

Impact of Corporate Social Responsibility and Enterprise Risk Management on Financial Performance of Islamic Banks: A Conceptual Framework

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Abstract

This study presents a conceptual framework that employs enterprise risk management (ERM) as a mediator to better understand how corporate social responsibility (CSR) practices contribute to enhancing financial performance (FP). Past studies examining the direct relationship between CSR and FP have produced inconsistent results, often explained using mediating variables. This paper contends that the influence of CSR practices on financial performance can be explained by ERM. The study draws on the literature on CSR-ERM-FP nexus and expands it to the banking sector, focussing on Islamic banks, where such research remains limited. This study adopts stakeholder theory and signalling theory as the underpinning theories in developing the conceptual models to offer insights into the CSR-ERM-FP relation. We propose a quantitative approach using content analysis method to

obtain data on Islamic banks' CSR practices, alongside secondary data from DataStream on ERM and FP.

Keywords: Corporate Social Responsibility, Enterprise Risk Management, Financial Performance, Islamic Banks.

Introduction

Over the past decades, increasing concern over the negative impacts of business practices on society has heightened the importance of companies' corporate social responsibility (CSR) efforts. Businesses need to consider the well-being of the community and its environment alongside the production of their final products (Malik, 2015; Nizam et al., 2019). CSR refers to actions taken to improve the community and environment that go beyond the company's legal obligations (McWilliams & Siegel, 2001). Accordingly, CSR has become a crucial element in gaining legitimacy among stakeholders and maximising organisational wealth (Gray et al., 2003; Garriga & Melé, 2004). Numerous researchers have paid much attention to explore the outcomes of CSR practices in different areas of firms' environmental management. For examples, perceived legitimacy, corporate reputation, consumer satisfaction, and resources attraction such as skilled human capital, and competitive advantage (Surroca et al., 2010; Galbreath & Shum, 2012; Saeidi et al., 2015). One of the most important areas receiving considerable attention is how CSR activities affect financial performance (FP). A plethora of studies have found that CSR practices impact FP. Nevertheless, results of these studies are conflicting and inconclusive (Huang et al., 2020). On this perspective, there are critical reviews of studies that attempted to examine CSR and FP relationship (Orlitzky et al., 2003; López-Arceiz et al., 2018; Lu et al., 2018). Scholars argue that one of the major issues behind these mixed findings has been linked to the lack of consideration for possible indirect influences such as mediating effects (Javed et al., 2016; Reverte, 2016; Wang & Sarkis, 2017). Therefore, additional variables need to be incorporated into the CSR and FP investigation to provide a clearer picture and to enhance understanding of the relationship.

Despite research that view CSR practices as a value creation strategy, studies on the risk-reduction capabilities of CSR have not fully investigated CSR practices within this framework. In undertaking CSR activities, companies plough deeper to understand the risks involved with various stakeholder groups. Disputes surfaced as companies implement their CSR agendas to achieve superior FP. Several social and environmental risks surface in their CSR practices which may negatively affect their performance. Moreover, firms practising CSR are perceived to have higher business risk arising from environmental and social issues, which in turn increase their operating costs and stakeholders risk perception. That said, the aspect of risk management is incorporated into the analysis when examining the influence of CSR implementation on financial performance. Businesses operating in high-risk environment may use CSR as a way of increasing their reputations, creating value, and ensuring sustainability (Olson & Wu, 2023). Thus, utilizing CSR effectively to mitigate and avoid risks is critical for maintaining continuity and long-term success (Devie et al., 2019). Furthermore, since it is imperative to consider stakeholders' concerns regarding social and environmental issues, firms' risk management practices to address such concerns must be fully integrated to their corporate strategy (Kleffner et al., 2003). Therefore, we conjecture that enterprise risk

management (ERM) plays key role in firms' CSR activities in reducing risk and improving performance.

