

The Contribution of Zakat to Sustainable Financial Performance: Evidence from Sharia Compliance Firms

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Abstract

Triple bottom line is mainly the focus of corporations to pursue a high reputation among stakeholders and to achieve high corporate financial performance (CFP). This paper seeks to investigate the correlation between zakat and sustainability of financial performance. This study employs a panel data regression model with Sharia compliant firms in Kuwait, Saudi Arabia, and Malaysia obtained from Thomson Reuters. This study reveals firms with strong zakat payments may not exhibit high levels of financial performance sustainability. This finding supports agency theory, which states that firms should create financial benefit. Consistent with agency theory, shareholders perceive that zakat payment may not hold the same goals and principles as the shareholders. Thus, this relationship may not demonstrate positive relationship between zakat and sustainability financial. The findings of this paper contribute to Islamic and sustainability literature

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1. Introduction

A substantial body of literature on financial performance indicates that corporate financial performance (CFP) is associated with corporate social performance (CSP). Evidence to date reveals mixed findings regarding the impact of CFP towards CSP (Adelina et al., 2020; Nguyen et al., 2022; Homayoun et al., 2023; Lopatta et al., 2024). Based on stakeholder theory, firms with strong CFP are likely to allocate significant resources to social activities (Chung et al., 2019). On the other hand, firms with high levels of CFP may also influence stakeholders perception of their social responsibility (Lian, 2022; Arian et al., 2023; Bokhari et al., 2023; and Sarhan & Al-Najjar, 2023).

In recent decades, the growth of sharia compliance firms has accelerated due to high demand for halal and Islamic products. The State of the Global Islamic Economy Report 2016/2017 indicates that surveyed participants perceive the

aggregate Islamic economy as a high-growth segment. This study also revealed that approximately 86% of respondents are optimistic about the prospects of Islamic economy. Additionally, it is noteworthy that sharia compliance firm should align their activities with Islamic principles such as engaging in halal transaction and zakat payment. Furthermore, zakat serves as an Islamic obligation that demonstrates a firm's social responsibility and adherence to sharia principles.

In several Islamic countries, governments regulate zakat payments for sharia compliant firms, reflecting a widespread of zakat among governments, companies, and other stakeholders (Ali et al., 2023). In Kuwait, the Ministry of Awqaf and Islamic Affairs supports this regulation and educates the public about the importance of zakat. Similarly, in Saudi Arabia, the Zakat, Tax, and Customs Authority (ZATCA) promotes awareness of zakat collections awareness to enhance societal welfare. In Malaysia, the Department of Islamic and Development mandates zakat for

both individuals and companies. This phenomenon indicates that some countries consider zakat as pivotal for addressing stakeholder concerns.

Several studies have explored the relationship between zakat as a proxy for corporate social responsibility (CSR) and financial performance (Ali et al., 2023; Nuruddin et al., 2023). The findings of these studies generally suggest that firms with strong zakat payment tend to demonstrate higher levels of financial performance. However, existing research often lacks a comprehensive explanation about the sustainability of financial performance. This study aims to address this gap by expanding the measurement of variables, country coverage, and firm sample.

Theory of stakeholder explains that companies should meet the expectation of their stakeholders. Such alignment is positively perceived by stakeholders and, in turn, has the potential to enhance the company economic performance and future prospects (Clarkson, 2011). Stakeholders are defined as entities or groups that influence or be influenced by the company achievement of its goal. They include shareholders, customers, employees, governments, media, competitors, regulators, political activist groups.

Consistent with the stakeholder theory approach, companies should not only strive for profit maximization but also cultivate positive relationships with all relevant parties (Lange & Bundy, 2018; Donaldson, 2023; Koh et al., 2023). Russo & Perrini (2010) stated that harmony between company management and stakeholders is crucial for company success. Companies that maintain strong relationships with their stakeholders are likely to achieve high financial performance (Xie et al., 2019; Coelho et al., 2023). Consequently, corporate social responsibility activities can significantly affect company performance (Clarkson, 2011).

Recent literatures emphasize the important relationship between zakat payments, financial performance, and their impact on social justice. Al-Malkawi & Javaid (2018) highlight how zakat payments can mitigate social inequality. Other research indicates that zakat payments have a positive impact on corporate governance and financial sustainability (Hambari et al., 2020).

