

The Sharia Compliance and Social Performance at Sharia Rural Bank in Indonesia

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Publication Date: 2025/10/25

Abstract: The objectives of study included 1) to explain and provide empirical evidence of the influence of the Islamic Income Ratio (IsIR) on social performance at sharia rural bank in Indonesia; to explain and provide empirical evidence of the influence of the Profit Sharing Ratio (PSR) on social performance at sharia rural bank in Indonesia; to explain and provide empirical evidence of the influence of firm size on social performance at sharia rural bank in Indonesia; to explain and provide empirical evidence of the influence of firm age on social performance at sharia rural bank in Indonesia. This study is an explanatory research. The population of this study is the annual financial report of Islamic banking, especially Islamic rural financing banks in Indonesia for the period 2019 to 2022. Based on the sample selection process, it shows that the selected sample was 28 sharia rural bank with 252 research observations. The data analysis method uses panel regression. The results of the study show that 1) the Islamic Income Ratio has an effect on the Islamic Performance Index. Based on this explanation, the fifteen Islamic Income Ratio (IsIR) hypothesis has a positive effect on social performance at sharia rural bank in Indonesia; 2) Profit sharing ratio has an effect on the Islamic Performance Index. This proves the sixteenth hypothesis which states that the Profit Sharing Ratio (PSR) has an effect on social performance in sharia rural bank in Indonesia

Keywords: *Islamic Income Ratio, Social Performance, Profit Sharing Ratio, Sharia Rural Bank.*

How to Cite: Ponti Primastuti Aulia Nugraheni; Sudarsih; Pascawati Savitri Universitasari (2025) The Sharia Compliance and Social Performance at Sharia Rural Bank in Indonesia. *International Journal of Innovative Science and Research Technology*, 10(10), 1233-1237. <https://doi.org/10.38124/ijisrt/25oct1051>

I. INTRODUCTION

The development of sharia rural bank in Indonesia is also caused by the development of the Islamic financial industry in Indonesia. The purpose of establishing the Islamic People's Financing Bank is to improve the economic welfare of Muslims (Azzahra, 2020). Development of sharia rural bank during the period of December 2015–June 2021, the number of BPR office networks in the same period increased by 107 office networks or 3% from the original 3,198 to 3,305 office networks. The development of the number of sharia rural bank, assets, DPK and credit has been decreasing over time. Problems with sharia rural bank performance are marked by various challenges and problems faced by sharia rural bank which can threaten the sustainability of BPR and sharia rural bank businesses. Since 2019 to 2021, it was recorded that 4 sharia rural bank have been liquidated by the Deposit Insurance Corporation, while 2 sharia rural bank are still in the process of liquidation

Research on the comparison of financial performance of banks between countries has previously been conducted by several researchers, such as The comparison of Islamic and conventional banks in Pakistan. Then Karina & Filianti,

(2018) which examines the comparative financial performance of Islamic banks in Southeast Asia. Malik et al., (2020) researching the comparative performance of countries in ASEAN-5 including Indonesia, Malaysia, Singapore, Thailand and the Philippines, which found that the financial performance in these countries differed significantly. Mahdi (2021) researching the comparison of financial performance in Indonesia with Malaysia. Gazi et al., (2022) examined the differences in financial performance between traditional banks and Islamic banks in Bangladesh. In general, there are still differences in research results among these researchers regarding performance assessment.

Islamic banks are directed to achieve four objectives, namely sharia compliance, economic, social and ethical. Previous research generally measures the performance of Islamic banks using asset value and profitability. Assurance regarding the fulfillment of Sharia (Shariah Compliance) of all customer fund management activities by Sharia banks is a very important thing in the business activities of Sharia banks. (Muhammad et al., 2021). Sharia compliance is an indicator that differentiates between Islamic banking and conventional banking (Usdeldi et al., 2022). Islamic banking financial reports must include information that meets the sharia

compliance measurement indicators according to (Mursyid et al., 2021) there are reports on zakat, profit sharing, Islamic income and Islamic investment. Indicators to measure Sharia compliance or sharia compliance are Profit Sharing Ratio, Zakat Performance Ratio, Islamic Income ratio.