In recent years, the extended link between CSR practices and risk management as a mechanism for reducing risk has gained the attention of academicians and practitioners (Lu et al., 2022). Since the start of the financial crisis in 2008, organisations have begun integrating CSR into their management strategies (Chen et al., 2018). Prior studies have shown that a close link exists between CSR and several aspects of risk reduction. For example, engaging in CSR activities generate positive moral capital and create goodwill that can work as an insurance in the face of adverse events (Kytte & Ruggie, 2005; Godfrey et al., 2009). In addition, CSR could mitigate the risk of stock price crash (Utz, 2018; Wu & Hu, 2019); reduce the cost of equity capital in firm (El Ghouli et al., 2011; Yeh et al., 2020); and increase firm value through decreasing firm risk (Albuquerque et al., 2019; Harjoto & Laksmana, 2018). Besides, CSR promotes employees' well-being related to safety and health through human capital investment and psychosocial risk management (Jain et al., 2011). Furthermore, CSR could reduce social risks along with other risks such as litigation, functional, product, and technology-related risks (Starks, 2009), build firm's reputation to help resolve conflicts among stakeholders and enable firm to effectively manage a wide range of environmental, social and ethical risks (Meng & Zhao, 2010). In this regard, it is argued that CSR practices make possible an integrated approach to holistic risk management by reducing a firm's exposure to environmental and social risks alongside financial risk, thus boosting a company's sustainability value (Hummel et al., 2021; Liu, 2019). Although these studies provide useful insights into CSR's positive contribution to various aspects of risk management, limited attention has been paid to address how it affects a firm's risk management strategies. Therefore, this conceptual paper attempts to enhance understanding of the influence of ERM in the relationship between CSR implementation and FP. The emphasis is on ERM as an important practice in promoting sustainability and improving performance. Recent development in the regulatory framework and the growing complexity of risks have made ERM an increasingly important strategy (Lechner & Gatzert, 2018). According to the Committee of Sponsoring Organisations of the Treadway Commission (COSO) framework, ERM was developed to handle an organisation's risk portfolio by tackling and combining all-inclusive measures rather than focusing on individual risks to ensure an effective risk management strategy in addressing business risks (COSO, 2004). In today's dynamic environment, organisations utilise ERM as a holistic approach to managing risk rather than relying on solo risk-based risk management approach. Research has shown that effective ERM integration improves FP of firms. ERM helps to make business plans more efficient which in turn allows organisation to achieve its business objectives successfully. Agustina and Baroroh (2016), explained that the adoption of ERM as a mechanism in agency theory is to safeguard against existing risks exposure of the principal. The agents have mandate to implement ERM which guide firm's operations to help improve performance. According to Gordon et al (2009), corporations that employ ERM perform better than those that do not utilise it. By implementing ERM, organisations stand to gain several intangible and tangible benefits as rightly assumed by the value maximisation theory of risk management. ERM helps to strengthen management's confidence and improve firm's risk profile (Shad et al., 2019). ERM has been used by managers as a holistic approach to counter any risks through the use of

broad and integrated approaches in dealing with imminent risks. Furthermore, in addition to improving firm's FP, ERM enhances competitiveness, internal control, and also the quality and standard of corporate governance (Lechner & Gatzert, 2018).

Moreover, ERM has considerable contribution towards the sustainable development of firm through the holistic management of risks, including CSR-related risks (Shad et al., 2019). Several studies concluded that CSR practices act as a risk management tool to reduce risk exposure (Utz, 2018; Chollet & Sandwidi, 2018). According to Kytte and Ruggie (2005), CSR is closely linked to crisis management by identifying risks and assisting management to develop crisis reduction strategies in responding to the risks. Harjoto and Laksmana (2018), argue based on stakeholder theory that ERM influences FP due to its close relation with CSR performance. Liu (2019), emphasises ERM's importance on FP by arguing that it promotes profitability through ethical CSR practices and the compliance of relevant laws and regulations. Lu et al (2022), indicated that companies who practice CSR probably adopt ERM as a means of improving financial performance, particularly CSR activities that target both primary and secondary stakeholders. Chairani and Siregar (2021), concluded that the effect of ERM on firm performance and value is significant in the presence of ESG activities among firms in Asian countries. Thus, the resulted CSR benefits arising from ERM efficiency may incentivize management to allocate resources to enhance CSR activities.