In line with previous studies, we assess financial performance sustainability by calculating the slope of previous income after tax and zakat. Unlike previous studies that have used return on equity (ROE) or return on asset (ROA), which lack of persistence, our approach aims to provide

more reliable measure. Furthermore, this paper extends the analysis to include Saudi Arabia, Kuwait, and Malaysia thereby enhancing the robustness and external validity of findings. These countries were selected based on prior study recommendation and data availability in Thomson Reuters (Obaidullah, 2016). Unlike previous research that focused on a single industry (Reskino, 2016), this study broadens the industry coverage by employing dummy variables to categorize firm industries. Additionally, the study emphasizes sharia compliance firms, which possess unique characteristics and adhere to sharia principles, such as zakat payment requirements, halal products, prohibition of interest transaction (riba). This study will come up with new insights to investor's understanding of sharia compliant firms.

The objective of this paper is to analyze the relationship between zakat and the sustainability of financial performance. Understanding this relationship is crucial for evaluating the financial prospect of firms, especially those that comply with sharia principles. We test this hypothesis using data from Thomson Reuters and World Bank.

Our empirical findings provide evidence that zakat positively influences the sustainability of financial performance. The results indicate that zakat plays a significant role in enhancing corporate financial performance. These findings have important implications for international investors, policy makers, and financial report users in their interpretation of zakat impact.

2. Hypothesis Development

Over the past decade, the relationship between financial performance and Corporate Social Responsibility has been extensively examined. However, discussion on sustainability, financial performance and zakat as a variable measurement has received relatively less attention. Financial performance remains a crucial priority for management, and recent trends suggest that management should pursue a triple bottom line approach (Bunga, 2023; Zubeltzu-Jaka et al., 2024). Consequently, management strives to maximize profit, protect the planet, and enhance social welfare (Ashrafi et al., 2018; ElAlfy et al., 2020; Wu & Jin, 2022; Shayan et al., 2022; Pasko et al., 2022).

The concept of going concern comes from strategic management literature. A company achieves a sustainable competitive advantage by con-

sistently maintaining superior long-term financial performance. With respect to social and environmental concerns, companies should allocate funds for social welfare and planetary preservation. Some firms perceive a negative relationship between CSR and financial performance, aligning with signaling and value improvement theory. Conversely, other firms believe that CSR has positively impacts Corporate Financial Performance (Chen & Lin, 2015; Lin et al., 2019)

A substantial body of studies have investigated the link between CSR Expenditure and social concern (CSR) and financial performance. Yan et al. (2017) focusing on companies listed on the Taiwan Stock Exchange, found a positive relationship between social funds allocation and financial performance.

In terms of zakat as CSR measurement, Javaid & Al-Malkawi (2018) used zakat proxies to examine the relationship between social care funds and financial performance. Reskino (2016) found a significant positive relationship between financial performance and zakat in Islamic banking in Indonesia. Conversely, Samad et al. (2015) discovered a significant relationship companies in Malaysia companies.

According to value enhancement and stakeholder theories, CSR payments foster a positive reputation, which in turn, increases stakeholders' awareness (Brammer & Millington, 2008). Increased stakeholder awareness can lead to improve financial performance (Lev et al., 2010). Brown et al., (2006) stated that strong relationship among company stakeholders creates loyalty and protection to the company. Zakat payments can enhance efficiency and profitability, contributing to sustainable financial performance (Ali et al., 2023; Nuruddin et al., 2023). Therefore, social payments including zakat impact sustainable financial performance.

In conclusion, zakat payments positively impact sustainable financial performance by enhancing wealth distribution and social welfare. This improvement in social equity and economic sustainability contributes significantly to overall sustainable, including, the financial performance of companies. Prior studies demonstrate a positive relationship between zakat payments and social welfare, leading to increased consumer purchasing power, which in turn positively impacts the financial of companies.

