspective, corporate social responsibility only emphasizes on stakeholders (human and nature). Based on the view of shari'ah enterprise theory that stakeholders consist of God, human, and nature (Triyuwono, 2007).

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The researcher develops shari'ah corporate social responsibility from concepts that exist in the shari'ah enterprise theory. Corporate social responsibility activities are implemented by the company as the party given the mandate must be accountable to God as the highest stakeholder. Researchers believe that the larger the firm size will have greater ability to implement shari'ah corporate social responsibility, so that the greater profitability. The company carries out shari'ah corporate social responsibility as a form of servitude to God.

2 LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

2.1 Syari'ah Corporate Social Responsibility

In a conventional perspective, the company realizes that carrying out corporate social responsibility activities is important but in its implementation there are still objections. The existence of these two contradictory goals will encourage the company to implement corporate social responsibility activities in various ways (lawful or not lawful) so that both objectives are achieved. Actions that are in accordance with shari'ah in Islam are called lawful, whereas actions that are not in accordance with shari'ah are called not lawful (unclean). In an Islamic perspective, the company implements corporate social responsibility to get profits and to provide stakeholders' welfare which is done in lawful way to get the blessing of Allah SWT. Corporate social responsibility activities carried out by the company as worship to Allah SWT means that corporate social responsibility activities are based on a sincere heart to provide the best results for all parties. Corporate social responsibility activities implemented by companies based on worship to Allah SWT in line with shari'ah enterprise theory are called shari'ah corporate social responsibility.

2.2. Shari'ah Enterprise Theory

Shari'ah enterprise theory is developed based on the zakat metaphor basically having a balance value, such as balancing egoistic and altruistic values, material and spiritual values. As consequence of the value of this balance, shari'ah enterprise theory does not only pay attention to individual interests (such as shareholders in entity theory) but also concerns the interests of other stakeholder. Shari'ah enterprise theory has a concern for stakeholders who consist of God, humans, and nature. Shari'ah enterprise theory positions God as the highest stakeholder which is the only goal of human life. Based on an understanding of the concept of shari'ah enterprise theory, meaning welfare is different from entity theory and enterprise theory. The concept of welfare according to the entity theory is profit for shareholders, in enterprise theory means welfare is economic value added, while in shari'ah enterprise theory means welfare is shari'ah value added consisting of economic welfare, mental welfare, and spiritual welfare (Triyuwono, 2007).

2.3 Firm Size and Profitability

Pervan and Visic (2012) said that there are several reasons large companies have higher profitability including : (1) market forces, larger companies have greater market power to provide higher prices and get higher profits; (2) economies of scale, larger companies can benefit because of their size from lower costs. Firm size will be the bargaining power of suppliers and when products are produced on large scale so that large companies are more efficient; (3) market experience, large companies can overcome better opportunities related to market losses and uncertainties so that large companies have lower risks; (4) favourable financing conditions because small companies often experience funding difficulties that make it difficult to develop; (5) advantages in research and development programs, large companies have the ability to exploit research results. The results of previous studies that show the results that the firm size affects the corporate financialperformance carried out by Dogan (2013); Pervan dan Visic (2012); Babalola (2013). Based on theoretical and empirical studies, the hypothesis proposed in this study is as follows:

H1: Firm size affects profitability.

2.4 Firm Size and Shari'ah Corporate Social Responsibility

Based on the view of slack resource theory that firm size has an impact on the availability of resources to implement shari'ah corporate social responsibility. The larger the size of the firm, the greater the resources available for use in carrying out shari'ah corporate social responsibility activities. The company uses slack resources to implement corporate social responsibility as a community relationship, relationship with employees, and emvironmental performance. Based on legitimacy theory, the greater the size of the firm, the more activities of companies that have an impact on the environment and social. Therefore, there will be greater public pressure on the company so that the corporate social responsibility activities carried out by the company will be wider in scope. Previous research that shows the results that the size of the firm affects corporate social responsibility by Waluyo (2017), Nawaiseh (2015), and Kiptoo et. al (2017). Based on the theoretical and empirical study of the hypothesis proposed in this study is :

