

# Contribution of Corporate Social Responsibility and Innovation in Performance of Islamic Banks in Emerging Economy: An Empirical Investigation

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**Abstract:** The study examines the influence of corporate social responsibility (CSR) and innovation on performance of Islamic banks in Pakistan as an emerging economy. It is observed that CSR and innovation are growing trend in the banking industry especially in Islamic banks (IB) of Pakistan. This study investigates the contribution of CSR and innovation in performance of IBs because Innovation and CSR are considered essential element in the financial sector especially in the Islamic financial institutions of Pakistan. Therefore, this study examined performance of highly competitive and diversified Islamic financial institutions due to innovativeness and concerns for its stakeholders. The target population of the study was the employees of all full flagged Islamic banks. Researchers approached the target audience in person to document their responses and noted their experiences regarding innovation and CSR practices at their respective IB for data collection. 250 respondents were approached for data collection as per sample size, 219 filled questionnaires were received, and 18 questionnaires were discarded due to incomplete data. Therefore, this study used 201 respondents to collect the data from Lahore and Gujranwala by using simple random sampling technique. In this study, research questioners are used as the research instrument to collect the data from the respondents. These questioners are consisting of close ended questions. Questioners are developed in the light of existing knowledge to collect the data. Responses were collected by self-administrative approach i.e., the questioners are filled from respondents by visiting himself personally. Appropriate statistical tools were used to analyze data including Smart PLS and Structural Equation Modelling in addition to the correlation and regression analysis. Results reveal significant positive impact of selected determinants of CSR that could improves the performance of Islamic banks. Moreover, output of regression analysis also reveals an important indication regarding ethical responsibility and religious responsibility for bank performance. Results indicate significant positive impact of two dimensions of CSR i.e., Economic, and religious on performance of Islamic banks. Moreover, innovation can influence perceived performance of IBs that is evident from results. It is also observed that majority of the respondents is willing to encourage innovation and inclusive approach for individual and collective well-being by considering the CSR initiatives of IFIs for their stakeholders. This study helps both practitioner and researcher and provide basic knowledge about CSR and performance of IB.

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**Key words:** Economic CSR, Religious CSR, Innovation, Performance of Islamic Banks

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## 1.0 Introduction

Corporate Social Responsibility (CSR) became an essential component of Islamic financial institutions especially in the banking sector. CSR has attracted attention of organizations and academia worldwide to assess its role in the performance of any corporate entity by addressing the needs and requirements of relevant stakeholders. It's all because organizations don't survive in isolation but exist within a society, so the organizations must do for the betterment and development for society in which they are doing their business operations. Banking sector plays an essential role for the development of a country. In Pakistan two types of financial system are prevailing that is, conventional and Islamic system, and Islamic financial institutions run their operations on Shariah compliance features. Islamic financial institutions annual reports shows that the IFI's are also expending on socially responsible matters such as donating charitable institutions, conducting sports events, help NGOs, government agencies etc. Islamic banking in Pakistan has experienced very turbulent environment since its inception due sudden changes in internal and external environment especially in the banking sector (Ahmad et al. 2010). The concept of philanthropy was coming on the scene in the late 1800s, but it is very difficult to distinguish that whether it was individual philanthropy or business as John D. Rockefeller (Visser, 2010). The formal writing about social responsibility was found influential in the pre-1950s.

Corporate Social Responsibility (CSR) is rooted back to more than 4,000 years in one form and another. The formal writing about CSR is also the product of twentieth century, of more than 60 years. In Pakistan, CSR is considered an essential element to serve the relevant stakeholders of Islamic banks by blending innovation. Islamic financial institutions are very important in any economy. The Islamic banking is in developing stage and requires structural and procedural changes according to Shariah principles. Therefore, Islamic banks are required to provide CSR practices and innovative products to meet emerging needs of its stakeholders especially customers. This study helps us to investigate the contribution of CSR and innovation in the performance of IBs in Pakistan as an emerging economy based on empirical data. It is observed that CSR has a long history and organization were working for the wellbeing of the stakeholders including society in different modes, but the proper working of CSR is started in the twentieth century especially after 1950s and originated in the USA. The modern CSR started working after the Industrial revolution in 18th century, mainly focus on employees and with the concept of how to make them more productive worker (Visser, 2010). But now, sometimes it is complicated to distinguish that what organization are doing to make a productive worker and what for helping to meet their need, to make them better and one of the more contributing members of society.