While CSR practices have been shown to play various roles in influencing both ERM and FP, existing CSR literature paid limited attention to the mediating role of ERM in enhancing FP while examining their relationship in different sectors and settings. Besides, it has been argued that the role of ERM in determining the overall success is particularly challenging for institutions that operate in various regulatory, cultural, and institutional environments (COSO, 2004; Gordon et al., 2009). As noted by Liu (2019), the effect of risk management philosophy within an ERM system may be different depending on each society's self-regulatory mechanisms. Further, as proven empirically, risk profile related to firms' value creation is not homogeneous, such as risk factors related to health, safety, and environmental issues (Kuo et al., 2021). Such issues raise concerns about the functionality of ERM in different settings and therefore specific context needs specific consideration.

The current research aims to expand the CSR literature by focusing on the banking sector, particularly the Islamic banking sector of the Gulf Cooperation Council (GCC) countries due to the distinct culture and research scarcity on CSR and ERM. The Islamic banking sector operates based on Islamic jurisprudence (Shariah) that integrates into its operation equitable and transparent implementations which contribute to community and mortality's welfare (Dusuki & Abozaid, 2007). Accordingly, CSR is considered an essential component of the Islamic banking system (Dusuki, 2008), and to what extent CSR practices affect Islamic banks' FP is of significant importance to managers and investors. Islamic banks face higher expectations when performing CSR due to ethical principles of Islamic rules that encourage fair and honest operations that support philanthropic or social interests (Haniffa & Hudaib, 2007; Zafar & Sulaiman, 2019). However, Islamic banks are confronted with several challenges while implementing and practising CSR. Scholars argue that Islamic banks fall short of aligning their actual CSR practices with those required by the Islamic principles (Maali et al., 2006;

Haniffa & Hudaib, 2007; Arsad et al., 2014). In addition, CSR practices and reporting have been ineffective and of low quality although they are shown to impact reputation and financial performance (Platonova et al., 2018; Jan et al., 2019). These studies suggest that failure in meeting ethical obligation and addressing stakeholders' concerns through CSR could impact financial performance negatively. Furthermore, in addition to the inconclusive findings of the CSR-FP relationship, no study has investigated the risk management perspective in the CSR-FP nexus. Ashraf et al (2017), agrees on ERM being a contributor towards improving FP by Islamic banks through enhancing individual factors that lead to improved performance. Hence, a deeper analysis of Islamic banks' CSR practices and their impact on risk and profitability could provide valuable insights.

The implementation of ERM system varies by context and is indeed true for the Islamic banking sector. The ERM of Islamic banks is inherently more complicated due to information asymmetry, the need to comply with ethical principles and dependency on multiple ERM aspects in enhancing banks financial performance. The current study contributes to the literature in two ways: first, by producing an updated literature review on the CSR-FP nexus and second, by investigating the mediation role of ERM on CSR-FP nexus within the Islamic bank context. The next section provides review of each literature stream and testable hypotheses. Section 3 discusses the proposed conceptual framework of CSR performance for Islamic banking institutions. Section 4 presents the proposed methods and empirical challenge of the research. The sections that follow discuss research implications. Section 7 concludes and considers potential future research.

Literature Review and Hypotheses Development

This section discusses the theoretical framework and the development of research hypotheses.

Theoretical Development

This study presents two theories relevant to the research topic, namely stakeholder theory and signalling theory as discussed below.