H2 : Firm size has an effect on shari'ah corporate social responsibility

2.5 Shari'ah Corporate Social Responsibility and Profitability

The company in carrying out its business activities seeks to satisfy stakeholders. Companies that can satisfy stakeholders will have a good image and reputation, this is in line with good management theory. Companies that have a good image and reputation will improve the competitiveness of the company which in turn will have an impact on improving profitability. Based on shari'ah enterprise theory, the implementation of shari'ah corporate social responsibility activities by companies must be accountable to God and can prosper people and nature. In other words, the shari'ah corporate social responsibility activity of the company provides shari'ah value added, namely economic welfare, mental welfare, and spiritual well-being. Previous research that shows the results that corporate social responsibility affects profitability carried out by Fauzi dan Idris (2009); Rahmawati et al. (2014); Haryono and Iskandar (2015); Bolton (2013); Su et al. (2014); Kanwal et al. (2013); and Arshad et al.(2012). The hypothesis proposed in this study is:

H3: Shari'ah corporate social responsibility affects profitability.

3 METHODOLOGY

This type of research is explanatory research which is a research that aims to analyze the relationship between one variable and another or how one variable influences other variables. This study uses secondary data from annual reports of firms that listed in Indonesia Stock Exchange (IDX) selected from Jakarta Islamic Index (JII). Sample selection in this study uses purposive sampling with the following criteria: (a) companies that listed on Jakarta Islamic Index consecutively from 2011 to 2016; (b) the company's annual report is available is full from 2011 to 2016; (c) other data needed are available. This study uses firm size as an independent variable, profitability as a dependent variable, and shari'ah corporate social responsibility as an intervening variable. Firm size are measured by total assets, total sales, and number of employees. Profitability are measured by using Return on Assets (ROA) and Price to Book Value Ratio (PBV). Shari'ah corporate social responsibility is measured by the Islamic social reporting (ISR) checklist that consists of 43 statements. The data of shari'ah corporate social responsibility activities are collected from firm annual reports and the content analysis used to check the information about corporate social responsibility activities done by the firms with the list of statement on Islamic social reporting disclosure checklist. The approach to calculating the shari'ah corporate social responsibility level basically uses a dichotomy approach, such as each statement on the research instrument is given a value of 1 if it is disclosed and a value of 0 if not disclosed (Haniffa and Cooke, 2005). The formula for calculating the shari'ah corporate social responsibility level as follows (Haniffa and Cooke, 2005).

$$SCSR_j = \frac{\text{[illegible]}}{\text{[illegible]}}$$

Where :

SCSRj= Shari'ah corporate social responsibility disclosure index

nj= Number of items expected for jth firm

Xij= 1 if ith item disclosed

0 if ith item not disclosed

So that
≤ lj ≤ 1

Data analysis in this study uses partial least square (PLS). This study uses partial least square (PLS) for the following reasons: shari'ah corporate social responsibility variable is still not a strong empirical foundation, and the sample size is small (10 < sample < 100). Data analysis in the form of descriptive statistics of the data variables to be tested are carried out before testing the hypothesis. Partial least square (PLS) carried out in 3 stages, namely the outer model analysis, inner model analysis, and hypothesis testing.

4 Results and Discussion

The sample of this study are 78 firm-year observations from 13 firms that listed on the Jakarta Islamic Index from 2011 to 2016. Some stages in Partial Least Square (PLS) testing are as follows:

Outer Model Analysis

Outer model measurement evaluation aims to determine the validity and reliability of indicators that measure latent variables. There are 2 validity tests, namely convergent validity and discriminant validity. Convergent validity measures the validity of reflection indicators, can be seen from the outer loading of each variable indicator. The analysis indicators of the outer model are the value of the loading factor on the latent variable > 0,7 and Average variance extracted (AVE) > 0,5. Outer loading (see appendix 1). Based on appendix 1, loading factor that shows value > 0,7 are the variable indicator of firm size (X) is the number of employees with a value of 0,744; the indicator variable of shari'ah corporate social responsibility is an Islamic social reporting (ISR) with a value of 1,000; and the variable indicator of profitability (Y2) are ROA (0,812) and PBV (0,820). Construct reliability and validity can be shown in appendix 2. Based on construct reliability and validity can be seen that the variables that have average variance extracted (AVE) > 0,5 are shari'ah corporate social responsibility (Y1) and profitability (Y2).