This research identified the gap theoretically as well as practically that requires an examination of contribution of CSR and how it affects the performance of Islamic bank in addition to role of innovation. It is reported that corporate social responsibility is an important trigger of performance for services industry in Pakistan (Asad et al. 2011). The study will enable to identify the determinants of CSR in the local setting by approaching the relevant stakeholders and practitioners. Moreover, it also examined the role of selected CSR determinants in the performance of Islamic Banks. Through Financial Innovation, IFI's are more efficient, providing better service to their clients while also saving them money. As a bank regulator, the State Bank of Pakistan always encourages Islamic banks to use more creative techniques to better serve their clients and offers recommendations for successful

implementation of digital Islamic banking. Technology developments (such as mobile and internet) paired with their global acceptance are shifting customers' expectations, according to literature (Chuen & Teo, 2015). This research is to cover this gap theoretically as well as practically by examining the dimensions of corporate social responsibility and due to adopting these responsibilities what is the effect of these responsibilities on the performance of Islamic financial institutions of Pakistan. As Pakistan is based on the Islamic perspective, we also add the religious responsibility in our research as the Islamic banks is based on Shariah compliance features that, whether it is fulfilling its religious responsibility or not, within the limits and teaching of Shariah.

## 2.0 Literature Review

Bowen (1953) defines CSR as an obligation of the companies to follow policies and strategies for decision making which are desirable by society and compatible to the objectives and values of societies. Gambling and Karim's (1986) provide the theoretical framework to analyze the Islamic finance by explaining the characteristics and evaluating its social point of view. It is observed that Islam provides complete information about life including spiritual, social, and economic aspects of life. Islam provides a road map to develop conceptual models for Islamic finance and Islamic banks to serve its stakeholders by providing multifarious activities (Clark, 1993; Karim; 1995; Lewis, 2001 and Ahmad et al. 2011). Sadeghzadeh (1995) explain the Islamic structure for social responsibility and sustainability and compare it with the conventional theories of that area. Baydoun and Willett (2000) further elaborate the work of Sadeghzadeh (1995) by preparing normative standards for Islamic reporting that follow the two principles of full disclosure and social disclosure that are based on Islamic ethical standard.

Farook, Hassan, & Lanis (2011) conducted research to conclude the CSR disclosure of Islamic banks. It is reported that CSR disclosure has an impact on performance of Islamic banks working in Malaysia (Arshad et al., 2012). The result of another study shows that there is significantly positive relationship between CSR and performance of Islamic banks (Boutti, 2012). Similarly, Okoth (2012) concluded that CSR has positive effect on performance of large and medium size bank and have no effect on ROA of small size banks. The researcher concluded that, when all commercial banks are combined, CSR had a significantly positive effect on ROA and ROE. However, when the study is classified on the basis of the size of the firm the research reveals that CSR had a positive and significant effect on large and medium size banks and no significant result for the small size banks. The researcher gave their remarks that the small banks was not engage in CSR activities because it is not in the interest of shareholders as it will not give return to the shareholders (Daniel, 2014).

The terms "innovation" and "national development," as well as "technological advancement" and "economic success," are often used interchangeably. Innovation has become a vital component of any organization's success in today's competitive business environment. (Alamad, 2017). The literature has emphasized the critical significance of innovation in achieving a lasting competitive edge in today's corporate climate. According to several authors, innovation is a typical instrument that financial organisations might use to secure a competitive advantage in their economic operations (Samsudin, 2016). Poon, Chow, Ewers, and Ramli (2020) defines innovation in the financial services delivery system as 'a chance to obtain a competitive advantage' that would offer a retail banking service provider with 'a foundation for difference'. Similarly, Ali and Pua (2017) assert that innovation is critical for establishing a sustained competitive edge in today's environment. Islamic banks worldwide have started digitizing their operations in anticipation of the evident effect of FI (Knaack & Gruin, 2020). There has been a substantial amount of empirical research on the influence of FI on banking stability, however the findings are inconsistent. Only a few studies have looked at the impact of FI on the stability of conventional banks, but even fewer have looked at the impact on Islamic banks.

## 2.1 Hypotheses of the Study

H1: There is positive role of Economic CSR in the performance of Islamic Banks of Pakistan.

H2: Religious responsibility has positive affect on the performance of Islamic Banks of Pakistan.

