The Effect of Environmental Performance on Financial Performance with Islamic Corporate Social Responsibility (ICSR) as an Intervening Variable

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Abstract

Islamic Corporate Social Responsibility (ICSR) is one approach to reducing social problems by boosting community productivity and achieving justice. The objectives of this study are to analyze the effect of environmental performance on financial performance in the context of Islamic Corporate Social Responsibility (ICSR). This study employs quantitative methods. The study's population was mining corporations included in Indonesian Sharia Stock Index (ISSI). The researchers determined the sample purposively. This study includes 15 companies as samples. The researchers utilized secondary data of financial and annual reports taken from the Indonesia Stock Exchange's official website and the linked company's official website. Financial performance is the dependent variable, whereas environmental performance is the independent variable. The Smart-PLS 3.0 application program was used to do path analysis on the data. This study demonstrates that environmental performance affects financial performance, but ICSR is unable to regulate the connection of environmental and financial performance.

Keywords: Islamic Corporate Social Responsibility (ICSR); environmental performance; financial performance
INTRODUCTION

Mining company is company whose main production activities are investigation, exploration, construction, mining, management, transportation and sales. The activities of a mining company cannot be separated from various matters related to the environment. The development of mining companies can be indicated to increase the problem of waste and pollution in the surrounding environment. This environmental pollution occurs because mining companies do not pay attention to the surrounding environment in carrying out their company activities. In addition, the waste generated from the company’s operating activities is not treated properly, so it can pollute the surrounding environment. Based on Indonesian environmental statistics, the water quality data in 2018 reached 72.77, which then decreased in 2019 to 52.62, and in 2020 the water quality reached 53.53. The decline in water quality is indicated to be sourced from pollution of the company’s operational activities. One of them is the mining sector company.

Environmental problems are increasingly becoming a concern for the government, investors, and consumers. Various issues, such as environmental destruction caused by over-abuse of unbalanced nature with natural advancements, caused disruption of natural balance, such as waste and factory pollution, which may disturb and impact the surrounding environment. In each period, environmental sustainability has evolved into a government policy in Indonesia (Setyaningsih & Asyik, 2016).

One example of environmental pollution by mining companies is pollution by PT. Bukit Asam (Persero) Tbk in mid-2019, which received administrative sanctions imposed by the government from the South Sumatra Environment and Land Service (DLHP) for not managing air quality and controlling water pollution (CNN Indonesia, n.d.)

The development of mining companies can be indicated to increase the problem of waste and pollution in the surrounding environment. Environmental pollution occurs because mining companies neglecting the surrounding in carrying out their activities. In addition, the harmful residue originated from the industrial function is not treated properly so it can pollute the surrounding environmental conditions (Wahyudin, 2020).

Based on Indonesia's environmental statistics, water quality data in 2018 reached 72.77, which
decreased in 2019 to 52.62, and in 2020 water quality reached 53.53. The decline in that water quality is indicated to be sourced from the pollution-caused mining sector activities. (Menlhk, n.d.)

The company’s environmental conservation efforts will give several benefits, including the interests of shareholders and stakeholders in the revenues generated by ethical environmental management. (Wahyudin, 2020). From the research results, it is stated that in carrying out their activities, the company could stay in the community, especially for companies whose activities are exploring natural resources, such as mining companies (Wahyudin, 2020).

The objectives of this study are to analyze the effect of environmental performance on financial performance in the context of Islamic Corporate Social Responsibility (ICSR). This research is viewed from the research that Widhiastuti, Saputra, and Budiasih have done. The results of their research state that environmental performance using the PROPER rating indicator affects financial performance using the Return On Assets (ROA) indicator affecting companies’ stock return. (Luh et al., 2017).

The similarities and differences between previous research and this research are that both examine the effect of environmental performance on company financial performance. From the results of this study there are several studies that both use intervening variables. However, the intervening variable used in previous studies, namely Corporate Social Responsibility (CSR), this intervening variable is a difference from existing studies. If previous research used Corporate Social Responsibility (CSR) without involving Islamic law as an intervening variable, this research will involve Islamic law by using Islamic Corporate Social Responsibility (ICSR) as an intervening variable in environmental performance and financial performance variables.

**LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT**

**Legitimacy Theory**

Legitimacy theory describes how businesses engage with society. According to legitimacy theory, businesses continue to attempt to ensure they can function within the framework and standards of the society or environment in which they are placed (Tarigan & Semuel, 2015).