Stakeholder Theory

Freeman's stakeholder theory (1984), suggests that firms and their various stakeholders are interconnected. The stakeholders include not only shareholders but also all parties and individuals who can affect or be influenced by firms' activities (Freeman, 1984). The theory posits that an organisation should create value for all of its stakeholders. From the CSR perspective, Freeman and Dmytriyev (2017), argues that there are three critical areas of the stakeholder theory relating to corporate social responsibility and these include: *purpose* (align its purposes through social responsibility to match the interest of the society); *value creation* (organisations should provide value to all their stakeholders); *stakeholder interdependence*, (businesses should consider various stakeholders when making decisions). By involving stakeholders in the decision-making processes, firm can improve its risk management by utilizing information and solutions from multiple actors. Inputs to the risk management process in the form of knowledge and values are not held by just an individual, thus the involvement of multiple stakeholders could ensure that important information and different

types of knowledge are taken into consideration (Monteduro et al., 2021). In this way, engaging multiple stakeholders enhance the effectiveness and legitimacy of risk management by taking into consideration all relevant knowledge and values in the decision-making process (Ndlela, 2019). Thus, stakeholder involvement is essential to manage risk successfully. Islamic banks, operating in accordance with the principles of the Islamic economy, emphasize the importance of socioeconomic justice. This commitment underscores the relevance of CSR in driving societal development. These banks integrate CSR into their business models not only as a moral obligation but also as a strategic competitive advantage, thereby creating both value and purpose in their operations.

Signaling Theory

The signalling theory is useful in explaining two parties' behaviour when they have different types of information. The two parties are the sender and receiver. According to Connelly et al (2011), organisations are affected by the signals they send to and received from the society. These signals contain details on the managers' activities in realizing the owner's wealth maximization goal. The activities can be a firm's financial or social activities indicating its contribution to the community at large. Organisations that embrace CSR practices in their operations send positive signals to investors suggesting that they have strong capabilities compared to their competitors due to their initiatives and commitment to fulfil corporate social responsibilities (Long et al., 2020). Thus, it is essential for firms to embrace and maintain an institutionalised CSR framework, procedures, or personnel to demonstrate normativity, reliability, and legitimacy to external stakeholders (Marquis & Qian, 2014). Regarding risk management, Sakr and Bedeir (2019), find that the average debt ratio of an organisation sends positive signal about its risk in the short term. Similarly, Dionne and Ouederni (2011), find that cash flow transmits a positive signal for an organisation indicating low risk level for investors. Organisation that manages its cash flow more effectively has lower operation risk in maintaining its performance and sustainability.

Corporate Social Responsibility (Csr)

Financial institutions, including conventional and Islamic banks, play substantial part in meeting the needs of the community (Platonova et al., 2018). These institutions are expected to be responsive to the distinct requirements of stakeholders. Islamic banks embrace the 'moral economy' value, rooted in religious principles which emphasizes the inclusion of communal and ecological focus in their investment policies (Belal et al., 2015). Thus, most Islamic banks' operations reflect Islamic principles, which include social accountability and socio-economic justice (Maali et al., 2006).

Broadly, Islamic banks conform to universal Islamic principles, and align with various CSR agendas as codified in the UN Global Compact and even exceed the UN standards in developing human capital and promoting transparency in business transactions (Williams & Zinkin, 2010). The principles of social egalitarianism and society's welfare are predominant to the Shariah principles (Aribi & Arun, 2015). It is important to recognize that Shariah principles represent the higher ethical objectives of Islam, and Islamic banks are obligated to uphold these principles to promote social good and enhance social responsibility beyond voluntary efforts.

These principles guide Islamic banks in their commitment to ethical conduct, ensuring that their operations contribute meaningfully to the well-being of society (Mergaliyev et al., 2021). These principles are evident in the CSR practices of Islamic banks, differentiating them from conventional banks. The Islamic principles are instituted to promote justice and social responsibility as the basis of the Islamic society (Darus et al., 2014). In adhering to Islamic principles, Islamic banks are required to demonstrate the socio-economic objectives of Islam and affirm their ethical identity by integrating both economic and social responsibility goals (Haniffa & Hudaib, 2007).

The Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI) has developed CSR dimensions for Islamic financial institutions and Islamic banks covering all activities to meet their religious, economic, legal, ethical, and voluntary responsibilities as financial intermediaries (AAOIFI, 2010). Therefore, this study focuses on the CSR practices from the Islamic perspective. The differences between conventional and Islamic banks regarding CSR principles and components are shown in Table 1.

Table 1.

Differences of CSR Practices between Conventional Banks and Islamic Banks

CSR Components	Objects	Conventional Bank	Islamic Bank
Economic	Religious	Not applicable.	All operations and dealings are based on Shariah principles.
	Economic orientation:	Profit-seeking model that focuses on shareholders' expectations.	Profit and moral seeking model that focuses on broader stakeholders' interests
	Economic transactions and Products:	Interest-based deposit and lending funds.	Profit and loss sharing based deposit and lending fund and investments.
	Forbidden elements:	Not applicable.	liberated from the forbidden elements i.e. interest (<i>riba</i>), uncertainty (<i>gharar</i>), gambling (<i>maysir</i>), activities detrimental to environment.
	Asset-based contracts	All contracts deal with money and monetary papers only.	All contracts must be backed by real tangible assets.
Legal	trust-building	Comply with the business codes of conduct	Adhere to the norms and substance of Shariah principles. Every transactions and dealings should be based on mutual understanding, justice, trust, and honesty.

Ethical	Moral dimension	The moral implications and transparency are not a concern in the activities financed.	Respect all moral codes and norms in terms of the intentions, thoughts, feelings, words, deeds, and behaviors of Muslims that should be aligned with Islamic laws which are bound by the written legal codes.
Social welfare	Social justice Community	Charitable donations.	Charitable donations (<i>Sadaqah</i>) and alms (<i>Zakah</i>), benevolent loans (<i>Qardh-Hassan</i>), endowment (<i>Waqf</i>) and other social activities.

Source: Developed based on the review of the literature.

Enterprise Risk Management (ERM)

The global financial distress has highlighted the need to improve the efficiency of risk management and corporate governance practices so that banks are able to detect risk early, respond promptly, and hence adapting more effectively to crises. The Basel Committee on banking supervision has established various frameworks (Basel I, Basel II, and now Basel III) to strengthen banks' crisis management practices. Crisis management is much more complex for Islamic banks as they cannot conveniently adopt the practices of conventional banks. Nevertheless, on crisis management process, Islamic banks remain relevant to conventional banks. Kayed and Hassan (2011), underlines that the risk management processes of Islamic banks and conventional banks are similar, as both start with risk identification, mitigation, and minimize risk exposure to safeguard stakeholders. However, unlike conventional banks, Islamic banks must ensure that their framework is in accordance with the Shariah requirements and that all instruments used comply with the Shariah principles. Risk identification in Islamic banks is a two-way process: First is negative Shariah screening, which excludes *Riba*, *Gharar*, and *Maysir*-based transactions. Second is positive screening, which emphasises on justice, ethics, and accountability. However, traditional risk management practices are implemented within a business unit, without considering potential links of crisis and communal effects (Lu et al., 2022). This method of managing risks becomes less effective as risks become more complex (Fraser et al., 2008), especially when the risks impacts several departments. Therefore, considering the limitations of the silo approach and the increasing complexity of risks, enterprise risk management (ERM) has been introduced as a new risk management technique to manage a business's risk portfolio. According to COSO (2004: 3) enterprise risk management (ERM) is "a process, effected by an entity's board of directors, management and other personnel, applied in a strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives". Firms with ERM are better equipped to recognize, assess and manage risks in their portfolio. Given that financial institutions including Islamic banks are highly regulated under the Basel II regulations, they have been the early adopters of ERM. Therefore, these institutions implement ERM to manage several risks such as market, strategic, credit, financial and operational risks (Adelina et al., 2020).

