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The Role of Intellectual Capital to Fill the Missing Link Between Social Responsibility and Islamic Banking Performance in Indonesia

Bima Cinintya Pratama[1]*, Makhrus[2], Maulida Nurul Innayah[3]

[1,3]Faculty of Economics and Business, Universitas Muhammadiyah Purwokerto, Indonesia
[2]Faculty of Islamic Religion, Universitas Muhammadiyah Purwokerto, Indonesia

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Abstract

The aim of this study is to examine the relationship between Islamic banks' social responsibility and intellectual capital and their performance in Indonesia. The role of IC as a mediator between CSR and corporate performance is also examined. According to the findings of this study, corporate social responsibility (CSR) strategies may increase corporate IC, generating a new subset of IC known as "Sustainable IC," which has a direct relationship to the environmental and social knowledge necessary for companies to succeed in the present day. The findings of this research corroborated the mediating function of IC in the relationship between CSR and performance. The results of this study have significant practical implications for financial institutions, which might use them to argue for increased funding of CSR implementation strategies that enhance CSR indicators associated with greater use of IC resources and, therefore, better business outcomes. The study confirms that IC and social responsibility have a positive impact on the financial standing of Islamic banks in Indonesia.

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Introduction

The last forty years have seen a flurry of activity in the implementation of the Islamic-based financial system. Notwithstanding setbacks, the Islamic banking movement advanced successfully. Results from the past quarter century's efforts have been promising. Building stakeholder trust is an ongoing issue for Islamic financial institutions. It's common knowledge that only banks that earn the confidence of their constituents can thrive. The government's budget deficit for development can be appropriately financed, banks can effectively mobilize savings, attract investment, distribute financing, invest, and expand employment, and the economy can progress swiftly.

Different standards apply to Islamic and traditional banks (Maali et al., 2006). When compared to traditional banking and finance, Islamic banks are seen as having a special social and economic function due to their adherence to the Islamic Sharia's ideals of social justice and equality. This view is shared by those actively contributing to the expansion of the Islamic-based finance and economics sector (El-Gamal & Inanoglu, 2005; Haniffa & Hudaib, 2007). To meet these criteria, Islamic banks must document the charitable work they do, which align with their values and aim to enhance community welfare and cohesion. Indeed, Islamic banks are seen as financial institutions that not only seek to achieve maximum profit but also prioritize their role in providing broad societal welfare, in line with the principles of Islamic economics. For this reason, it is essential that Islamic banks provide full disclosure on how their actions align with Sharia goals and promote social responsibility to serve the ummah (Muslim society).

Information and understanding are critical in today's knowledge-based economy for businesses to enhance their operations and productivity (Ferraris et al., 2018). Intellectual capital (IC) is crucial in today's competitive economic world. When developing their IC, companies face crucial strategic decisions, including those pertaining to CSR (corporate social responsibility). According to research Hart (1995), there is a connection between a company's IC and CSR activities, and this might affect the firm's performance. Experts are trying to figure out how IC and CSR affect a business by conducting studies on the subject (Beretta et al., 2019).

The company's societal and environmental performance may be affected by its IC, according to research by (Chang & Chen, 2012). Businesses may improve their intangible assets and acquire a competitive edge by creating strategies relating to environmental and social challenges (Nikolaou, 2019). CSR, social, and environmental factors may all have a beneficial impact on IC's growth, as stated by the firm's Non-Resource-Based Vision (NRBV) (Hart, 1995; Chang & Chen, 2012). Yet, there is a dearth of writing on CSR and IC, especially as it pertains to the growth of "Sustainable IC" (SIC). Due to measuring challenges, it is also currently unclear what role intangibles play in the connection between CSR and performance (Grewatsch & Kleindienst, 2017). Therefore, according to K. H. Kim et al., (2018), further study is required to establish the impact of CSR and IC on corporate performance and the relationships between these two aspects. Thus, previous research Margolis and Walsh (2003) propose that in order to solve these problems, academics should expand on existing models by include additional factors in their examinations of the link between CSR and business success.

