

Effect of Islamic social reporting: A comparative study between Indonesia and Malaysia

Ayu Nailil Kiromah , Herlina Rahmawati Dewi*

Department of Accounting, Faculty of Economics
Islamic University of Indonesia
e-mail: herlina.rd@uii.ac.id

Abstract

This research aims to find out: (1) The Effect of Islamic social reporting on financial performance, (2) The Effect of Islamic social reporting on the company value, and (3) Differences in disclosure of Islamic Social Reporting in Indonesia and Malaysia. The population in this research are companies listed in Indonesia Sharia Stock Index (ISSI) and Islamic stocks in Malaysia, Suruhanja Sekuriti, during the period 2014-2017. The samples of companies were determined using purposive sampling technique. The research samples in Indonesia were 50 companies with 400 observations. While in Malaysia the research samples were 50 companies with 700 observations. Data analysis used robust regression analysis. The research results indicate that (1) There are differences in the disclosure of Islamic Social Reporting between Indonesia and Malaysia. (2) Islamic social reporting has a significant positive effect on financial performance. (3) Islamic social reporting has a significant effect on company value.

Keywords: Islamic Social Reporting, Financial Performance, Company Value

Abstrak

Penelitian ini bertujuan untuk mengetahui: (1) Pengaruh pelaporan sosial Islam pada kinerja keuangan, (2) Pengaruh pelaporan sosial Islam pada nilai perusahaan, dan (3) Perbedaan dalam pengungkapan Pelaporan Sosial Islam di Indonesia dan Malaysia. Populasi dalam penelitian ini adalah perusahaan yang berada dalam Indeks Saham Syariah Indonesia (ISSI) dan saham syariah di Malaysia, Suruhanja Sekuriti, selama periode 2014-2017. Perusahaan yang dijadikan sampel ditentukan dengan teknik purposive sampling. Sampel penelitian di Indonesia sebanyak 50 perusahaan dengan 400 pengamatan. Sementara sampel penelitian di Malaysia sebanyak 50 perusahaan dengan 700 pengamatan. Analisis data menggunakan analisis regresi yang kuat. Hasil penelitian ini menunjukkan bahwa (1) Ada perbedaan dalam pengungkapan Pelaporan Sosial Islam antara Indonesia dan Malaysia. (2) Pelaporan sosial Islam memiliki efek positif yang signifikan terhadap kinerja keuangan. (3) Pelaporan sosial Islam memiliki pengaruh signifikan terhadap nilai perusahaan.

Kata kunci: Pelaporan Sosial Islam, Kinerja Keuangan, Nilai Perusahaan

Introduction

Rapid economic development encourages Islamic economic growth. Investors pay more attention to the sharia-based institutions. This is proven by the increase in Indonesia's sharia stock index. On February 23rd, 2018, the Jakarta Islamic Index (JII) rose by 3.86% to 776.12 and the Indonesia Sharia Stock Index (ISSI) also increased by 0.43% at 195.92 (www.sahamsyariah.com). This is directly proportional to social responsibility initiative increase by various stakeholders. It might

occur due to the pressure on sharia-based companies to improve their responsibility reports and communicate them to stakeholders. Demand increase on sharia-based companies, promotes the initiative to report social responsibility in Islamic perspective. Reporting on social responsibility in Islamic perspective is known by the researchers as Islamic Social Reporting (ISR).

ISR conceptual framework development based on Islamic principle is required to complement the limitation of conventional social responsibility report (Haniffa, 2002). ISR is a concept of reporting company social responsibility that adopt the Islamic financial system. This concept is based on AAOIFI reporting standards which are developed by the researchers. ISR expansion from CSR standards is the addition of a spiritual perspective. ISR is required for sharia-based companies. In addition, ISR is also required for the decision making of stakeholders who want to invest in sharia-based companies.

ISR-related research is still limited and requires a review. Based on this background, the researchers want to re-examine the differences in ISR disclosure among Islamic law-based countries and non-Islamic law-based country with major Muslim population. This step is required to determine whether there are any differences in ISR disclosure for countries with Islamic government system and a country with major Muslim population.

