Al-Mal: *JurnalAkuntansi dan Keuangan Islam*
E-ISSN: 2715-9477, P-ISSN: 2751-954X
Volume 05 Issue 01, 30-June-2024
Journal Page is available to:01-11
http://ejournal.radenintan.ac.id/index.php/al-mal/index

The Effect of Governance on Zakat Funds of Indonesian Islamic Commercial Banks with Company Size as a Moderating Variable

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ARTICLE INFO

Article history:
Received 16-06-2023
Revised 22-01-2024
Accepted 28-01-2024
Available 30-06-2024

Kata Kunci:
Corporate governance; zakat performance

Paper type: Research paper

Please cite this article:
Finashih,N."The Effect of Governance on Zakat Funds of Indonesian Islamic Commercial Banks with Company Size as a Moderating Variable" Al-Mal: Jurnal Akuntansi dan Keuangan Islam [ONLINE}, Volume 05 Number 01 (June 30, 2024)

Cite this document:
Al-Mal edisi ke-1

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ABSTRACT

Zakat collection and distribution in Islamic banking is poor compared to the zakat potential that should exist in Indonesia, even though zakat is regarded as a social performance of Islamic banking and thus demands more attention from companies. This study aims to look at how corporate governance affects Islamic Commercial Banks' zakat funds in Indonesia. This study's population comprises seven ICBs registered with the OJK between 2011 and 2020. Purposive sampling is used in this study. The research method used was quantitative, with panel data regression analysis performed using Eviews. Corporate governance relies on the size of the board of directors and the Sharia Supervisory Board (SSB). The study's findings reveal that the size of the board of directors and the SSB have little effect on zakat funds. Company size cannot act as a moderating variable for the size of the board of directors or the size of the SSB with zakat funds. Control variables such as profitability and bank size substantially impact zakat funds. The most significant factor influencing zakat funds is bank size.

INTRODUCTION

Indonesia has the largest Muslim population globally and the largest Islamic financial institutions. As a result, the potential for zakat is significant in the country. Zakat is significant in various aspects, including religion, society, economy, and social welfare. It is considered a form of worship with great importance.

Islamic banking is crucial in fulfilling its social responsibility by effectively managing zakat funds. The financial statements include reports on the sources and uses of zakat funds during a specific period (Muhammad & Hudayati, 2023)) and the zakat funds that remain undistributed as of a certain date. Islamic banking plays a crucial role in efficiently collecting zakat in Indonesia, thanks to its widespread network of offices. In December 2022, the overall count of Islamic banking offices stood at 2,612. In 2022, the National Amil Zakat Agency (Baznas) reported that the Java Region in Indonesia has a significant potential for corporate zakat. The estimated amount for the Java Region alone is IDR 76.74 trillion, contributing to the overall zakat potential of IDR 169.5 trillion.

Recognizing the zakat potential, it becomes evident that Islamic banks, rooted in Sharia principles, should actively engage in social performance by participating in zakat. However, it is evident from their annual reports that not all Islamic banks have fully tapped into the potential of zakat. The amount of corporate zakat received by institutions like Baznas does not necessarily correlate with the number of companies (Rizki et al., 2019).

Zakat is considered a social function (Nugraheni, 2018). it is important to note that this function is a unique characteristic of Islamic banks that sets them apart from conventional banks. Islamic banks manage social funds such as zakat, alms, and *qardul Hassan* (Haniffa & Hudaib, 2007). Furthermore, Islamic banks are required by Law Number 21/2018 article 4 (2) to fulfill social functions as social performance objectives alongside their commercial functions as financial performance objectives (Muhammad & Hudayati, 2023).

Mollah et al. (2017) pointed out that the governance structure of Islamic banks has a significant impact on their financial performance. The governance structure in Islamic banks differs from that of conventional banks. The Sharia-compliant characteristics of Islamic banks are governed by the Sharia Supervisory Board (DPS), which is the primary governance structure of Islamic banks (Mollah et al., 2019) and is subject to and compliant with dual governance with a Shariah Supervisor and Board of Directors (Khalil, 2021).

In the concept of Agency theory, directors serve the purpose of safeguarding stakeholders and providing assistance. Managers should strive to optimize bank profitability (Muhammad & Hudayati, 2023). Rahman & Haron (2019) demonstrate that the performance of Islamic banks can be enhanced by increasing the number of board directors. This finding aligns with the concept of stakeholder theory, which suggests that as the number of directors increases, so does the representation of stakeholders. In contrast to the findings of Naushad & Malik (2015), which indicated a negative impact of board size on the financial performance of Islamic banks, smaller boards are better equipped to monitor the management of the banking sector closely.