This legitimacy theory has a fairly close relationship with research variable X, namely environmental performance. This theory shows that the environmental performance
variable of a weak company can pose a threat to the company's social legitimacy. These threats can encourage a company to be able to disclose the output of its company operations in the Annual Report (Sri Rokhlinasari, n.d.)

This study uses legitimacy theory since a company has a contract or an obligation to adapt its company to its surrounding environment. One form of adjustment made by a company in the surrounding environment is by carrying out company operational activities following applicable norms and values and trying to meet the surrounding community's needs in the form of welfare development and environmental life in the place where the company operates. This is because the company's operations need to get approval and permission legally from the environment around the company (Utami & Yusniar, 2020)

**Sharia Enterprise Theory**

Sharia Enterprise theory is a theory that recognizes accountability of the owner of the company and the stakeholders more broadly (Utami & Yusniar, 2020). This theory is used to understand the stakeholders of a company from an Islamic perspective. This theory states that corporate stakeholders are related to humans, the natural surroundings, and God. God is the ultimate responsibility center for all activities in the world. Therefore, the urgency of Corporate Social Responsibility (CSR) in the perspective of this theory is as a form of human responsibility for all that has been given by God so that later humans can return to their God. (Risna, 2018)

This theory is relevant to the research variable: environmental performance associated with Islamic principles. It is also related to the intervening variable of this research, namely Islamic Corporate Social Responsibility (ICSR) which prioritizes welfare with Allah SWT, humans, and the environment.

**Environmental Performance**

Environmental performance can be defined as the performance participation in conserving the environment. Environmental performance is made in the form of a rating by an institution related to the environment (Kurniawati & Yaya, 2017). Environmental problems caused by mining industry tend to cause destruction. Thus, this encourages the emergence of environmental accounting practices as a means of accountability or public accountability for the company's efforts (Sudjoko, 2011)
Environmental performance shows its concern for creating a good work environment. The care for the surrounding environment can be measured through the results of the government’s assessment of companies participating in the Company Performance Rating Program in Environmental Management (PROPER) (Ladyve, 2020).

Environmental performance is a company's performance that demonstrates its concern for establishing a good working environment. The outcomes of the government’s evaluation of companies taking part in the PROPER can be utilized to gauge the company’s care for the environment (Ladyve, 2020). Companies that operate satisfactorily in environmental performance are likelier to publish their performance in social responsibility because the corporation feels that doing so will draw market players interested in investing in the company (Kurniawati & Yaya, 2017).

**Financial Performance**

A company's financial reports are an expression of accountability to external as well as internal parties. In decision-making, each stakeholder frequently conducts an analysis. Profitability is one of the financial report evaluations. Profitability is the ability to obtain revenue. From this information, stakeholder is able to evaluate the financial performance and determine the stock to invest in (Khairiyani et al., 2019).

A company’s financial performance could be determined by studying and examining its financial statements. Financial position derived from the company’s previous financial performance could be used to forecast the future financial condition (Khairiyani et al., 2019).

Financial performance can be enhanced by disclosing Corporate Social Responsibility (CSR), expecting the market to respond positively, as demonstrated through stock prices improvement. Because firms are now compelled to be accountable for their environmental impacts, environmental concern is one element affecting financial performance. Disclosure of good environmental performance increases the community’s acceptance of the company’s existence, allowing it to realize good financial performance (Khairiyani et al., 2019). A financial ratio is a method of assessing finances that are used to measure the performance and position of a corporation (Aisyiah, 2011).
Islamic Corporate Social Responsibility

Islamic Corporate Social Responsibility (ICSR) is similar to Corporate Social Responsibility (CSR). A company is committed to contributing to long-term economic growth by focusing on the societal obligation and balancing economy, social, and environmental concerns (Afdani, 2019)

Corporate Social Responsibility (CSR) conveys to certain cluster of concern and community as the environmental and social repercussions of an organization’s economic actions. Environmental devastation is prohibited under Islamic law. Hence a corporation must not breach the specified regulations (Arifin & Wardani, 2016)

Companies with excellent environmental performance (Corporate Social Responsibility) will receive favorable feedback from investors through changes in stock prices that are rising from period to period. However, companies with poor environmental performance (Corporate Social Responsibility) will receive negative responses from investors through the stock price uncertainty in a declining market. (Supadi & Sudana, 2018)

This study will reveal Islamic Corporate Social Responsibility (ICSR) in mining companies as the business sector with the most environmental and social impact. Therefore, mining sector companies must realize that environmental performance should receive serious attention to gain legitimacy from the surrounding community. Legitimacy becomes a prerequisite for the company to be accepted in society. Likewise, stakeholders will consider their decisions in investing through the company’s environmental performance.