H₁: Zakat will have a positive impact on sustainability financial performance

3. Data and Methods

The sample data used to test hypothesis in this paper was retrieved from the Thomson Reuters database. The sample period spans 11 years and includes data from three countries such as Kuwait, Saudi Arabia, and Malaysia. Gross Domestic Product (GDP) data were collected from worldbank.com. The Data on industrial types are classified into two group, financial and non-financial. This classification is based on the argument that financial industries are subject to relatively more regulation compared to non-financial industries. Sample for this paper indicates that number of firms from each country, with 133 firms from Kuwait, 81 firms from Malaysia, and 495 firms from Saudi Arabia. The final number of observations is 709. This section also addresses proxies for sustainable financial performance and control variables.

To test the hypothesis that zakat affects sustainable financial performance, this paper employs panel data regression models. The dependent variable is sustainable financial performance, while the independent variable is zakat. Control variables include the natural logarithm of Assets (Ln Assets), Gross Domestic Product (GDP), the industry classification (DINDUSTRY), and previous financial performance (Net Income_{t-1}). The panel data regression model is specified as below,

$$\text{Sustainability Financial Performance}_{i,t} = \delta_0 + \delta_1 \text{Ln Zakat}_{i,t} + \delta_2 \text{SIZE}_{i,t} + \delta_3 \text{GDP}_{i,t} + \delta_4 \text{DIndustri}_{i,t} + \delta_5 \text{NI}_{i,t-1} + \varepsilon_{i,t}$$

To measure sustainable financial performance (EGC), this study uses earnings sustainability calculated using formula from Delkhosh & Sadeghi (2017). Model for calculated sustainable financial performance as follows:

$$\text{EARN}_{i,t+1} = \alpha_0 + \alpha_1 \text{EARN}_{i,t} + \varepsilon_{i,t}$$

Where: EARN_{i,t+1}= Next year earnings; and EARN_{i,t}=Current year's earnings

The symbol α_1 represents the regression slope indicating the level of sustainable financial performance. Thus, a value of α_1 gets closer to 1 indicates more sustainable earnings. Concerning the zakat variable, this study follows the methodology proposed by Javaid & Al-Malkawi (2018), who employed zakat proxies to measure corporate social responsibility (CSR). This approach is further supported by Lin et al. (2019), who used a donation ratio as a proxy for social expenditure. Accordingly, the measurement of zakat in this pa-

per aligns with the approach of Javaid & Al-Malkawi (2018), albeit with a natural logarithm transformation applied as follows:

$$\text{Zakat} = \ln \text{Zakat}$$

According to Thomson Reuters, zakat is defined as an Islamic wealth tax, and it is to be treated equivalently to other income taxes, regardless of its presentation on the Income Statement. The application of natural logarithms to zakat measurement is intended to normalize the data, thus mitigating heteroscedasticity.

In this study, control variables are introduced at multiple levels. At national level, Gross Domestic Product (GDP) is utilized as a control variable. At the industry level, an industrial dummy variable (INDUSTRI) is employed. At the firm level, control variables include company assets (SIZE) and lagged financial performance (NI_{t-1}).

Empirical research has demonstrated that a country's GDP influences the corporate financial performance (Hong & Razak, 2015). This finding is further confirmed by empirical evidence showing that GDP impacts financial performance specifically within Pakistan banking sector (Rashid & Jabeen, 2016). In addition, GDP controls for the heterogeneity of the capital markets across different countries, which can affect the corporate financial performance.

The industrial dummy variable differentiates between regulated industries (such as banks, insurance, and other financial industries) and unregulated industries (non-financial industries). These different regulations reflect differences in cor-

porate governance practices, which subsequently affect company financial performance.

The next control variable is firm size. Kaen et al. (2010) argued that company size has an effect on financial performance due to increased costs associated with transactions, agency, and organization. Consequently, company size has a negative effect on company's financial performance (Javaid & Al-Malkawi, 2018). In addition, Waddock & Graves (1997) also states that relationship between company size and corporate financial performance is a negative.

Lagged corporate financial performance is included as a control variable in this paper. Javaid & Al-Malkawi (2018) argue that a company's current financial performance is significantly influenced by its performance in the previous year.

4. Result

Descriptive Statistics

The descriptive statistics summarize the data set, including count (N), minimum (Min), mean (Mean), maximal (Max), standard deviation (SD), and skewness. The sample consists of 31 observations from financial industries and 678 from non-financial industries, totaling 709 observations.