There are several things that often become problems in sharia compliance, especially in Islamic banks, including sharia rural bank in Indonesia. The existence of low contribution and participation of Muslim communities towards sharia rural bank. The legal problem of the presence of Islamic banking institutions is caused by low public trust. The absence of sharia compliance assurance for all sharia banking activities is very important for customers and the community. This means that the implementation of sharia compliance at sharia rural bank in Indonesia has not been carried out optimally.

Several previous studies have shown that Sharia compliance has a positive effect on the Islamic Performance Index. (Usdeldi et al., 2022). Sharia compliance has a positive effect on the performance of Islamic banking in Indonesia. This means that the higher the level of Sharia compliance, the higher the level of BUS performance. (Nurjannah et al., 2020). The assessment of Islamic bank performance using social performance showed good values. Nurjannah et al., (2020) as well as Azzahra, (2020) found that Sharia compliance has a positive effect on the Islamic Performance Index.

This research is important to do because it has important implications. Measuring Islamic banking performance using conventional banking performance benchmarks creates a mismatch between conventional bank performance metrics and broader Islamic banking objectives. (Ishak & Nasir, 2021) and (Usdeldi et al., 2022). Performance measurement based only on financial indicators is not enough, but must also be based on financial indicators that comply with sharia principles (Nomran & Haron, 2020). Performance measurement based on Maqashid Syariah has also been carried out showing the average level of health of Islamic banks (Mursyid et al., 2021). The objectives of this research include 1) to explain and provide empirical evidence of the influence of Islamic Income Ratio (IsIR) on social performance in sharia rural bank in Indonesia; to explain and provide empirical evidence of the influence of Profit Sharing Ratio (PSR) on social performance in sharia rural bank in Indonesia; to explain and provide empirical evidence of the influence of firm size on social performance in sharia rural bank in Indonesia; to explain and provide empirical evidence of the influence of firm age on social performance in sharia rural bank in Indonesia.

This research was expected to contribute to theory, regulation and practitioners. This research provides additional theoretical framework in developing an analysis model to predict social performance and its relationship to sharia compliance. This is explained on the basis of RDT theory explaining the relationship between sharia compliance and social performance so that it becomes a development of these theories in the research model. For researchers/academics, it provides input to deepen the development of financial

accounting theories, especially the sharia industry in Indonesia about the relationship between sharia compliance and social performance at sharia rural bank which is used to advance financial science later.

II. LITERATURE REVIEW AND HYPOTHESES

➤ *Shariah Enterprise Theory (SET)*

Shariah Enterprise Theory is a refinement of the theory underlying the previous enterprise theory. This theory is a theory that derives the variables of sharia compliance and maqashid sharia performance as the basis for the formation of the relationship between the variables of sharia compliance and social performance. (Rahma & Arifin, 2022). Muchlis et al., (2024) states that SET is able to adapt to the diversity of society (stakeholders). Therefore, this Shariah Enterprise Theory is more suitable for an economic system based on sharia values, one of which is Islamic banking. The added value of sharia as an income concept in sharia accounting is a form of added value that is stipulated in sharia, namely halal, thoyib, and free from usury (Muchlis et al., 2024). Sharia Enterprise Theory can be linked to the Zakat Performing Ratio (ZPR), Profit Sharing Ratio (PSR) and Islamic Income Ratio (IsIR) as indicators of sharia compliance in influencing the Islamic Performance Index.

➤ *Sharia Compliance*

Sharia compliance or sharia compliance is the obedience or compliance of a Sharia subsidiary to the rules of sharia principles. Sharia compliance is a manifestation or evidence of the fulfillment of all sharia principles in an institution by showing the character, integrity, and credibility of a Sharia Bank. Bank compliance with sharia standards is known as sharia compliance. Banks must follow sharia law in running their businesses. (Nurjannah et al., 2023). SSB completes the supervisory tasks assigned by the commissioner (Harmaen et al., 2022). Sharia compliance is measured by several indicators including Profit Sharing Ratio (PSR) and Islamic Income Ratio (IsIR) which is a ratio that measures the proportion of zakat issued by the bank from all net assets owned, regardless of bank debt.