Based on this explanation, this research aims to re-examine the effect of ISR disclosure on financial performance and company value by replicating the research of Arshad, Othman, and Othman (2012), Arifin and Wardani (2016), Cahya, Nuruddin, and Ikhsan (2017). In addition, this research also aims to discover the differences in ISR items disclosure by companies in Malaysia and Indonesia.

Theoretical Frameworks

CSR is defined as an action that appears to promote social good, beyond the interests of the company and what is required by law (McWilliams and Siegel, 2001). According to this definition, CSR does not only affect investment stakeholders such as shareholders, but also non-investment stakeholders such as customers, communities, social organizations, and others. Dusuki and Abdullah (2007) highlight that CSR framework establishes behavior standards that companies must follow to affect society in positive and productive way. CSR becomes a strength among business companies in developed countries, especially in United States and Britain, as well as Europe. For developing countries, CSR practices are generally advanced but remain a challenge for business managers.

CSR does not only grow in conventional economics but also in the Islamic economics. CSR disclosure in Islamic perspective is first proposed by Haniffa (2002). The limitation of conventional social responsibility disclosure encourages the formation of social responsibility disclosure in an Islamic perspective called Islamic Social Reporting (ISR). ISR is an extension of social reporting that includes not only broader expectation and belief from the community relating to the company role in the economy but also in the spiritual perspective.

Stakeholder theory indicates that companies that pay more attention to the stakeholder groups will obtain more attention in well-developed markets (Donaldson and Preston, 1995). In addition, the company in operation must be ensured to meet the norms enforced by the company and ensure the outside parties can accept the company activities. This is consistent with legitimacy theory. Deegan et al., (1997) stated that the legitimacy of an organization can be accepted as a gift to the company for the company's existence. Social responsibility report disclosure in the Islamic perspective (ISR) becomes an evidence that company gives more attention to the stakeholders, so that the company can be accepted by the public. ISR is one of the important factors to make the stakeholders have trust in sharia-based companies. Customers trust on the halal (permissibility) of product is expressed in ISR. This step will establish a company image, as a result the customers will

be loyal to the company's products. Customer loyalty triggers an increase in income in the future which ultimately affects the company's financial future. The increase in financial performance is expected to increase stakeholder assessment on company value.

ISR Effect on Financial Performance

Stakeholder theory indicates that when companies meet the various stakeholders' expectations, they are capable to create superior company performance (Freeman, 1984). In line with the stakeholder theory perspective, many companies have incorporated CSR into their business strategies. In addition, in globalization era, sharia business actors are also required to report social responsibility. This step drives the ISR emergence.

The potential increase in ISR activity disclosure is expected to improve the relationship with stakeholders. It is required so that the companies can obtain the stakeholders' support and trust. When a company obtains a trust such as customer loyalty, it will affect the financial performance improvement indirectly.

Previous research has reported conclusive result about the relationship between social responsibility and company performance (Saeidi et al., 2015). Based on the previous research, this research proposes a positive relationship. This result is based on the argument that in business environment where various stakeholders have high expectations of company's ICSR (Islamic Corporate Social Responsibility), managers are expected to recognize and implement ICSR activities to improve performance (Arifin & Wardani, 2016). Based on this explanation, this research proposes the following hypothesis:

H₁: ISR has a positive effect on company's financial performance

ISR Effect on Company Value

Stakeholder theory indicates that companies that pay more attention to stakeholder groups will obtain more attention in well-developed markets (Donaldson and Preston, 1995). Social responsibility report disclosure in Islamic perspective (ISR) becomes an evidence that the company gives more attention to the stakeholders.