Inner Model Analysis

Output Path Coefficient can be used to see the significance of the influence of each variable consisting of the size of the firm, shari'ah corporate social responsibility, and profitability. Path Coefficient can be shown in figure 4.1 below:

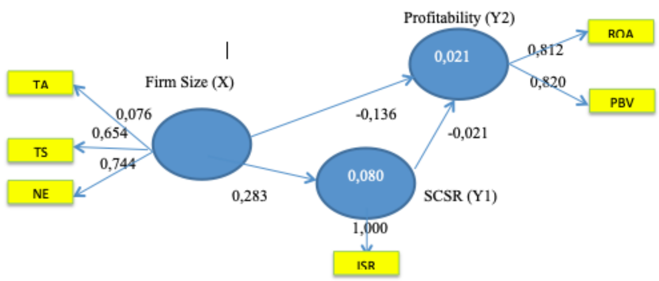

Figure 4.1 Research Model

Following the inner model testing by looking at the value Q2 (predictive relevance). Q2 is calculated by the following formula:

Q2 = 1 - (1-R12) (1-R22) = 1 - (1-0,080) (1-0,021) = 1 – (0,92) (0,979) = 1 – 0,900 = 0,1

The results of the calculation of Q2 showns the value of 0,1. Means that the model accuracy of 10% explains that the contribution of the model to explain the structural relationship of the variables studied consisting of firm size, shari;ah corporate social responsibility, and profitability is 10% and the rest is explained by other variables not examined in the model.

5 Hypothesis Testing

Based on appendix 3 can be shown the significance of the influence of each variable firm size, shari'ah corporate social responsibility, and profitability as follows:

Hypothesis	Direct Effects	Path coefficient	p-value	Results
H1	X → Y2	-0,136	0,212	Insignificant
H2	X → Y1	0,283	0,000	Significant
H3	Y1 → Y2	-0,021	0,876	Insignificant

5.1. The Affect of Firm Size on Profitability

The results of statistical tests on the effect of firm size on profitability show that firm size does not affect profitability. Profitability and sales are related because profitability comes from profit and profit comes from sales. This research finds that there is no effect of firm size on profitability because there are other factors that contribute more dominantly to profitability, such as non-operating expenses. So that the relationship between sales and profitability becomes weak. In this study, one proxy on the firm size is the total assets and profitability is proxied by ROA. Therefore total assets are denumerators of ROA so that the greater the total assets owned by the company, the smaller the ROA, assuming the company's net income is constant and vice versa. The results of this study are not in line with the results of Dogan (2013); John dan Adebayo (2013); Pervan dan Visic (2012); Babalola (2013) which states that firm size has significant effect on profitability. However, the results of this study support the results of research conducted by Kartikasari and Merianti (2016); Niresh dan Velnampy (2014) which states that there is no relationship between firm size and profitability.

5.2. The Affect of Firm Size to Shari'ah Corporate Social Responsibility (SCSR)

The results of statistical tests on the effect of firm size on shari'ah corporate social responsibility show that the effect of firm size on shari'ah corporate social responsibility is significant with a positive direction. The results of this study indicate that the greater the size of the firm the better the reporting information syatem that can be produce various financial information and other information needed by stakeholders. Therefore, companies increasingly need shari'ah corporate social responsibility activities. On the contrary, the smaller the size of the firm, the smaller the disclosure of shari'ah corporate social responsibility required by stakeholders.The results of this study support the results of research conducted by Waluyo (2017), Nawaiseh (2015), and Kiptoo et al. (2017). Waluyo (2017) stated