This research was inspired by a need to find a solution to this issue by exploring IC's function as a mediator for CSR and company performance. This research suggests that CSR initiatives can improve corporate IC and pave the way for a new form of IC called "sustainable IC," which is linked to the environmental and social knowledge that successful businesses require (Chang & Chen, 2012). To accomplish these aims, this paper conducts an empirical analysis of IC's function as a mediator between CSR and the performance of Indonesian Islamic commercial banks.

This study aimed to expand existing knowledge on Intellectual Capital (IC), with a focus on its connection to green growth. This research will solve the research gap by looking into how CSR affects a company's IC and, in turn, its performance. It is argued that when a business adopts a sustainable strategy, it gains a deeper comprehension of social and environmental concerns and engages with all relevant parties. The research seeks to broaden the scope of IC analysis by investigating how a corporation's approach to CSR can influence the intellectual capital (IC) effectiveness, in terms of the Value-Added Intellectual Coefficient (VAIC), and thus the corporation's long-term performance. In addition, this research highlights the times when IC and CSR are helpful to business performance, stressing the importance of IC in comprehending the consequences of CSR success. At last, a novel mediator between CSR and business performance is investigated.

Based on the results of this research, companies should adopt CSR strategies to improve their CSR. The company's productivity will rise as a consequence of the increased availability of IC resources. The building of a sustainable competitive advantage via practices that are difficult to duplicate by competitors should be a top priority for managers. Thus, the originality of this research lies in the fact that it demonstrated the significance of a new viewpoint of IC, sustainable IC, in the connection between CSR and corporate performance. This research also highlights the importance of CSR and IC in making businesses less susceptible to shocks like the COVID-19 pandemic and facilitating a more rapid shift towards an economic system that is more sustainable.

It is crucial, therefore, to study IC's function as a mediator between CSR in Islamic banking and banking performance. If Islamic banks can improve their social performance, they will likely win back the support of existing customers and attract new ones. An in-depth analysis of Islamic banks' social duties is necessary to enhance their efficiency.

Resource-based Theory (RBT)

To comprehend and foretell competitive advantage and corporate performance, resource-based theory (RBT) is a vital foundation (Barney et al., 2011). One of the earliest studies to have a substantial effect on this idea was that of (Wernerfelt, 1984). Barney (1986) research also contributed to the theory's development and enrichment. Barney expanded on the RBT's rudimentary ideas and elucidated resources' and competitive advantage's defining characteristics in 1991.

Resource-Based Theory (RBT) explain that a successful campany and their growth depend on how well its resources are managed and put to use (Wernerfelt, 1984). According to RBT, in order to stay ahead of the competition, businesses must be adept at holding on to and effectively allocating scarce, unique, and irreplaceable assets (Barney, 1991). Barney (1991) argues that a resource is valuable if it is difficult or impossible to replace. Under these circumstances, investments in resources can provide superior results and boost the efficiency of a company.

Kozlenkova et al. (2014) developed the four VRIO (Valuable, Rare, Imperfectly Imitable, Organization) attributes to assess a resource's ability to give a sustainable competitive advantage. According to RBT's analysis, IC has the ability to meet the aforementioned VRIO standards and provide firms a leg up in the marketplace. With this advantage, businesses may flourish in a highly competitive market and achieve their full potential.

The Relationship Between Corporate Social Responsibility and Company Performance

According to K. H. Kim et al. (2018), organizational initiatives to boost stakeholder satisfaction are often referred to as "corporate social responsibility" (CSR). Several studies have examined how CSR impacts a company's financial performance, although the results have been mixed (Carroll & Shabana, 2010; K. H. Kim et al., 2018; Grewatsch & Kleindienst, 2017). The RBV Freeman (1984) argues that CSR may boost a company's performance by increasing its intangible assets, improving its connections with stakeholders, and giving it a competitive edge. It has been shown in other works that when profits are higher, managers may allocate more money to corporate social responsibility initiatives (Waddock & Graves, 1997). In addition, actual and symbolic CSR investments are distinguished by (Kim et al., 2012). The former describes an organization's practices of CSR and the promotion of a company's culture where such concerns are given top billing. In the second case, a company's CSR efforts are mostly symbolic in nature and are undertaken for the express purpose of improving the company's public image among investors.