H3: Financial Innovation positively affects the performance of Islamic Banks of Pakistan.

## 3.0 Methodology

The study used self-structured questioners to collect the data from the employees of full-flagged Islamic banks i.e., Meezan Islamic bank, Dubai Islamic bank, Burj bank, Bank Islami and Al-Baraka bank limited. The target population of the study was the employees of all full flagged Islamic banks that is, Meezan Islamic bank, Dubai Islamic bank, Burj bank, Bank Islami and Al-Baraka bank limited.

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## 4.0 Results and Discussion

### 4.1 Demographic Profile

**Table 1: Demographic Characteristics of Respondents**

Variable	Percent
<b>Gender</b>	
Male	84
Female	16
<b>Age of Respondents</b>	
22-30 Years	28
31-40 Years	47
41-50 Years	25
<b>Qualification of Respondents</b>	
Master	60

M.Phil	40
<b>Length of service</b>	
1-5 Years	31
06 - 10 Years	43
11-20 Years	26

Table 4.1 demonstrates the demographic profile of the respondents. The findings suggested that majority of the respondents are male (84.25%). Further, the table demonstrate that majority of the respondents age was 31 to 40 years (46.94%) having majorly qualification of Master (60.34%) and respondents' length of service was 06-10 years (43.44%).

#### 4.2 Measurement Model

To test the measurement and structural models, Anderson and Gerbing (1988) state that two phases of data analysis were performed. The researcher investigated the measurement model's fit. Prior to making any judgments about the link between constructs, this established the reliability and validity of concept measures (Albort-Morant et al., 2018). As seen in Table 1, our data met the convergent validity criteria since all variables in this study had standardised factor loadings larger than 0.4 (1999, Holland).The researcher use variance inflation factor for analyzing multicollinearity issue in the data. Multi-collinearity is acceptable if the number is below five, according to Hair et al. (2011). All calculated VIFs for our model variables were less than threshold. The reflecting constructions have a construct reliability of above 0.70. (Nunnally and Bernstein, 1994). Furthermore, table 1 indicated that the values of (Rho A) and C-A are higher than the acceptable limit i.e. .70. The AVEs obtained for all constructs ranged from .505 to .619, suggesting high construct reliability and convergence of measurement models.

**Table 2: Reliability Analysis**

Construct	F-items	FA	VIF	AVE	CR	Rho_A	C-A
Innovation	I1	0.701	1.831	.505	.864	.845	.824
	I2	0.709	1.688				
	I3	0.817	1.444				
	I4	0.762	1.399				
	I5	0.709	1.526				
	I6	0.894	1.641				
	I7	0.732	2.071				
	I8	0.765	2.347				
	I9	0.77	1.918				
Economics_CSR	E1	0.792	1.755	.582	.819	.772	.749
	E2	0.715	1.556				

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	E3	0.779	1.566				
	E4	0.865	1.448				
	E5	0.778	1.394				
	E6	0.826	2.465				
	E7	0.738	1.276				
	E8	0.707	1.532				
	E5	0.727	2.275				
	E6	0.704	2.865				
	E7	0.734	2.782				
	E8	0.741	1.355				
Religious CSR	R1	0.861	2.505	.571	.820	.783	.746
	R2	0.741	1.799				
	R3	0.508	1.158				
	R4	0.583	1.586				
	R5	0.492	1.356				
	R6	0.527	1.387				
	R7	0.638	1.457				
IFI Performance	P1	0.668	2.065	.619	.901	.893	.879
	P2	0.735	1.561				
	P3	0.727	1.565				
	P4	0.544	1.965				
	P5	0.769	2.491				
	P6	0.769	2.118				
	P7	0.474	2.61				
	P8	0.532	2.423				
	P9	0.515	2.187				
	P10	0.402	2.567				
	P11	0.593	2.299				
	P12	0.607	1.931				
	P13	0.733	1.709				
	P14	0.655	1.659				