Corporate Social Responsibility and Financial Performance

CSR practices by banks are regarded as a significant matter to a broad range of stakeholders (Buallay, 2020). Most studies shown a strong positive correlation between CSR and FP of the banking sector using both accounting-based and market-based measures. For example, global studies (Shen et al., 2016; Wu et al., 2017) have shown that CSR implementation is positively associated with FP. Similar findings were reported in the European context (Bussoli & Conte, 2018; Abou Fayad et al., 2017; Gangi et al., 2019). In the Islamic banks' context, despite limited research in this area, studies have found positive link between CSR practices and the FP of Islamic banks (Ashraf et al., 2017; Platonova et al., 2018). For instance, Platonova et al. (2018) offer evidence that bank CSR implementation has positive impact on the current and future FP of the GCC Islamic banks using ROE and ROA. Similarly, Jan et al (2019), highlighted the positive effect of sustainability practices on accounting-based measures of FP. However, no evidence was found on the market-based performance for Malaysian Islamic banks. Ashraf et al (2017), found positive impacts of CSR implementations on the FP of both Islamic and conventional banks in Pakistan and Bangladesh.

On the contrary, other studies have reported either a negative relationship between CSR implementations and FP (Mukhtaruddin et al., 2019; Marín-Hernández & Ortiz-Martínez, 2022) or an insignificant relationship (Halamka & Teplý, 2017; Zabawa & Kozyra, 2020). Numerous studies have reported mixed findings on the relationship between CSR practices and FP (Laguir et al., 2018; Matuszak & Rózańska, 2019). Mallin et al (2014), examined the link between CSR practices and Islamic banks' FP and found that the relationship is positive and complex depending on the dimensions of CSR and some other specific factors. Harun et al. (2020) documented a significant negative association between CSR practices and firm value of Islamic banks in the GCC region. Likewise, Rehman et al (2020), reported a significant negative relationship between the aggregate dimension of CSR practices and FP based on four Islamic banks in Pakistan. While the analysis of individual CSR dimensions found that environmental and economic responsibility have large positive impact on FP, the legal, philanthropic, and ethical dimensions were found to have insignificant effect on FP.

Despite the inconclusive finding of CSR's value relevance, there is a growing interest in the banking sector to understand how CSR practices contribute to a firm's long-term success (Landi & Rapone, 2018). In Islamic banks' context, it is expected that increased CSR practices lead to improved FP based on the belief that Islamic banks were established to promote societal well-being and contribute positively to their communities and stakeholders. Thus, the current research aims to investigate the link between CSR practices and FP of Islamic banks. It is conjectured that CSR practices positively influence the FP of Islamic banks from an accounting and market perspectives. Accordingly, the hypotheses are as follow:

P1a: *CSR practices have a positive effect on the accounting performance of Islamic banks.*

P1b: *CSR practices have a positive effect on the market performance of Islamic banks.*

Enterprise Risk Management and Financial Performance

Past studies have insufficiently addressed the impact of ERM implementation on firm performance, especially within the banking industry (Anton & Nucu, 2020). Empirical

evidence indicated that ERM has a significant effect on FP. Most studies conducted across various industries show that ERM has strong positive impact on firm performance (Zou et al., 2019; Yakob et al., 2020). Similarly, numerous studies also indicate that financial institutions with strong ERM adoption experience higher levels of FP and better cost and revenue efficiency (Bohnert et al., 2019; Altuntas et al., 2021). McShane et al. (2011) find that while firms with high ERM ratings have higher value, the positive impact on firm value diminishes for firms that have very high ERM ratings.

According to Gordon et al (2009), that the link between ERM and firm performance depends on how well the adoption of ERM aligns firm-specific factors such as firm size, complexity, environmental uncertainty, oversight of board of directors and industry competition. Glowka et al (2021), reported a significant relationship between ERM and FP of Austrian SMEs. Likewise, ERM positively affect listed companies' performance in Indonesia (Sofia & Augustine, 2019).