Gray et al. (1995) explain through the legitimacy hypothesis, companies that engage in CSR strategies stand to reach competitive advantages and improve their long-term performance (McWilliams & Siegel, 2011). Implementing CSR-related activities like sustainable product creation, new methods with less environmental impact, and others may have detrimental effects on a company's financial line and short-term profitability (Darnall & Edwards, 2006). According to Martín-de Castro et al., (2016), while evaluating the CSR strategy's impact on performance, it is important to account for the length of time it takes to realize returns on the investment. CSR has the potential to boost a company's long-term performance and reputation among its staff and its external stakeholders. Involving stakeholders and living up to their expectations, as pointed out by Martin-De-Castro et al. (2016), may boost a company's competitive edge and contribute to its long-term profitability. Considering the increasing importance of CSR, this study assumes that:

H1: *Corporate social responsibility has a positive and significant effect on company performance*

The Relationship Between Intellectual Capital and Company Performance

A company's capacity to create value and sustain fast growth depends greatly on its level of intellectual capital. Intellectual capital is the major source of an organization's competitive advantage and value creation, according to Resource-Based Theory (RBT) (J. Barney, 1991). Only by strategically allocating and employing resources that are precious, scarce, and difficult to copy can a competitive edge be maintained over the long term (Barney, 1991). According to Resource-Based View (RBV), an organization's intellectual capital consists of its store of know-how, skills, and other intangible assets that help it succeed in the marketplace and grow profitably (J. Barney, 1991; Nazari & Herremans, 2007). Intellectual capital is inherently difficult for rivals to assess or replicate since it is immaterial and embodies the intangible attributes that set a firm apart (Ray et al., 2004). Intellectual capital is crucial for businesses since it encourages innovation and increases productivity. (Mondal & Ghosh, 2012).

Greening & Turban (2000) and Gregory et al. (2016) are just two examples of the many studies that show how a company's social performance may provide it a competitive advantage in the marketplace. Intellectual capital has been shown to have a positive effect on the performance of Islamic banks in previous research (Nawaz & Haniffa, 2017; Ousama & Fatima, 2015; Setianto & Sukmana, 2016). Several studies in the past have conclusively linked intellectual capital to financial success. Chen et al. (2005) found that a company's intellectual capital might be a good predictor of its value and performance. Clarke et al. (2011) found a robust relationship between enterprises' levels of intellectual capital and their performance on the Australian Stock Exchange. Several studies (Pratama, et al., 2019; Pratama, Wibowo, et al., 2019; Tan et al., 2007) find a positive relationship between intellectual capital and financial results. Furthermore, previous studies have shown that intellectual capital has a beneficial effect on the efficiency of Islamic banks (Nawaz & Haniffa, 2017; Ousama & Fatima, 2015; Setianto & Sukmana, 2016). For this reason, we propose the following hypothesis:

H2: *Intellectual capital has a positive and significant effect on company performance*

The mediating effect of IC in the relationship between social responsibility and corporate performance.

The Industrial period saw firms expand their economies by investing in physical assets like new machinery, factories, and office buildings. This practice has given way to the information age. However, in the digital age, intellectual resources like people, processes, and capabilities are essential for economic growth (Guthrie et al., 2007). Workers' knowledge and expertise are included in this category of intangible assets, sometimes called intellectual capital (IC). Such specialized talent is irreplaceable and crucial to any enterprise's success (Peteraf & Barney, 2003). The three pillars of IC are human capital, structural capital, and relational capital (Sveiby, 1997). According to Bontis (2001), relational capital was presented as an alternative to customer capital in the same study. Joshi et al. (2013) and Nadeem et al. (2017) explain that the same Relational capital measure was utilized in subsequent investigations.

Companies' bottom lines can benefit greatly from engaging in corporate social responsibility (CSR) (Tsoutsoura, 2004). Environmental concerns, ethical company practices, governance, human rights, and community investment are all part of what's known as "corporate social responsibility," or CSR. This dedication encourages stakeholders both inside and outside the organization to increase their financial support for CSR initiatives (Tsoutsoura, 2004). Both IC and CSR have an impact on the bond between businesses and their communities (Sumita, 2005). Human capital (HC), which includes employees' knowledge, skills, and capacities, is an essential part of IC since it directly affects workers' well-being and is widely recognized as a corporate social and economic obligation (Voegtlin & Greenwood, 2016).