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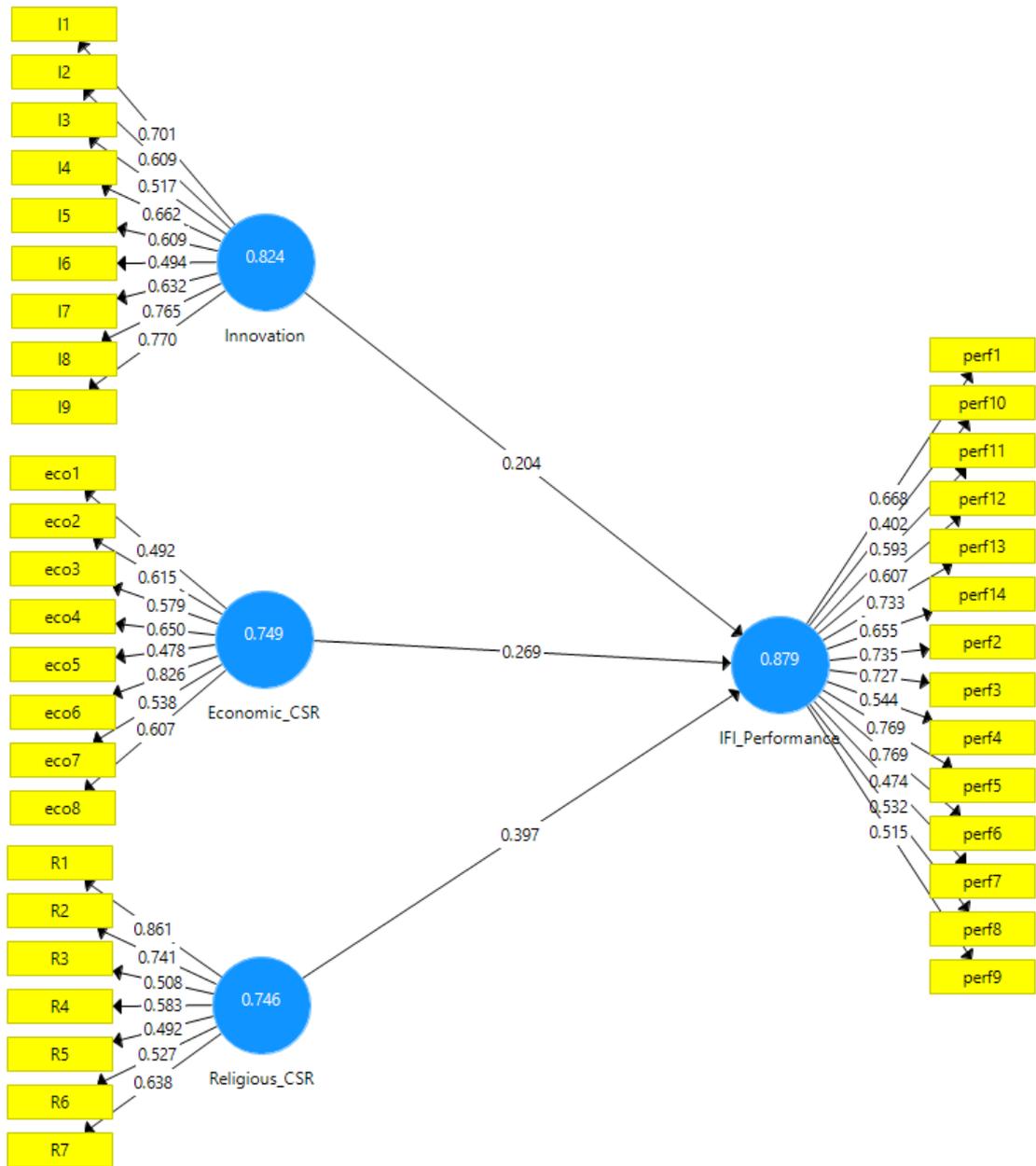


Figure 1: Measurement Model

### 4.3 Structural Model

Researcher evaluated the hypothesized structural correlations between variables. Our findings show that Economic CSR has an influence on IFI Performance (Beta=0.269, T= 2.504, P=0.014) which supports the first hypothesis (H1). Our findings confirm H2's claim that religious CSR influences IFI performance significantly (Beta= .397, T= 4.661, P=.000). Our data also revealed the significance of Innovation and IFI Performance ( $\beta = .397$ , T= 4.661, P= 0.031). As a consequence, H3 is likewise supported (Table 3).