In this study, ERM is expected to create value for Islamic banks. Instead of analysing individual risks, ERM combines various measures to tackle all-inclusive business risk. In agency theory, ERM is used as a mechanism to safeguard against anticipated risks that may arise in the near future (Agustina & Baroroh, 2016). Therefore, firms are mandated to implement ERM to guide their operations in improving FP. Moreover, an effective ERM system signals to outside investors that a company has robust mechanism to manage risks, hence enhancing its financial standing (Berry-Stölzle & Xu, 2018; Wang et al., 2018). Furthermore, since Islamic banks have unique risks compared to conventional banks, it is crucial for Islamic banks to adopt a more comprehensive risk management framework such as ERM, to manage their risks more effectively. Accordingly, the following hypotheses have been formulated:

P2a: ERM has a positive effect on the accounting performance of Islamic banks.

P2b: ERM has a positive effect on the market performance of Islamic banks.

Erm as a Mediating Factor

Prior research on CSR practices has highlighted that the relationship between CSR implementations and financial performance of an organisation cannot be fully understood without examining the value protection component and its impact on the overall risk management (Gordon et al., 2009; Lu et al., 2022). Studies showed that higher CSR engagement levels lead to stronger creditworthiness and lower cost of equity capital (Goss & Roberts, 2011; El Ghoul et al., 2011). Researchers suggested that CSR performance demonstrates how companies handle environmental and social risks alongside financial risks, thereby providing a holistic view of ERM and its effectiveness (Hummel et al., 2021; Liu, 2019). Consequently, ERM effectiveness contributes to enhancing firm's performance. Prior studies of this literature strand indicate that firm's ERM contributes positively to FP. For instance, Malik et al (2020), proved through an empirical study that firm's ERM effectiveness significantly enhances FP. Similarly, some other studies also suggested that ERM lead to superior performance, hence highlighting ERM's crucial role in determining the FP of firm (Zou et al., 2019; Yakob et al., 2020). That said, this suggests that ERM can potentially mediate the link between CSR and FP. However, such relationship has not been sufficiently examined in

the literature as prior studies focused more on the moderating role of ERM (Chairani & Siregar, 2021; Wirawan et al., 2020). Shatnawi et al (2019), suggested that ERM moderates the effect of board characteristics on listed companies' FP in Malaysia. They also concluded that research on ERM as an intervening variable is limited. Regarding the mediating effect of ERM, Naseem et al (2020), examined the mediating role of ERM in the relationship between CSR practices and FP of Asia Pacific non-financial companies. The findings indicated that ERM partly mediates the relationship between CSR practices and FP. As the CSR-ERM link can be contextual, additional research is needed to examine the mediating role of ERM in different contexts such as within the realm of Islamic banks. Hence, investigating the moderating role of ERM in the CSR-FP nexus of Islamic banks would provide valuable insights for both academics and industry. Islamic banks need to understand how CSR practices influence ERM implementation to impact financial performance positively. That said, this study conjectures that ERM mediates the influence of CSR practices on Islamic banks' FP.

P3a: ERM positively mediates the effect of CSR on the accounting performance of Islamic banks.

P3b: ERM positively mediates the effect of CSR on the market performance of Islamic banks.

Proposed Conceptual Framework

Drawing on the above discussions, the conceptual framework of this study is shown in Figure 1. This proposed model aims to provide understanding of the impact of CSR practices on the financial performance of Islamic banks and the mediating role of ERM in the relationship. The proposed study also includes bank size, age, the board size, Shariah supervisory board (SSB), and Risk Management Committee (RMC) as control variables. The control variables were selected based on the findings of previous studies.