The performance of Islamic banks can be impacted by various factors, including DPS (Nugraheni, 2018). DPS ensures that all bank activities adhere to the principles of sharia law. An increased number of DPS members is anticipated to adopt a more rigorous approach to overseeing activities to ensure compliance with Sharia principles. Consequently, it is expected that the performance of Islamic banks will also improve. The significance of DPS aligns with the findings of Mollah & Zaman (2015), Nomran et al. (2018), and Aslam & Haron (2020). These studies indicate that a higher number of DPS members positively impacts the overall financial performance of Islamic banks.

On the other hand, Rahman & Haron (2019) found a negative correlation between the size of DPS and the performance of Islamic banks. A clear correlation exists between the size of a bank's DPS and its overall performance. Specifically, Islamic banks with a larger DPS size experience a decrease in their performance.

Various factors can impact performance, with company size being one of them. This is because the size of a company can indicate its capacity to generate profits (Dewi et al., 2021). Islamic banks possess a significant advantage in effectively addressing challenges and maximizing profitability due to their substantial corporate assets.

There are variations in the research conducted compared to previous studies. These differences include the research's focus and the year it was conducted. In this study, conducted in 2022, an additional variable has been introduced - company size - which serves as a moderating factor, enhancing the relationship between the variables. In theory, the distinction lies in the overarching theory that serves as a foundation for examining the variables under study. The specific grand theory employed in this case is agency theory.

RESEARCH METHODS

This study adopts a quantitative approach. This study focuses on the population of Islamic Commercial Banks in Indonesia from 2011 to 2020. The sample selection was done using the purposive sampling technique, resulting in seven banks with 70 observations that met the criteria. The data utilized consists of secondary data sourced from OJK, specifically the annual reports from 2011 to 2020 about Islamic Commercial Banks in Indonesia.

Table 1. Measurement of Variables

Variable	Measurement
Dependent Variable: Zakat fund (Y)	The distribution and collection of zakat funds
Independent Variable: Size of the board of directors (X1) Size of DPS (X2)	The number of directors The number of DPS members
Moderating Variable: Company Size	Total Assets
Control variable: Profitability Size of banks	Net income and assets

The analysis technique utilizes panel data regression with the Fixed Effect model through the E-Views application. The regression equation used in this study is presented below:

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \beta_6X_6 + e$$

Description:

Y : Zakat funds
β_0 : Intercept
β_1-β_6: Partial regression coefficient
X_1 : Board size
X_2 : DPS size
X_3 : Company size moderates board size
X_4 : Company size moderates DPS size
X_5 : Profitability
X_6 : Bank size
e: *Error*

The Effect of Governance on Zakar Funds of Islamic Commercial Banks in Indonesia

Recognizing the significant impact of zakat in Indonesia, it is crucial to grasp the importance of efficient zakat management. The effective governance of zakat plays a vital role in ensuring its proper administration (Dahlan, 2018). Well-established Islamic banking institutions and organizations can handle zakat effectively (Wardhani et al., 2022).

The governance structure in Islamic banks differs from that of conventional banks. The Sharia-compliant characteristics of Islamic banks are governed by the Sharia Supervisory Board (DPS), the main governing structure

(Mollah et al., 2019). These characteristics are subject to dual governance, with both Sharia Supervisors and Directors involved. In his study, Khalil (2021) explored the correlation between the board of directors and DPS in Islamic financial institutions. These institutions have a unique governance structure that includes a board of directors and DPS. This arrangement adds complexity to the governance of Islamic banks, which is more robust than conventional banks. The board of directors oversees the company's governance, while the DPS plays a crucial role in approving banking transactions and services (Khalil, 2021). Together, they enhance the credibility and trust of stakeholders.

Darwanto & Chariri (2019), Mollah et al. (2019), Muhammad & Hudayati (2023), and Rahman & Haron (2019) found that the focus was on the impact of governance on the performance of Islamic banks. The findings indicated a noteworthy positive correlation between the board of directors and the financial performance of these banks. Nugraheni (2018), Abdallah & Bahloul (2021), Mollah & Zaman (2015), Nomran et al. (2018), and Aslam & Haron (2020) all show that having a larger DPS member increases Islamic banks' financial performance. A larger DPS is intended to be tighter in supervising activities to ensure compliance with Sharia rules, resulting in greater performance for Islamic banks.