ISR is one of the important factors that makes the stakeholders have trust in sharia-based companies. Trust and attractiveness have an impact on increasing the company value among investors' eyes. This is based on the argument that social responsibility report affects company value with the affecting institutional ownership level and it also depends on economic conditions. (Chung, Jung, & Young, 2018)

Cahya, *et al.* research (2017) prove that ISR is able to mediate the strength of company governance, company size, and profitability on company value. Based on the explanation of the relationship between CSR and company value on the previous research, this research proposes the following hypothesis:

H₂: ISR has a positive effect on company value

ISR disclosure difference between Indonesia and Malaysia

The growth of sharia-based companies has increased over the years. This is followed by the increasing number of demands from stakeholders on the companies that use sharia system. This promotes the emergence of social responsibility disclosure based on Islamic principles through ISR. ISR disclosure helps sharia-based companies to meet the stakeholders' demand.

ISR is increasingly developing in various countries both in countries with Islamic system and countries with major Muslim population. Malaysia is a model that represents a modern Islamic country due to the process of Islamization (i.e. Islam Hadhari) to integrate Islamic values that is implemented throughout the country in all levels, from individuals to institutional organizations.

Hassan (2014) stated that the Sharia Advisory Council in Malaysia was established in 1996 to advise the Securities Commission regarding Sharia issues. This issue includes providing guidance on Islamic Capital Market (ICM) transaction and activities with the aim to standardize and harmonize the applications (Bursa Malaysia, 2007). ICM refers to the markets whose activities are conducted in good way in line with the Islamic principles. The ICM establishment led to ISR where Muslim decision makers expect the companies to disclose relevant information that can help them meet their spiritual needs (Haniffa, 2002).

ISR also develops in a country that has major Muslim population, for instance, Indonesia. However, the Indonesian government is not based on Islam. Even so, Islamic economics in Indonesia is growing as well. This growth process is in line with the stakeholders' demands on the companies practicing sharia-based business. This step encourages ISR disclosure to meet the stakeholders' demands while helping the decision making.

Each country experiences different growth in Islamic finance. Further, based on this explanation, the research will look at the difference in social disclosure among the two countries because it has a different foundation of government. So, this research proposes the following hypothesis:

H₃: There is a difference among ISR practices in companies listed on the Islamic market stock in Islamic law-based country (Malaysia) and non-Islamic law-based country (Indonesia).

Idea Framework

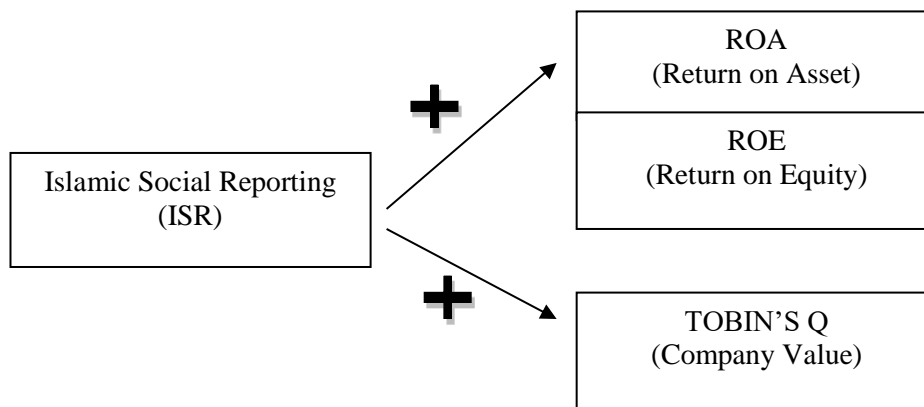


Figure 1. Idea Framework

Method

The population in this research were companies in Indonesia Sharia Stock Index (ISSI) and Islamic stocks in Malaysia, Suruhanja Sekuriti, during 2014-2017 period. The samples were determined through a purposive sampling technique. This research used 50 companies as samples that were included in the group of 50 highest capital markets from each exchange. There were two reasons here. First, large companies had more resources to disclose the information voluntarily, while small companies might not have the same resources even though they might be willing to disclose further information. Second, large companies were considered as industry leaders. Therefore, as an example for other small companies they would disclose more information voluntarily. However, companies in the financial sector were excluded in this research due to the different nature of their business activities. Finally, data analysis in this research used robust regression analysis.