Based on the prior description, ICSR that Islamic Corporate Social Responsibility (ICSR) is one of the theoretical frameworks designed specifically for making decisions based on Islamic guidelines in fulfilling its duty to Allah and the community at large.

The Effect of Environmental Performance on Financial Performance

Environmental performance is an effort made by companies to preserve the environment, because most companies generate waste in running their companies, especially companies engaged in the mining sector. This will reflect how much the company's efforts are in fulfilling its responsibilities to overcome the impacts. The lower the environmental
damage caused, the better the company's environmental performance which can later improve the company's good image which can affect the company's financial performance.

Based on the theory of legitimacy, the existence of a company has boundaries that are in accordance with the norms that apply in the surrounding environment. Therefore, companies need to pay attention to their responsibilities for their company's operations to increase the trust of the surrounding community in carrying out their company's activities.

In research conducted by Khairiyani et. al. (2019), states that environmental performance has a significant influence on financial performance. The results of this study are in line with research conducted by Supadi et. al., (2018) and research conducted by Supiadi (2017) and (Dewi, n.d). However, the results of research conducted by Meiyana, et. al. (2019) and Putra (2018) state that environmental performance does not affect the company's financial performance. So, the hypothesis that the author proposes is as follows:

\[ H_1: \text{Environmental performance affects financial performance} \]

The Effect of Environmental Performance on Financial Performance with Islamic Corporate Social Responsibility (ICSR) as an Intervening Variable

Islamic Corporate Social Responsibility (ICSR) is a corporate social responsibility that is adapted to Islamic law. As a company listed on the Indonesian Sharia Stock Index (ISSI), it is necessary to apply Islamic rules in running its company. In the Sharia Enterprise Theory (SET) it is explained that a company needs to pay attention to its interests at several levels of stakeholders.

Based on research by Meiyana, et. al. (2019) the implementation of Corporate Social Responsibility (CSR) is capable of being an intervening variable from environmental performance to financial performance, and based on research conducted by Rifan (2019), Utami, et. al. (2020) and Indrayani & Risna (2021), that Islamic Corporate Social Responsibility (ICSR) has an effect on the company's financial performance.

While research conducted by Supiadi et al stated that corporate social responsibility disclosure cannot be an intervening variable on environmental performance and financial performance. Based on research conducted by Arifin & Wardani, that Islamic Corporate
Social Responsibility (ICSR) has no effect on financial performance. So, the hypothesis that the author proposes is as follows:

H₂: Environmental performance has no effect on financial performance with Islamic Corporate Social Responsibility (ICSR) as an intervening variable.

Broadly speaking, to see an overview of the direction of research can be seen in the flow of the following framework of thinking (Figure 1).

**METHOD**

This study focused on mining companies whose shares were listed in the Indonesian Sharia Stock Index (ISSI) from 2016 to 2020. This study examined the company's environmental and financial performance in its published annual report. The firm data was gathered from numerous official websites, including the Indonesia Stock Exchange (IDX), the Indonesian Sharia Stock Index (ISSI) at the Financial Services Authority (OJK), and related web pages.

This study employs a causal associative approach: research that seeks to understand the relationship or influence of variables on other variables. It was used to assess the effect of the environmental performance variable on the financial performance variable, using the intervening variable, Islamic Corporate Social Responsibility (ICSR). Furthermore, the author employs library research, which is research conducted utilizing literature (library) in the form of books, notes, and previous study results (Sugiyono, 2017).

The quantitative approach research method is used in this study. Quantitative research is a method that employs numbers acquired from direct research data or data processed with statistics (Sugiyono, 2017).

The population is a broad category of things or subjects with specific features and attributes.
identified through research to be researched and conclusions formed. (Sugiyono, 2016) This study's population consists of mining companies. The sample population in the study consisted of 47 mining companies listed on the Indonesian Sharia Stock Index.

The sample comprises several parts drawn from the overall population; in other words, it is a subset of the total population (Sugiyono, 2017)

Purposive sampling is used in this study to determine the sample. The following are the sample criteria determined in this study:

a) Mining companies consistently listed on the Indonesian Sharia Stock Index (ISSI) for 2016-2020.

b) Mining companies registered in the 2016-2020 Company Performance Rating Program in Environmental Management (PROPER).

c) Mining companies that publish financial reports between 2016-2020.