According to Gangi et al. (2019), corporate social responsibility (CSR) programs can boost productivity and HR results by addressing moral and financial concerns in the workplace. Additionally, as they draw in skilled and competent individuals, these actions help to increase human capital (HC) and achieve a competitive advantage (Branco & Rodrigues, 2006). When combined with SC and a supportive company culture, HC is a powerful driver of creativity and productivity in the workplace (Barrena-Martinez et al., 2018). Initiatives focused on corporate social responsibility (CSR) have the potential to improve productivity and employee engagement while fostering a long-term company culture (Kim et al., 2010). Internal CSR similarly promotes trustworthiness in the workplace, which benefits both organizational knowledge and leadership abilities and eventually results in greater employee output (Brammer et al., 2007).

In addition, it has been shown that corporate social responsibility (CSR) increases a company's relational capital (RC), which improves its reputation among stakeholders (Aras et al., 2011; Gangi et al., 2019). Melo & Garrido-Morgado (2012) explain that public often thinks highly of businesses that participate in CSR initiatives, this has several benefits for businesses, including reduced labor expenses (McWilliams & Siegel, 2011), consumer loyalty has been boosted Y. Kim (2017); Aramburu & Pescador, (2019), and easier access to funding (El Ghoul et al., 2011). This indicates that CSR and RC are positively related.

Intellectual capital refers to the resources unique to a company that can generate wealth and provide a competitive advantage over rivals, including the skills and competencies of employees (Peteraf & Barney, 2003). While traditional accounting practices do not account for intangible assets in financial statements, practitioners and academics have increasingly recognized the significance of IC (Edvinsson & Malone, 1997). Previous studies have mainly overlooked intellectual property as a significant contributor to a company's financial performance.

Several theoretical frameworks have been utilized to examine Intellectual Capital's (IC) contribution to improved business performance. Resource-Based View emphasizes the importance of maximizing one's strategic resources in order to obtain an edge over the competition. Khan et al. (2019) study lends credence to the idea that IC helps businesses gain an edge and perform better generally. According to the principle of organizational learning, businesses should encourage their employees to engage in ongoing education, in order to foster creativity in both products and procedures. Structural Capital (SC), in this context, refers to an organization's innate expertise and facilities. Research and development spending has been linked to more successful companies (Nadeem et al. 2017). Another viewpoint that stresses the significance of external resources in affecting business behavior and performance is the Resource Dependency hypothesis. Smriti and Das (2018) show that businesses who invest in their Human Capital (HC) effectively see gains in productivity and efficiency. Thus, the following hypothesis is advanced in light of these theoretical considerations:
H3: *Corporate social responsibility has a positive and significant effect on IC, which then positively affects company performance. Therefore, the relationship between corporate social responsibility and company performance is mediated through IC.*

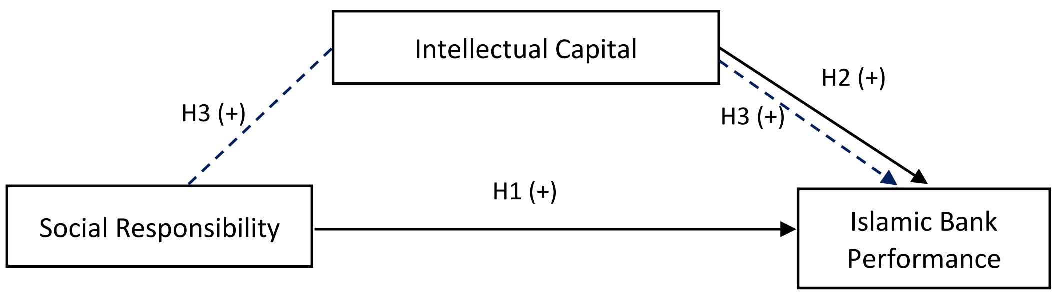

Figure 1. Research Framework

Method

Sample Selection and Data Sources

The population and the sample for this research consisted of all Islamic commercial banks in Indonesia that were registered with the Financial Services Authority (OJK) between 2009 and 2021. The information was obtained from the OJK or corporate websites using a documentation approach called a pooled unbalanced panel, which comprised all available samples. For the years 2009-2020, fourteen Islamic commercial banks were suitable for the sample.