According to Nugraheni (2018), Muhammad & Hudayati (2023), and Widiyono (2020), zakat is a social performance of Islamic banks. Islamic banks' social function must perform a function known as baitul mal, which involves receiving monies from zakat, infaq, sadaqah, grants, or other social funds (Widiyono, 2020). Mukhibad et al. (2017) investigated the factors influencing Islamic commercial banks' financial and social performance in Indonesia. Zakat and Qardhul Hasan judge social performance. Islamic banks will pay more zakat as their revenues increase (Muhammad & Hudayati, 2023). Therefore, this study produces the following hypothesis:

H1: Board size positively affects the zakat funds of Islamic commercial banks in Indonesia.

H2: DPS size has a favorable effect on the zakat funds of Islamic commercial banks in Indonesia.

The Effect of Company Size in Moderating the Governance of Zakat Funds

There are numerous benchmarks for measuring a company's success; elements such as company size can have an impact on performance because a company's size can indicate its ability to make profits (Dewi et al., 2021; Wahyuningsih & Yusnelly, 2021).

The entire set of assets controlled by a company determines its size. Because huge corporate assets underpin Islamic banks, they will be better equipped to deal with challenges and generate profits. The larger the company, the better the governance is expected, resulting in higher profits or performance. The demand for information sharing increases with corporate scale compared to smaller companies. Disclosing more information demonstrates that the organization has followed the principles of excellent corporate management and governance.

According to Maudi et al. (2020), enterprises with substantial assets have a larger capacity to issue more zakat, whereas companies with lower assets must consider several factors when spending. Then (Nasution et al., 2018) discovered that firm size modifies the effect of Islamic corporate governance on the financial performance of Islamic banks in Indonesia. Therefore, this study produces the following hypothesis:

H3: Company size moderates the positive effect of board size on zakat funds at Indonesian Islamic Commercial Banks.

H4: Company size moderates the positive effect of DPS size on Islamic Commercial Banks' zakat funds in Indonesia.

RESULTS AND DISCUSSION

The Effect of Board Size on Zakat Funds

Table 2. The Result of the Fixed Effect Model Test

Variable	*Coefficient*	*Std. Error*	*t-Statistic*	*Prob.*
C	-8,81	5,49	-1,60	0,11
X1 (Board size)	-0,51	0,64	-0,80	0,43
X2 (DPS size)	0,55	0,77	0,72	0,48
X3 (Board size x *size*)	-0,14	0,14	-1,02	0,31
X4 (DPS size x *size*)	0,07	0,29	0,24	0,81
C1 (Profit)	0,18	0,07	2,55	0,01
C2 (Size)	0,86	0,20	4,27	0,00

Source: Process data.

The t-test findings for the board size variable reveal a coefficient of -0.802501 with a probability of 0.4256 larger than 0.05, indicating that the size of the board of directors has no significant effect on zakat funds at Islamic commercial banks. Thus, H1, claiming that the size of the board of directors positively influences zakat funds, is rejected. This result is consistent with the findings of Intia and Azizah (2021), Indriyani and Asytuti (2019), and Setiawan (2016).

The results showed a negative coefficient direction, indicating that smaller board sizes will improve Islamic banks' performance. In Indonesia, corporate governance does not set a maximum or minimum number of directors for Islamic banks (Rahman & Haron, 2019). A huge board size adds to the inefficiency in carrying out its functions. This complicates coordination and communication, possibly leading to inadequate Islamic bank performance monitoring. Large boards are typically viewed as ineffectual. As a result, the negative association between board size and performance is not surprising (Mollah and Zaman, 2015).

The Effect of the Sharia Supervisory Board (DPS) on Zakat Funds

The t-test for the variable size of the Sharia Supervisory Board (DPS) yielded a coefficient of 0.719306 and a probability of 0.4749 larger than 0.05, indicating that the size of the DPS has no significant effect on zakat funds at Islamic Commercial Banks. Thus, H2, which claims that DPS size benefits zakat funds, is rejected. This conclusion is consistent with the findings of Intia and Azizah (2021), Eksandy (2018), and Indriyani and Asytuti (2019).

This is conceivable when the DPS just serves as an advisor (Mollah and Zaman, 2015). He stated that the influence of Sharia supervision might be positive or bad, depending on whether the DPS serves as a supervisor or an advisor. Furthermore, DPS typically has no monitoring role beyond providing opinions on the Sharia conformity of Islamic bank products and services (Mollah & Zaman, 2015; Intia & Azizah, 2021).