➤ *The Influence of Islamic Income Ratio (IsIR) on Social Performance of sharia rural bank in Indonesia.*

Islamic Income Ratio (IsIR) is a measurement of the size of income obtained from the halal income sector obtained from management activities. The higher the halal income, the higher the Islamic bank will improve the performance of Islamic banking in producing the Maqashid Syariah Index (MSI). (Nurjannah et al., 2020), Nurjannah et al., (2020) (as well as Azzahra, (2020) found that the Islamic Income Ratio (IsIR) has a positive effect on social performance. Based on this explanation, the hypothesis proposed is:

- H1: *Islamic Income Ratio (IsIR) has a positive effect on social performance at sharia rural bank in Indonesia.*

➤ *The Influence of Profit Sharing Ratio (PSR) on Social Performance of sharia rural bank in Indonesia.*

According to Maysari & Firda, (2020), Profit Sharing Ratio (PSR) is a measure of profit sharing identification and a

benchmark for the success of fund distribution using mudharabah and musyarakah contracts. The efficacy of Islamic banking in producing the Maqashid Syariah Index (MSI) can be increased by a combination of increasing PSR and smooth financing. Nurjannah et al., (2020) found that Profit Sharing Ratio (PSR) has a positive effect on social performance. Based on this explanation, the hypothesis proposed is:

- H2: *Profit Sharing Ratio* (PSR) has an effect on social performance at sharia rural bank in Indonesia.

III. METHOD

This research was a research with a quantitative approach where the design or plan in collecting, measuring, and analyzing data is made to answer research questions. This research is explanatory research and tests the hypothesis formulated in the research.(Hermawan & Amirullah, 2021). The population in this study were the annual financial report of Islamic banking, especially Islamic rural financing banks in Indonesia for the period 2019 to 2022. Based on the sample selection process, it showed that the selected sample was 28 sharia rural bank with 252 research observations.

The data collection technique in this study is documentation, namely the technique of collecting data by viewing, recording, and analyzing secondary data published by Bank Indonesia, as well as other literature sources that are relevant to the problems that are the object of the study. The research variables include independent variables which are stimulus variables or variables that affect other variables. The independent variables in this study are the Islamic Income

Ratio (ISIR) and the Profit Sharing Ratio (PSR). This study uses a dependent variable between social performance. The panel data in this study was processed using the Eviews 12 statistical application. The panel data testing method in this study is descriptive statistical analysis, panel data model estimation selection analysis, and hypothesis testing analysis.

IV. RESULTS AND DISCUSSION

➤ Results

Based on the results of the panel regression analysis, it shows that the Islamic Income Ratio variable has an average of 0.238 with a standard deviation of 0.201. The Islamic Income Ratio is the proportion of halal income or bank income originating from mudharib to total income which includes total sharia income and non-halal income. The minimum value of the Islamic Income ratio is 0.347 and the maximum value is 0.868. While the standard deviation of the Islamic Income ratio of 0.201 indicates that the Islamic Income ratio value is approaching the average value and its variation is getting smaller.

Profit sharing ratio has an average value of 0.332. The profit sharing ratio assesses the amount of money spent from all financing. The profit sharing ratio value has a minimum value of 0.537 to a maximum value of 1.628. The profit sharing ratio is measured by the number of positions of members before serving as SSB. While the standard deviation of the profit sharing ratio is 0.277. This means that the profit sharing ratio shows a value that is far from the average and its variation is getting bigger. Based on the results of the analysis and testing of classical assumptions, the best random effect model was obtained by making improvements to the data normality test as in Table 1.

Table 1 Random Effect Regression Model

Variables	Coefficient	Std. Error	t-Statistic	Prob.
C	-2.283999	0.493634	-4.626913	0.0000
<i>Islamic Income Ratio</i>	0.164042	0.077121	2,127070	0.0346**
<i>Profit sharing ratio</i>	0.059027	0.046777	2.261881	0.0285**

Source: Processed Data, (2024)

- Note: *) , **) , ***) are significant at $\alpha=1\%$, $\alpha=5\%$ and $\alpha=10\%$

Based on model regression results, each independent variable is tested individually and the results show that Sharia compliance variables consist of Islamic Income Ratio which has a regression coefficient of 0.164042 (sig=0.0346<0.05). This result means *Islamic Income Ratio* have an impact on *Islamic Performance Index*. *Profit sharing ratio* had a regression coefficient of 0.059027 (sig=0.0285<0.05) which shows that *Profit sharing ratio* had an impact on *Islamic Performance Index*.