Definition and Measurements of Variables

Social Responsibility

For the purposes of this research, Islamic Social Reporting (ISR) serves as a proxy for CSR (CSR). Disclosures made in accordance with ISR are compliant with Islamic law. Sharia law must be followed in developing ISR standards. The ISR index used in this study is one of 43 different types of disclosures developed by the Islamic Financial Institution's Accounting and Auditing Organization. The ISR index, developed from prior research by Othman et al., (2009), is used in this investigation.

Intellectual Capital

Intellectual capital is measured by iB-VAIC, which served as the study's independent variable. Ulum (2013) adapted Pulic's (2000, 2004) iB-VAIC technique for use in assessing Islamic Financial Institutions' IC. The iB-VAIC model was created using financial reporting data, reporting standards, and relevant legislation relating to Islamic banking, allowing it to be used to identify the accounts in the financial statements of Islamic banks. Previous research Nurhidayat & M. Syarief, (2020); R. Rizkyanti et al., (2020); Syah & A. Fauzan, (2020) has employed it as a stand-in for IC in Islamic financial institutions. iB-VAIC I may be calculated as follows (Ulum, 2013):

$$\boxed{\textbf{iB-VAIC = iB-VACA + iB-VAHU + iB-STVA}}$$

Where:

iB-VAIC	= Value added intellectuals coefficients
iB-VACA	= VA / CE; human capital efficiencies coefficients
iB-VAHU	= VA / HC; structural capital efficiencies coefficients
iB-STVA	= SC / VA; the physical capital efficiencies coefficients
VA	= OP + EC + D + A; OP is operating profits; EC is the costs of employees; D is Depreciations, and A is Amortizations.
HC	= employee expensed
SC	= iB-VA – HC; structural capitals
CE	= availables employed fund (total equities)

Islamic Bank Performance

In this analysis, Return on Assets (ROA) served as the performance metric for Islamic financial institutions (Nawaz & Haniffa, 2017). The selection of Return on Assets was based on its ability to reveal how proficiently management turns assets into cash flow. Because of their ability to more accurately portray the monetary worth of intangible assets, financial performance metrics like Return on Assets (ROA) are frequently preferred for use in IC studies (Stewart, 1997). This research followed the IC methodology by measuring Islamic bank performance using Return on Asset (ROA), an accounting-based statistic.

$$ROA = Profit\ before\ tax\ /\ Average\ total\ assets$$

Bank Size

As per Baklouti's (2022) recommendation, this study will incorporate a control variable, namely bank size, to consider the variations in the specific characteristics of banks.

Analysis techniques

In this study, we use panel data regression techniques, namely fixed effect or random effect regression. Initial steps are taken to determine the best regression model for the study. These assumptions are analyzed using a two-equation model. The first model looks at how Islamic banks' moral obligations and intellectual resources impact their bottom lines. Model two analyzes how CSR affects intellectual capital and how that, in turn, affects a company's bottom line via the lens of the mediation role played by IC. We used the following model in our study:

$$\boldsymbol{ROA = \beta_0 + \beta_1 ISR + \beta_2 iBVAIC + \beta_3 BankSize_t + \varepsilon_t} \quad \textbf{(1)}$$

$$\boldsymbol{IC = \beta_0 + \beta_1 ISR + \beta_2 BankSize_t + \varepsilon_t} \quad \textbf{(2)}$$

where:

ROA	= Performance
ISR	= Islamic Social Responsibility
iBVAIC	= Intellectual Capital
BankSize	= Bank Size
t	= error term

Result and Discussion

Descriptive Statistics

The summary of descriptive statistics provides information, such as the mean value, stdev, etc. The standard deviation is a statistical measure of the spread of data points around the mean. The lower the value of the standard deviation, the closer the data values are to the mean. Table 1 contains descriptive statistics on all of the variables in the research. It turns out that the average values for ROA and IC are 0.0067144 and 3.847391, respectively. Bank Size has an average value of 29.87925 in terms of control variables, whereas Social Responsibility (ISR) has an average value of 0.4487944. The variables' descriptive statistics are shown in Table 1.