ISR disclosure level was measured by comparing the contents of each annual report with the items in the index and given a score of "1" if the item was disclosed and "0" if it was not

disclosed. As in previous research, the scores of items disclosure that were considered as not valid for the company would not be reduced (Arshad, et al., 2012). Furthermore, in assessing the applicability of particular item, the entire annual report would be read to ensure there was no similar information found in any part of annual report before an assessment was made.

The ISR disclosure index score for each company was calculated as the ratio of actual score given to the company, divided by the maximum potential score given to that company. The ISR index that was used for each company to measure the ISR level was as follows (Arshad, et al., 2012):

$$ISR_j = \frac{\sum_{i=1}^{n_j} X_{ij}}{n_j}$$

Notes:

- n_j = number of Index expected to be reported by company, n_j was ≤ 32 ,
- X_{ij} = 1 if I disclosed th item and 0 if I did not disclose th item, So $0 \leq ij \leq 1$

ISR_j total value represented the number of points given to company j and this was the ordinal measure of ISR level for each company. The score was additive and not weighed. Non-weighted scores were used in this research for several reasons. First, the use of non-weighted index assumed that each item disclosed by the company was as important as the relevant stakeholders' decision making. Second, using a weighted disclosure index would involve the weight to reflect the importance of certain information types. The level of importance was generally based on the rank from the combined opinion of subject groups (analysts or preferred user groups). The subjective assessment involved in determining the consideration reduced index objectivity as a measure of ISR disclosure extent. Furthermore, the use of weighted or non-weighted disclosure indexes could be exchanged since the results were almost equivalent when using one of the indexes. The evaluation approach using a non-weighted disclosure index in this research was also supported by the used and adopted approach in several previous research on disclosure. (Arshad *et al.*, 2012).

Result and Discussion

Here are the robust regression results:

Table 1. Hypothesis Test Results in Indonesia

Model	Dependent Variable	Sig. Overall	Independent Variable	Reg. Coef.	T	Sig	R2
1	ROA	0.000	(Constanta)	-0.048	-3.674	0.000	0.347
			ISR	0.002	8.863	0.000	
2	ROE	0.000	(Constanta)	-0.727	-24.579	0.000	0.864
			ISR	0.015	30.694	0.000	
3	TOBIN'S Q	0.009	(Constanta)	0.613	4.677	.000	0.089
			ISR	0.009	3.807	.000	

Table 2. Hypothesis Test Results in Malaysia

Model	Dependent Variable	Sig. Overall	Independent Variable	Reg. Coef.	T	Sig	R2
1	ROA	0.000	(Constanta) ISR	-0.028 0.001	-1.239 4.600	0.217 0.000	0.125
2	ROE	0.000	(Constanta) ISR	-0.195 0.004	-2.852 4.679	0.005 0.000	0.129
3	TOBIN'S Q	0.001	(Constanta) ISR	2.375 -0.012	10.625 -3.557	0.000 0.001	0.079

Islamic Social Reporting Effect on Return on Assets (ROA)

Based on the hypothesis test results in Indonesia, the regression equation on Table 1 can be written as follow:

$$\text{ROA} = -0.048 + 0.002 \text{ISR}_j$$

The coefficient of ROA variable is -0.048, meaning that if the Islamic Social Reporting measured by ISR_j is zero, then the company's ROA is -0.048. In addition, the ISR_j coefficient value is 0.002 meaning that if the Islamic Social Reporting increases by 1 unit, the company's ROA will increase by 0.002.