Furthermore, a large size of DPS cannot lower costs or minimize the negative impact that DPS size has on a bank's financial health (Khalil & Taktak, 2020). This verifies Amine's (2018) findings and supports agency theory, which predicts that many Shariah experts in the DPS will raise agency costs. However, a big DPS makes it harder for scholars to coordinate their work and exacerbates communication issues. One probable explanation for this finding is that the DPS does not have enough Sharia experts.

Company Size Moderates the Effect of Board Size on Zakat Funds

The t-test for the company size variable moderating the board size variable yielded a coefficient of -1.026849 and a probability of 0.3088 larger than 0.05. This suggests that the company size variable modifies the association between the size of the board of directors and zakat funds in Islamic commercial banks but has no meaningful effect. Thus, H3 is neither accepted nor rejected.

Mukhibad et al. (2017) found that company size has no significant link with the zakat variable. The hypothesis is rejected due to the collection of zakat funds from outside the company, which means that increased assets do not always increase collected zakat funds. Furthermore, bank operations connected to the management of zakat monies may still be modest bank operations. Bank size has a negative and minor effect on performance as measured by ROE (Al-Homaidi et al., 2021).

Company Size Modifies the Effect of Sharia Supervisory Board Size (DPS) on Zakat Funds

The t-test findings for the company size variable that modifies the DPS size variable reveal a coefficient of 0.237135 and a probability of 0.8134 larger than 0.05. This suggests that the company size variable moderates the association between DPS size and zakat funds in Islamic Commercial Banks but has no meaningful effect. As a result, H4 is neither endorsed nor rejected. Al-Homaidi et al. (2021) investigated the relationship between zakat disclosure and Islamic banking performance in Yemen, finding that the number of Islamic banks had no significant effect on banking performance.

Control variables ensure that independent variables outside the model do not influence the dependent variable. Profitability control variables indicate a coefficient of 0.178050 and a probability of 0.0136, while bank size shows a coefficient of 0.858421 and a probability of 0.0001. Bank size is the most significant factor influencing Islamic Commercial Banks' zakat funds.

CONCLUSION

From the exposure that has been presented, it can be concluded that the independent variables simultaneously have a significant effect on the zakat funds of Islamic Commercial Banks in Indonesia, and partially, it can be concluded as follows:

1. The size of the board of directors does not affect the Islamic Commercial Banks' zakat funds.
2. DPS size does not affect the Islamic Commercial Banks' zakat funds.
3. The company's size moderates the effect of the size of the board of directors on Islamic Commercial Banks' zakat funds; there is no substantial effect.
4. The company's size moderates the influence of DPS size on Islamic Commercial Banks' zakat funds; however, there is no significant effect.

` However, profitability control variables and bank size are the most important factors influencing Islamic Commercial Banks' zakat funds. Bank size is the most significant factor influencing Islamic Commercial Banks' zakat funds.

This study shows no evidence that the size of the board of directors or the DPS impacts Islamic Commercial Banks' zakat funds. In Indonesia, corporate governance does not set a maximum or minimum number of directors for Islamic banks. The huge size of the board of directors may result in ineffectiveness in overseeing the performance of Islamic banks, complicating coordination and communication. The sharia supervisory board's responsibility is limited to supervising and reviewing the sharia components of Islamic banking operations, goods, and services.

This study has a few drawbacks. First, there is a lack of data availability; not all Islamic banks offer annual reports on zakat fund data and governance. Second, social performance measurement is restricted to the distribution or collection of zakat funds. Measurement can be combined with other elements like Qardhul Hasan money, Zakat on Assets, and Zakat on Equity. Third, instead of focusing solely on the size of the board of directors and the size of the DPS, BUS should prioritize traits such as competence, abilities, and professionalism exhibited by each board of directors and DPS. Add other characteristics, such as a board of commissioners and committees.

RESEARCH IMPLICATION

This research will likely help numerous parties, including scientists, by contributing to our understanding of how governance affects zakat funding and supporting future research that may be used as a benchmark for other researchers. For practitioners, the findings of this study are likely to be used as policymakers or decision-makers, particularly for Islamic banks that operate under Sharia standards. Healthy governance systems enable stakeholders to assess the performance of Islamic institutions more accurately. This research can provide policymakers, regulators, and stakeholders with vital information about governance practice competencies. As a result, performance increases.

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