Findings of the First Hypothesis

The first hypothesis will be put to the test to see if Islamic banks in Indonesia may benefit from becoming more socially responsible. Test of the hypothesis, summarized in Table 2, reveal that Islamic banks benefit enormously from practicing social responsibility. The coefficient in this situation is 0.1438, which provides strong support for the hypothesis at the 1% level. According to the results, Islamic banks may benefit from social responsibility initiatives since they boost the institution's reputation among its stakeholders and employees. According to previous research, this can boost a company's performance and make it more competitive in the market as explained by (Martín-de Castro et al., 2016).

Findings of the Second Hypothesis

The second hypothesis will be tested to see if a relationship exists between Indonesia Islamic Bank's IC and the company's performance. The hypothesis testing showed that IC had a positive effect on the performance of the Islamic bank, with a coefficient of 0.0014 at the 1% level of significance. This indicates that Islamic bank performance may be enhanced with the efficient and long-term application of IC. This lends credence to the second hypothesis, which states that IC has a beneficial impact on the efficiency of Islamic financial institutions. The findings from testing H2 indicate that Islamic banks will see improved performance as a consequence of IC's influence. According to the findings of prior research, IC has a highly beneficial effect on business outcomes (Chen et al., 2005; Clarke et al., 2011; BC. Pratama, 2016; BC. Pratama & Innayah, 2021; Pratama & H. Wibowo, 2017). This is consistent with the idea proposed by J. Barney (1991), which held that efficient management of intellectual capital would provide a corporation with a strategic edge.

Table 1. Descriptive Statistic Result

Variable Name	Mean	Min	Max	Std. Dev.
ROA	0.0067144	0.0325828	-0.1688571	0.1485718
ISR	0.4487944	0.1282053	0.1553156	0.6744186
IC	3.847391	9.987793	-10.05218	103.9765
Size	29.87925	1.402553	25.8087	33.21184

Analysis of the Hypothesis Test

Table 2. Results of Hypothesis Test

	1st Model			2nd Model		
	Dependent Variables					
Independent Variables	ROA			IC		
	Coef.	**Std. Err.**	**z**	**Coef.**	**Std. Err.**	**t**
Const	-0.1773	0.0704	-2.52**	0.6933	17.4118	0.04
ISR	0.1438	0.0327	4.39***	39.7080	10.0657	3.94***
IC	0.0014	0.0002	6.69***			
BankSize	0.0037	0.0019	1.96*	-0.4909	0.6907	-0.71
R^2 Within			0.7092			0.1642
Wald chi^2			62.06			
F						22.53
Prob > chi^2			0.0000***			
Prob > F						0.0001***

Significance levels are as follows: *** at 1%; ** at 5%; * at 10%.

Table 3. Sobel Test Results

Model: Social Responsibility → Intellectual Capital → Islamic Bank Performance	
A	39.70804
B	0.0014173
SE_A	10.06571
SE_B	0.000212
Sobel test statistic:	3.4012684
One-tailed probability:	0.00033537***
Two-tailed probability:	0.00067074***

Findings of the Third Hypothesis

We examine the third hypothesis to see whether IC mediates the relationship between social responsibility and the performance of Islamic banks in Indonesia. In Table 3, we see that a Sobel test indicates IC may serve as a mediator between social responsibility and the performance of Islamic banks. The results proved that the third hypothesis is supported. This research shows that corporate social responsibility strategies may boost a company's IC, giving rise to a new category of IC called "sustainable IC," which is intertwined with concerns for the environment and its inhabitants. This is necessary for businesses to enhance their competitive position (Chang & Chen, 2012). This research provides empirical evidence that IC functions as a mediator between social responsibility and company performance.

Conclusion and Recommendation

This study aimed to investigate whether social responsibility and intellectual capital affect the performance of Islamic Banks. Social responsibility and intellectual capital were shown to be advantageous to Islamic banks. Equally examined is the role of intellectual capital as a mediator between social responsibility and the financial performance of Islamic banks. According to the results, intellectual capital was proven as mediator of this connection. This study's findings have important practical implications, suggesting that organizations should prioritise CSR initiatives that boost their IC resources and, in turn, their productivity. The study's findings indicate that Islamic banks should prioritize CSR and IC.

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