The result of significance test with t test is 8.863 and sig. equal to $0.000 < 0.05$, then H1 is accepted meaning there is a positive and significant effect among Islamic Social Reporting on company's ROA. Meanwhile, the hypothesis test results in Malaysia in Table 2 can be written as a regression equation as follows:

$$\text{ROA} = -0.028 + 0.001 \text{ISR}_j$$

The coefficient of ROA variable is -0.028 meaning that if the Islamic Social Reporting measured by ISR_j is zero, then the company's ROA is -0.028. In addition, the ISR_j coefficient value is 0.001, meaning that if the Islamic Social Reporting increases by 1 unit then the company's ROA will increase by 0.001. Result of the significance test with t test is t count of 4.600 and sig. of $0.000 < 0.05$, here the hypothesis is accepted because there is a positive and significant effect among Islamic Social Reporting on company's ROA. In Malaysia the great effect of Islamic Social Reporting on ROA is indicated by the coefficient of determination (R2) of 0.125.

The results of two countries conclude that Islamic Social Reporting has a significant and positive effect on ROA. This means that companies registered in sharia stocks have maximized the management of tangible and intangible assets effectively and efficiently. Further, based on resource-based theory, companies that are capable to conduct Islamic social reporting disclosure will be able to create competitive advantages for the company itself. In the research, it indicates that companies that are disclosing more ISR items have better tangible asset management than companies that are disclosing fewer ISR items. The research results are consistent with the research conducted by Harahap, et al., (2014), Arifin & Wardani (2016) and Herwanti, et al., (2017) which have a positive effect on ROA.

Islamic Social Reporting Effect on Return on Equity (ROE)

Based on the hypothesis test results in Indonesia, the regression equation on Table 1 can be written as follow:

$$\text{ROE} = -0.195 + 0.015 \text{ISR}_j$$

The coefficient of ROE variable is -0.727, meaning that if the Islamic Social Reporting measured by ISR_j is zero, then the company's ROE is -0.727. In addition, the ISR_j coefficient value is 0.015, meaning that if the Islamic Social Reporting increases by 1 unit, the company's ROE will increase by 0.015. Significance test result with t test is t count of 30.694 and sig. of 0.000 < 0.05, here H_0 is rejected, meaning there is a positive and significant effect among Islamic Social Reporting on company's ROE.

Meanwhile, hypothesis test results in Malaysia in Table 2 can be written as a regression equation as follow:

$$\text{ROE} = -0.195 + 0.004 \text{ISR}_j$$

ROE variable coefficient is -0.195, meaning that if the Islamic Social Reporting measured by ISR_j is zero, then the company's ROE is -0.195. In addition, the ISR_j coefficient value is 0.004, meaning that if the Islamic Social Reporting increases by 1 unit, the company's ROE will increase by 0.004. The result of significance test by t test obtained t count of 4.679 and sig. of 0.000 < 0.05, here H_0 is rejected, meaning there is positive and significant effect among Islamic Social Reporting the company's return on assets.

From the test results on two countries, it can be concluded as Islamic Social Reporting has a significant and positive effect on Return on Equity. This means that the more companies disclose ISR, the greater the possibility of the company to generate profitability. It is in accordance with the theory that companies manage and utilize capital resources effectively and efficiently to earn profits or increase company's profitability. This profitability will affect stakeholders' policies on the investments made. The research indicates that companies disclosing more ISR items will have the ability to produce better profitability than companies that disclose fewer ISR items. The research results support the research conducted by Herwanti, et al. (2017) and Arifin & Wardani (2016), in which ISR has a positive effect on ROE.

Based on the results of ROA and ROE, it indicates that ISR disclosure significantly and positively affects financial performance. This is supported by the argument that in a business environment where various stakeholders have high expectations of company's ICSR (Islamic Corporate Social Responsibility), managers are expected to recognize and conduct ICSR activities to improve performance (Arifin and Wardani, 2016).

Islamic Social Reporting Effect on Company Value

Based on hypothesis test results in Indonesia in Table 1, we can write a regression equation as follows:

$$\text{Tobin's Q} = 0.613 + 0.009 \text{ISR}_j$$

The coefficient value of Tobin's variable is 0.613, meaning that if the Islamic Social Reporting measured by ISR_j is zero, company's Tobin's Q is 0.613. In addition, the ISR_j coefficient value is 0.009, meaning that if the Islamic Social Reporting increases by 1 unit, then the company's Tobin's Q will increase by 0.009. The results of the significance test with t test obtained t count of 3.807 and sig. of 0.000 < 0.05, there the hypothesis indicates that there is a positive and significant influence between Islamic Social Reporting on the company's return on assets.