Table 1 shows the descriptive statistics for the independent, dependent, and control variables. The zakat has an average value of USD 16,600,000 and a standard deviation of 79,000, indicating high variation or dispersion. As such, it would be transformed.

Table 1. Descriptive statistics (panel data; n = 709).

Variable	N	Min	Mean	Max	SD
EGC	709	-547.630	-0.410	423.840	33.110
Zakat (US \$ Thousand)	709	0.980	16600.000	80000.000	79000.000
Total Aset (US \$ Million)	709	2.640	4.710	1.24	1.37
GDP	709	7243.460	24128.170	55495.200	10043.890
NI_{t-1} (US \$ Million)	709	0.420	12.100	1.200	0.310

In the context of a sustainable financial performance measure (EGC), the average score for firms in the study sample is -0.41. This measure is derived from the slope of net income after taxes and zakat (net income after taxes and zakat). The negative value indicates that, on average, the firms in the sample experienced a decrease in net income after zakat and taxes, quantified at -0.14.

To ensure that the data conforms to a normal distribution, transformations were applied to the zakat variable, total assets, and net income after tax, and sustainable financial performance (EGC).

Following this transformation, the regression results were validated. Specifically, the transformed data shows slope values within a range of ± 2 for zakat data, total assets, and net income after tax.

Normality was assessed both graphically using a normal probability plot (Normal PP) and analytically. Chambers et al., (1983) define the normal probability plot as follows, graphical technique to visually evaluate the data distribution. This study employs PP plot to evaluate the normality of various research variables. For the dependent variable, zakat, a logarithmic of total

company zakat payments was used. In conclusion, the research data were found to be normally distributed and valid for hypothesis testing.

In terms of zakat data, Saudi Arabia exhibits the highest zakat payments, amounting to USD \$ 799,8507 million, compared to Kuwait and Malaysia. Kuwait, with the lowest payment, records USD \$ 989.77 million. The number of companies paying zakat in also highest in Saudi Arabia (495 companies), followed by Kuwait (133 companies) and Malaysia (81 companies).

Regarding the control variables, including company size (total assets), GDP per capita, and previous period earnings (Net Incomet-1 / Total Assets), the average values are as follows: USD \$ 4.71 billion, USD 24,128.17, and 12.10, respectively. This suggest that, on average, the companies in the sample are relatively large.

Table 2. Pearson Correlation.

	LnZakat	EGC	Log TA	GDP	NI _{t-1}
LnZakat	1.00				
EGC	-0.07 *	1.00			
Log TA	-0.09 *	0.03	1.00		
GDP			0.10	1.00	
NI _{t-1}	-0.37 ***	0.00	**	-0.07	1.00

Note: * p<0.10; ** p<0.05; *** p<0.01

Previous researches show a robust relationship between zakat and financial performance, primarily due to the fact that zakat payments augment the purchasing power within society. This, in turn, implies that zakat payments contribute to a reduction in economic inequality. Based on table 2 demonstrated the relationship between Ln Zakat, sustainable financial performance performance, and other control variables. The result indicate a negative relationship between CSR expenditures and sustainable financial performance, suggesting that higher CSR payment are associated with lower levels of sustaible financial performance.

Regression Result

The results of the regression analysis are presented in table 3. According to stakeholder theory and value enhancement theory, zakat payments are expected to enhance corporate reputation and increase stakeholder awareness (Brammer & Millington, 2008; Govindan et al., 2021; and Barauskaite & Streimikiene, 2021). However, this finding highlights that zakat have no effect on sustainability financial performance. This result is

consistent with Samad et. al. (2015), who found that a negative relationship between zakat payments and Islamic banks' performance. Morrover, this insignificant relationship demonstrates that zakat disclosures based on on individual or institutional calculations institution rather taht reflecting regulatory compliance. Thus, these findings are inconsistent with stakeholder theory.

Conversely, the finding align with agency theory, which posits that zakat payment may not fully meet the expectations of primary and secondary stakeholders. This discrepancy arises because stakeholders may have divergent goals and principles compared to corporate managers. The relationship between zakat and sustainability financial performance is negative.

Consistent with agency theory, some stakeholders perceives that zakat as an expeses used by management to enhance their reputation through discretionary giving. Thus, zakat may serve as a management tool to achieve personal goals, such as signaling 'doing good', which can affect stakeholder opportunity cost (Lin et al., 2017)

Tabel 3. Regression Result.