So that 15 companies in the mining sector were sampled in this study. The companies that became the sample in the study were determined based on the selection of the sample selection technique, namely purposive sampling, and based on the criteria that were used as determinants to become the research sample.

The Structural Equation Modeling (SEM) method was employed to analyze data in this study. SEM is a multivariate statistical technique combining factor analysis and regression analysis (correlation) to investigate the correlations between model variables, indicators, and their constructions and constructs. Variance-based SEM with Smart Partial Least Square (SmartPLS) version 3.0 software was employed in this study (Askuba, 2018).

RESULTS AND DISCUSSION

Result

Path analysis is used to determine the level of influence of a variable with other variables, either directly or indirectly. Through path analysis, it can be seen the form of the relationship between variables along with the path and level of relationship between variables. The path analysis model can be described in Figure 2.

The hypothesis test in this study was seen from the significance level of the relationship between variables and the coefficient of the relationship between the independent variables and the dependent variable. The results of the path analysis test show the level of significance between
the variables in the study. The path coefficient shows the direction and level of influence of the independent variables on the endogenous variables.

**Discussion**

Companies with excellent environmental performance are ranked in the PROPER. They may influence the financial performance of a company. The study by Supadi & Sudana is similar. The two studies had one thing in common that they were conducted on mining companies. (Supadi & Sudana, 2018).

Furthermore, other searches contradict the findings of this study, such as the work of Aida Meiyana and Mimin Nur Aisyah. According to this study, comparing environmental performance to financial performance has no positive effect. This demonstrates that the results of environmental performance, as reflected in the PROPER ratings, have yet to be able to entice stakeholders to make investments in the company (Meiyana & Aisyah, 2019).

Based on several analyses of previous studies relevant to this research, it can be determined that a company's attempt to maintain the environment will bring about several perks for the company itself, including the company's shareholders and all stakeholders in terms of revenue obtained from its activities in environmental management. In effective environmental management, it is possible to prevent numerous claims from the community and governments while simultaneously improving the product and performance qualities (Putra, 2018).

The study findings support the application of the legitimacy theory. It claims that mining companies on the Indonesian Sharia Stock Index (ISSI) in 2016-2020 that engage in the
PROPER program can pay attention to environmental management, resulting in a positive response from the community around them or the shareholders of the business. The favorable response will undoubtedly strengthen the company's reputation. (Khairiyani et al., 2019)

This follows the legitimacy theory, which explains that environmental performance can increase firm value. If a company can positively impact the environment around its operational activities, then its existence will certainly be seen favorably by the surrounding community.

Besides being in line with the legitimacy theory, this study’s results also follow the Sharia theory used in this study, the Sharia Enterprise Theory (SET). A company whose shares have been registered in the Indonesian Sharia Stock Index (ISSI) should be able to pay more attention to its concern for the surrounding environment. This fits the teachings of Islam to protect and preserve the environment on Earth. In addition, Islam teaches us to continue to help fellow brothers who are going through difficult times. Based on the outstanding cases, it is explained that companies, especially mining companies that have passed the Sharia level test, have contributed less to the surrounding environment. Some cases state that the company silences people who are fighting for their environment to get justice and can take advantage of environmental products properly.

Considering that to achieve a good PROPER color rating, planning for high company management costs is necessary. This allows one of the factors in improving the company's environmental performance, which is currently in a low condition. Talking about the provision of assets for the common good has been explained in the following hadith:

From Abu Umamah r.a., he said:

"The Messenger of Allah (SAW) said: "O son of Adam, certainly if you give an excess of your wealth, then it is better for you and if you withhold it, then it is very bad for you. You are not blamed for simplicity; put those who become your dependents first." (H.R. Tirmidzi)

This hadith means that the company should be able to set aside its assets, especially those obtained from its operations. The assets are given as a gratitude to the surrounding communities who have supported the company's operations.

This hadith is reinforced in the Qur'an surah at-Taghabun verse 16, which reads as follows: (Departemen Agama Republik Indonesia, n.d.)
Meaning:
“So, fear Allah as much as ye can; listen and obey and spend in charity for the benefit of your own soul and those saved from the covetousness of their own souls- they are the ones that achieve prosperity.” (Q.S. at-Taghabun:16).