Meanwhile, the results of hypothesis testing in Malaysia in Table 2 can be written as a regression equation as follows:

$$\text{Tobin's Q} = 2.375 - 0.012\text{ISR}_j$$

Tobin's Q variable coefficient value is 2.375, meaning that if the Islamic Social Reporting measured by ISR_j is zero, company's Tobin's Q is 2.375. In addition, the ISR_j coefficient value is -0.012, meaning that if the Islamic Social Reporting increases by 1 unit then company's Tobin's Q will increase by -0.012. Significance test result by t test obtained t count of 3.557 and sig. of $0.000 < 0.05$, here the hypothesis is accepted, meaning there is a positive and significant affect among Islamic Social Reporting on the company's return on assets.

From the test results involving two countries, it can be concluded that the Islamic Social Reporting has a significant and positive effect on Company Value. Disclosure on social responsibility report in the Islamic perspective (ISR) is a proof that the company gives more attention to stakeholders. Stakeholders are expected to become more interested and have more trust in sharia-based companies. The trust and attractiveness indirectly have an impact on the company value increase on the investor's eyes. This is based on the argument that social responsibility reports affecting company value vary by the affecting institutional ownership level and depending on economic condition (Buchanana, Caoa, and Chen, 2018). This research result is supported by the results of Cahya et al. (2017) that ISR is able to mediate the correlation of company governance strength, company size, and profitability on the company value.

Different Test Analysis

Hypothesis 3 (H3) test in this research used a different test analysis. It was conducted to discover the differences in index disclosures between two countries. This analysis examines the differences in the average index disclosure among the samples used. Different tests were conducted using Independent Simple T-Test method because the relationship between the two samples to be tested is different. In this research Simple T-Test was conducted using Mann Whitney test.

Table 3. Mann Whitney Test

	Countries	N	Mean Rank	Sum of Ranks
ISR	ISR_INDO	150	75.73	11359.00
	ISR_MALAY	150	225.27	33791.00
	Total	300		

Test Statistics

	ISR
Mann Whitney-U	34.000
Wilcoxon W	11359.000
Z	-15.000
Asymp. Sig. (2-tailed)	.000

a. Grouping Variable: COUNTRY

Based on the Statistics test output, the asymp Sig (2-tailed) is < 0.05 , therefore it can be concluded that hypothesis 3 is accepted. It also can be defined that there are differences in ISR disclosure in Indonesia and Malaysia. Malaysia has a better level of ISR score disclosure than Indonesia. These results indicate that ISR disclosure based on Islamic law in Malaysia is better (a higher ISR score) than a country whose population is predominantly Muslim. This conclusion is also supported by the data that Islamic economic growth in Malaysia is better than Indonesia. Islamic Finance Country Index 2017 data indicates that Malaysia is ranked first, while Indonesia rank drops in the seventh position.

Conclusion

This research aims to determine the differences among companies in Indonesia and Malaysia in Islamic social reporting (ISR) and its effect on financial performance and company value. The independent variable of ISR disclosure was measured by ISR score and used ISR disclosure items from Othman's research (2010). The dependent variable financial performance was measured using profitability ratios consisting ROA and ROE. While the company values were measured using Tobin's Q.

Based on the analysis results and discussion in the previous chapter, the conclusions are: (1) Islamic Social Reporting has a positive effect on ROA and ROE. It means that if the company increases ISR disclosure, then the company's financial performance will also increase. (2) Islamic Social Reporting has a positive effect on Tobin's Q. It means that if the company increases ISR disclosure, then the company value in the market will also increase, (3) ISR disclosure among companies listed in the Islamic market stock exchange in Indonesia and Malaysia have differences as indicated by differences in the ISR scores of each country.

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