➤ Discussion

- *The Effect of Islamic Income Ratio (ISIR) Against Social Performance of Sharia Rural Bank in Indonesia.*
The findings showed that the Islamic Income Ratio has

an effect on the Islamic Performance Index. Based on this explanation, the fifteen-hypothesis Islamic Income Ratio (IsIR) has a positive effect on social performance at sharia rural bank in Indonesia. This result is in accordance with the findings Nurjannah et al., (2020) as well as Azzahra, (2020) who found that the Islamic Income Ratio (IsIR) has a positive effect on social performance

Islamic Income Ratio had effect on Islamic Performance Index because halal income through mudharabah and musyarakah contracts is quite high when compared to non-halal income. Thus, there is still non-halal income generated by Islamic Commercial Banks in Indonesia which then becomes a charity fund that is distributed through donations. This calculation presents the halal income obtained by BUS compared to non-halal income, the higher the halal income will provide an illustration that BUS has implemented mudharabah and musyarakah contracts and avoided usury, gharar and maisir transactions, which will improve the

performance or controlled management of the company. This finding is in line with the Sharia Enterprise Theory (SET) in which Islamic banks are not only responsible to stakeholders. Islamic Income Ratio (IsIR) is a measurement of the size of income obtained from the halal income sector obtained from management activities. The higher the halal income, the higher the Islamic bank will improve the performance of Islamic banking in producing the Maqashid Syariah Index (MSI).

• *The Effect of Profit Sharing Ratio(PSR) on Social Performance of Sharia Rural Bank in Indonesia.*

The findings show that the profit sharing ratio has an effect on *Islamic Performance Index*. This proves the sixteenth hypothesis which states that *Profit Sharing Ratio(PSR)* has an effect on social performance at sharia rural bank in Indonesia. According to Maysari & Firda, (2020), Profit Sharing Ratio (PSR) is a measure of profit sharing identification and a benchmark for the success of fund distribution using mudharabah and musyarakah contracts. The efficacy of Islamic banking in producing the Maqashid Syariah Index (MSI) can be increased by a combination of increasing PSR and smooth financing. The findings of this study are in accordance with the results of the study Nurjannah et al., (2020) found that the Profit Sharing Ratio (PSR) has a positive effect on social performance.

Because sharia rural bank uses more profit sharing through mudharabah and musyarakah contracts, this shows that sharia rural bank is quite effective in managing productive assets according to mudharabah and musyarakah contracts. If in a picture the PSR increases accompanied by smooth financing, it can certainly increase the Maqashid Syariah Index (MSI). In line with the *Sharia Enterprise Theory (SET)* where Islamic banks are not only responsible to stakeholders but also to Allah SWT. This theory adopts the principles of justice, truth, trust, and responsibility which if improved will be categorized as healthy banking.

V. CONCLUSIONS AND RECOMMENDATIONS

The results showed that 1) Islamic Income Ratio influence on the Islamic Performance Index. Based on the explanation, the fifteenth hypothesis is that the Islamic Income Ratio (IsIR) has a positive effect on social performance in sharia rural bank in Indonesia; 2) Profit sharing ratio has an effect on the Islamic Performance Index. This proves the sixteenth hypothesis which states that the Profit Sharing Ratio (PSR) has an effect on social performance in sharia rural bank in Indonesia.

The limitations of this study include the fact that this study only used 30% of sharia rural bank from the total due to the lack of fulfillment of the required data so that the sample selection was carried out by extending the research period. Based on the results of the study and discussion, the following recommendation can be made by the researcher, it is hoped that sharia rural bank will continue to pay attention to the sharia supervisory board, because the sharia supervisory board is a factor that can affect social performance. In addition, sharia rural bank is also expected to continue to explore its ability to manage the company well because according to previous

research, good corporate governance will produce good maqashid performance.

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