According to the SmartPLS 3.0 test results, ICSR cannot be considered as an intervening variable in the relationship of environmental and financial performance.

These findings are inversely related to the legitimacy theory used in this study. According to the legitimacy theory, achieving a high PROPER rating improves the disclosure of the company’s Corporate Social Responsibility (CSR), which will be attached to the company’s annual report (Annual Report), where the report will be used as a comparison for investors to invest or as guidelines in investment decisions.

The findings of this study are corroborated by the findings of Syahrina N Dewi’s research, which show that Corporate Social Responsibility (CSR) cannot act as an intervening variable or mediate the relationship between environmental and financial performance. This study included 135 industrial companies on the Indonesia Stock Exchange (IDX). (Dewi, n.d.)

A study conducted by Johan Arifin and Eke Ayu Wardani investigated the impact of Islamic Corporate Social Responsibility (ICSR) on reputation and financial performance and found particular testing of the Islamic Corporate Social Responsibility (ICSR) variable, which follows the title of this study. The Islamic Corporate Social Responsibility (ICSR) variable is not a mediating variable or mediates from other variables in this study. According to the findings of this study, Islamic Corporate Social Responsibility (ICSR) has a favorable and significant effect on the company’s reputation and can boost financial performance. Another difference between the results of this study and the results of the previous study is the object of research; in the previous study, the research was conducted on Sharia-based banking companies, but in this study, the research was conducted on mining companies listed on the Indonesian Sharia Stock Index (ISSI). (Arifin & Wardani, 2016)

The study’s findings are inversely proportionate to the theory employed, Sharia Enterprise Theory (SET). In Islam, a company’s social obligation is not dissimilar to the
social responsibility of every Muslim; the social responsibility of every Muslim is to attempt to carry out His instructions while avoiding all His prohibitions.

In another meaning, accountability in Islamic Corporate Social accountability (ICSR) is that each individual is encouraged and obligated to do other forms of public devotion. The essence of this definition is that Islamic Corporate Social Responsibility (ICSR) is the responsibility of an individual in a company to have a good impact on the surrounding environment to protect the natural ecosystem and support people in need. (Arifin & Wardani, 2016)

Islam emphasizes the individual’s position as ruler on Earth, expecting each individual to be responsible for their surroundings. It is thought that if the concept is affiliated with a Muslim entrepreneur, it will be able to conserve the environment. Some situations in life have demonstrated the significance of a Muslim’s interaction with his natural environment.

In running a business, apart from focusing on responsibilities to interested parties, it is also necessary to pay attention to the general welfare of the community where they are located. This statement follows the Qur’an surah Al-A’raf: 56, which reads as follows: (Arifin & Wardani, 2016)

وَلَا تَعْتَسُوا بِالْأَرْضِ حَتَّى يُهْرِقَنَّكُمُ الْحَمْجُ وَيُخْرِجَنَّكُمْ مِنْهَا وَيَطْبُعَنَّكُمُ الْقَلَمُ، إِنَّ الْعَفَّةَ لَعِبَادِ اللّهِ الْمُجِيِّبِينَ

Meaning:
“Do no mischief on the earth, after it hath been set in order, but call on Him with fear and longing (in your hearts): for the Mercy of Allah is (always) near to those who do good.” (QS. Al-A’raf: 56)

The verse explains that Islam’s teachings demand preserving the natural environment and paying attention to the interests of the social community. In running a business, a Muslim must change the image of his company to a company that is responsible for the social environment and is not only impressed with making a profit (Arifin & Wardani, 2016)

CONCLUSION, IMPLICATION AND LIMITATION

Based on the findings of tests and analyses regarding the relationship between environmental performance and financial performance with ICSR as an intervening variable conducted on mining companies consistently listed on the 2016 Indonesian Sharia Stock Index (ISSI) – 2020, it can be deduced...
that environmental performance affect company's financial performance. The effects are positive and negative. Furthermore, there is no influence of environmental performance on financial performance through Islamic Corporate Social Responsibility (ICSR) or in another sense that Islamic Corporate Social Responsibility (ICSR) is unable to become intervening variables on environmental performance variables and financial performance of a company.

A company’s attention to environmental performance may impact its financial results and enhance its positive reputation. However, the mining companies included in this research sample are stated not to have operated their businesses according to Islamic religious beliefs as they are listed on the Indonesian Sharia Stock Index.

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