Table 3: Testing of Hypothesis

	Original Sample (O)	Standard Sample Mean (M)	Standard Deviation (STDEV)	T Statistics ( O/STDEV )	P Values
Economics_CSR -> IFI_Performance	0.269	0.295	0.108	2.504	0.014
Innovation -> IFI_Performance	0.204	0.202	0.093	2.187	0.031
Religious_CSR -> IFI_Performance	0.397	0.391	0.085	4.661	0

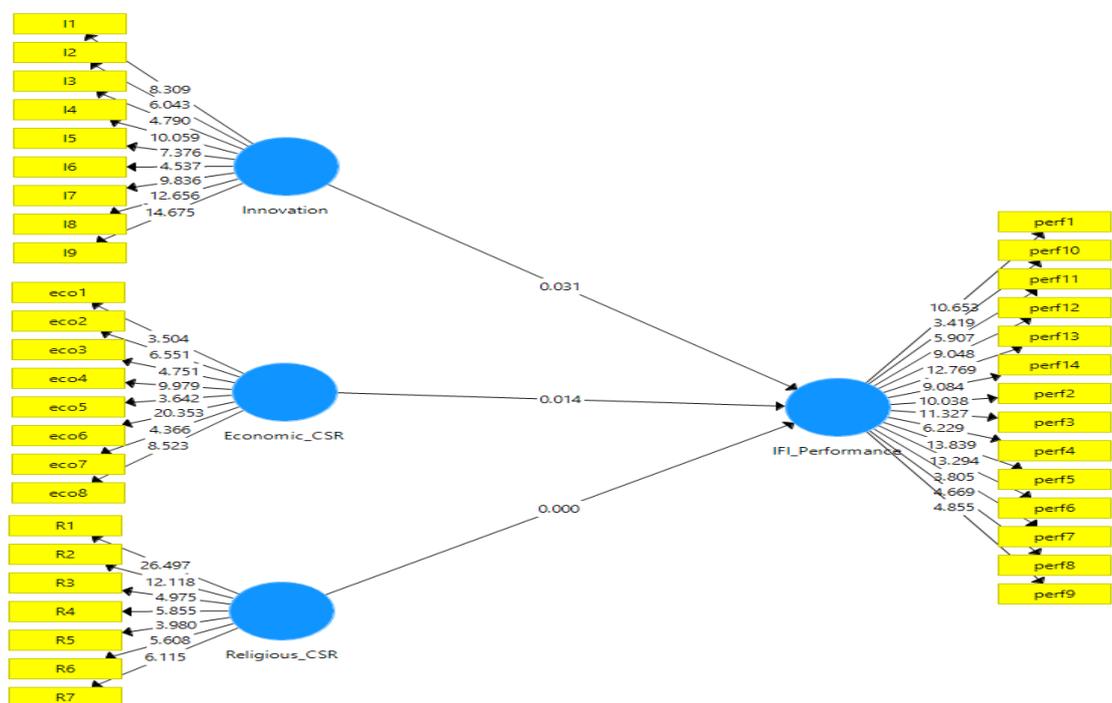


Figure 2: Structural Equation Modeling

### 5.0 Conclusion

This study is conducted to investigate the role of determinants of CSR and innovation in performance of Islamic banks in Pakistan. This study explores the critical role of determinants of CSR and innovation in performance of Islamic banks. The study considered different determinants of CSR including economic CSR, religious CSR and Financial Innovation (FI) in stabilizing the Islamic financial institutions. Data was collected from employees of IBs in this study. Correlation analysis is applied to test the association among the determinants of CSR. The results of correlation analysis depicts that there is positive/upward linear relationship between the determinants of CSR and performance of Islamic banks. Regression analysis is used to test the magnitude of the impact of determinants of CSR and performance of Islamic banks. According to the findings, economic and religious CSR and Financial Innovation has positive and significant effect on Islamic financial

institutions performance. The positive result of the study explains that it's good for Islamic financial institutions to invest in the field of CSR and motivate to invest more in future it improves their performance and maintain competitive advantage in financial sector especially in Islamic financial sector of Pakistan. This study proves the positive role of financial innovation on the performance of Islamic financial institutions in Pakistan. This study helps the management of Islamic banks, students, researchers and for those organizations that are participating in CSR and financial innovation activities and for that those are trying to participate in CSR activities. The major limitation of the study is limited sample size and targeted area due to resource constraints. It is also observed that majority of the respondents is willing to encourage innovation and inclusive approach for individual and collective well-being by considering the CSR initiatives of IFIs for their stakeholders. This study helps both practitioner and researcher and provide basic knowledge about CSR and performance of IB.

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