Variable	EGC	Note
Ln Zakat	-0.014	
Size	0.236	***
GDP	-0.000	***
NI _{t-1}	0.005	
Non Financial	0.574	
Cons	-1.497	***
N	709	
R2 Overall	0.041	
Chi2	20.127	
P-Value	0.001	

Note: * p<0.10; ** p<0.05; *** p<0.01

According to agency theory, CSR activities, including zakat may have an adverse impact on corporate sustainable financial performance. Othter explanation for this insignificant relationship is that zakat may incur corporate cost, potentially worsening overall corporate performance at the same time (Chen & Lin, 2015). Some companies may engage zakat payments not solely for financial benefits but due to regulatory requirement and community presure.

Based on agency theory, zakat payments can be viewed as additional agency costs resulting from conflicts of interest between shareholders and managements or the board of directors. This perspective is supported by Brown et al. (2006), who indicated that the relationship between social fund expenditures and corporate financial performance. Additionally, zakat pay-

ments reduce company income, thereby negatively affecting financial performance. Consequently, zakat payments are associated with decrease in corporate financial performance.

Sensitivity Analysis

As part of the robustness analysis, we employed the ratio of zakat to total asset as the independent variable. The result from this model supports main finding that the relationship between zakat and sustainable financial performance remains insignificant. This supports the agency theory explanation for the relationship between zakat and sustainable financial performance.

Table 4. Regression Result (Zakat/ Total Asset).

Variable	EGC
Zakat/ Total Asset	-10.44
GDP	-0.00 ***
Non Financial	0.02
NI _{t-1}	0.63 **
Cons	0.48 **
Observations	709

Note: * p<0.10; ** p<0.05; *** p<0.01.

In addition, to examine robustness and stability of model, we also reanalyzed using data for quartile 1 (Q1) and quartile 3 (Q3). The findings in these quartiles are consistent with the main results confirming that zakat has no effect on sustainable financial performance. This consistency further supports agency theory as a suitable framework for describing this relationship.

Table 5. Regression Result (Quartile 1 and 3).

Variable	EGC
Ln Zakat	-0.02
Size	0.25 ***
GDP	-0.00
Non Financial	-0.05
NI _{t-1}	0.83 *
Cons	-1.61 **
Observations	356

Note: * p<0.10; ** p<0.05; *** p<0.01.

5. Discussion

This study investigates the impact of zakat on sustainable financial performance. It addresses the gap identified in prior research concerning the persistence of measurement and extends the geographic scope to enhance robustness and external validity.

The findings highlight that CSR, including zakat, has no effect on sustainable financial performance. This result aligns with Samad et al.

(2015), who found a negative relationship between zakat payments and Islamic banks' performance. This insignificance suggests that zakat disclosures are often based on individual or institutional calculations rather than regulatory compliance, thereby challenging stakeholder theory.

The results of this study reveal that zakat does not significantly impact sustainable financial performance among Sharia compliant firms. One possible explanation for this finding is the varying levels of zakat implementation efficiency across countries and their diverse economic contexts. This divergence suggests that effectiveness and efficiency of zakat in promoting sustainable financial performance depend on the specific conditions and regulation in each country.

Our findings contribute to the ongoing debates regarding the impact of zakat on sustainable financial performance. It aligns more closely with Samad et al., (2015), which indicates that zakat has no significant impact on financial performance, particularly within the Malaysian context. Additionally, this study enhances the limited empirical literature by incorporating data from three diverse countries.

6. Conclusion and Suggestion

Conclusion

The results of the regression analysis differ from our initial hypothesis. The findings show that zakat does not influence sustainable financial performance. This can be attributed to the fact that zakat payments may not meet all stakeholder expectations. Stakeholders, including primary and secondary groups, may have divergent goals from corporate managements. This divergence of goals or principles called as the agency problem of CSR. Thus, this relationship may not exhibit positive relationship between zakat and financial performance.

Suggestion

This study has some limitations such as only focuses on the zakat in Kuwait, Malaysia, and Saudi Arabia. In the future, the researcher should take into account other countries such as GULF countries. Hopefully, this countries coverage provides more robust findings.

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