5.3. The Affect of Shari'ah Corporate Social Responsibility (SCSR) on Profitability

The results of statistical tests on the effect of shari'ah corporate social responsibility on profitability show that shari'ah corporate social responsibility does not affect profitability. The results of this study that the more corporate social responsibility activities carried out by the company will provide a good image so that investors will be loyal to the company that has an impact on profitability. On the contrary, the less corporate social responsibility activity will give a bad image to the company so that profitability will decrease. One reason the results of this study show that the two variables have no effect is that implementation of corporate social responsibility in Indonesia is mandatory with the enactment of law No. 40 of 2007. Negative relationship between corporate social responsibility and profitability can be caused by that fulfil corporate social responsibility obligations to stakeholders, the company will suffer losses due to to decreased profits because basically corporate social responsibility costs can be avoided or charged to other parties. So that the company if it incurs corporate social responsibility costs will reduce the profitability.The results of this study do not support the results of research conducted by Fauzi dan Idris (2007); Bolton (2013); Kanwal et al. (2013); Arshad et al. (2012); Haryono dan Iskandar (2015), but the results of this study support the results of research conducted by Rahmawati et al. (2014).

5.4. The Influence of Firm Size on Profitability Through Shari'ah Corporate Social Responsibility

Hypothesis states that shari'ah corporate social responsibility mediates the effect of firm size on profitability. Proof of hypothesis relates to the results of the test 2 path coefficients through firm size, shari'ah corporate social responsibility, and profitability. The Variance Accounted For (VAF) value of 4,2% or VAF < 20% indicates that there is no mediation effect.

Discussion

Based on data collection and analysis shows the results that there is no effect of firm size on profitability both directly and indirectly through shari'ah corporate social responsibility. Furthermore, there is no evidence that shari'ah corporate social responsibility can increase profitability. However, the empirical result show that firm size has positive impact on shari'ah corporate social responsibility. shari'ah corporate social responsibility does not mediate the relationship between firm size and profitability. In this research, Shari'ah corporate social responsibility was measured using Islamic social reporting in a dichotomous manner, so it did not measure shari'ah corporate social responsibility qualitatively. In addition, this research is not applied to companies that purely implement Islamic business so that some statements in the Islamic social reporting are not disclosed in the company's annual report. The result of this study can be concluded that firm size has no effect on profitability both directly and indirectly through shari'ah corporate social responsibility. Therefore, there is no evidence that shari'ah corporate social responsibility can mediate the relationship of firm size to profitability. However, the empirical result show that firm size has positive effect on shari'ah corporate social responsibility.

Limition and Future Research Direction

There are some limitions of this research. The first limition is that this study only focused on corporate social responsibility disclosure in the company's annual report, there are several forms of corporate social responsibility communication that companies use such as corporate websites, sustainability reports, and newspapers. The second limition is that researchers in measuring shari'ah corporate social responsibility use Islamic social reporting that is dichotomous, so this study didn't measure the quality of shari'ah corporate social responsibility. The third limition is the sample not all companies that run business in shari'ah. For future research, that shari'ah corporate social responsibility as measured by Islamic Social Reporting (ISR) should be applied to companies that are purely Islamic. The application of shari'ah corporate social responsibility is expected to give shari'ah value added that is profitability and corporate non-financial performance. For future research is expected to investigate the effect shari'ah corporate social responsibility on corporate non-financial performance

Implication

Research implications for companies or issuers are:
Company managers are expected to provide broader shari'ah corporate social responsibility disclosures in the company's annual report, because not all statements in the Islamic social reporting (ISR) are found in the company's annual report. Company managers are expected to choose social activities that are directly visible in activities related to the community, so that it becomes one of the right choices for companies that want to increase the value shareholders. However, corporate social responsibility activities must also consider the company's objectives to maintain the company's business continuity. Thus, the company can still synergize profit, planet, and people.

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Appendix

Appendix 1. Outer Loading

	Firm Size (X1)	SCSR (Y1)	Financial Performance (Y2)
TA	0,076		
TS	0,654		
NE	0,744		
ISR		1,000	
ROA			0,812
PBV			0,820

Appendix 2. Contruct Reliability and Validity

	Cronbach's Alpha	rho_A	Composite Reliability	Average Variance Extracted (AVE)
Firm Size (X)	0,161	-0,069	0,519	0,329
SCSR (Y1)	1,000	1,000	1,000	1,000
Profitability (Y2)	0,499	0,499	0,800	0,666

Appendix 3. Path Coefficients

	Profitability (Y2)	SCSR (Y1)	Firm Size (X1)
Profitability (Y2)			
SCSR (Y1)	-0,021		
Firm Size (X1)	-0,136	0,283	