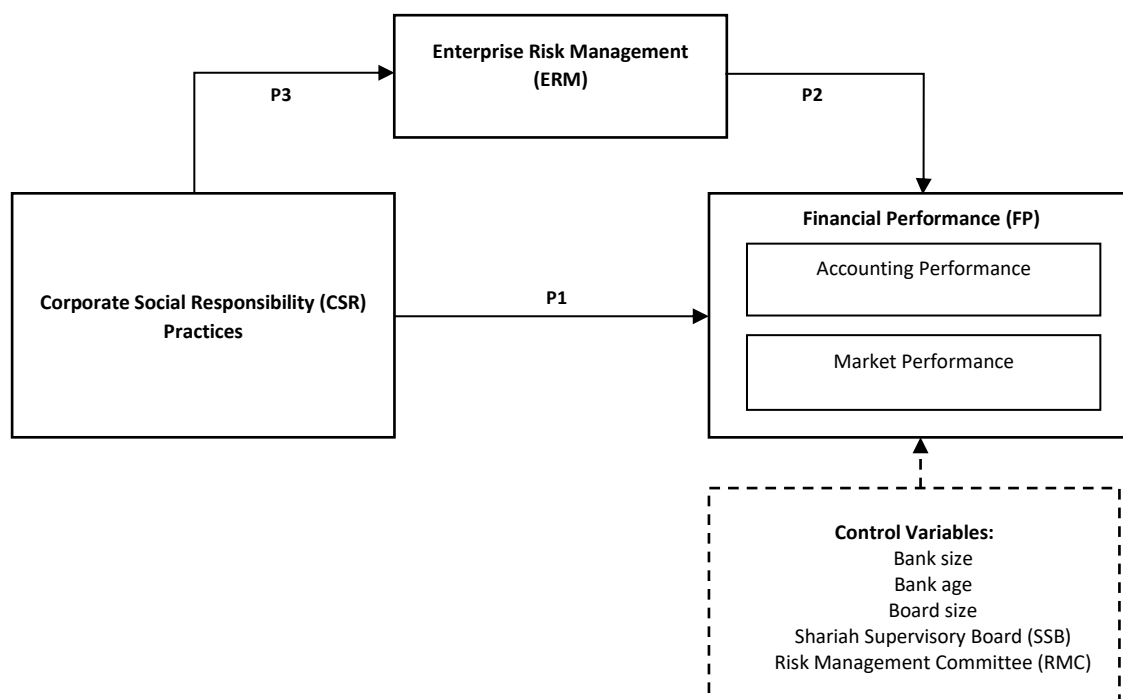


FIGURE 1. Conceptual Framework

Proposed Methods and Empirical Challenges

To empirically examine the relationships in the research model, this study needs to determine the population and sampling procedures along with the measurement of the variables and data analysis. The target population of this research is all Islamic banks operating in the GCC region. The data will be gathered from five countries in the GCC region comprising the Kingdom of Saudi Arabia (KSA), United Arab Emirates (UAE), Bahrain, Qatar and Kuwait. Data on CSR practices and ERM will be collected through content analysis of the annual reports of Islamic banks employing similar measurements from previous studies. The financial performance variables will be obtained from DataStream. The proposed sample period is from 2011-2020 for two reasons. Firstly, the year 2011 was chosen because the profitability of Islamic banking industry in the region declined sharply due to adverse economic conditions following the global financial crisis of 2008, resulting in sharp decline in the financial performance of banks. Second, many reforms and rules on corporate governance were implemented after the global financial crisis. Therefore, the selected sample period would provide insight into how changes of CSR and ERM practices of these banks respond to the regulatory and governance changes. Regarding variables measurements, this research proposes to examine CSR practices of GCC's Islamic banks using the Islamic CSR index. This index reflects the Islamic principles and follows the AAOIFI standard No.7 of CSR conduct and has been employed in prior studies (Haniffa & Hudaib, 2007; Ali Aribi & Arun, 2015; Platonova et al., 2018). To assess the quality level of risk management, this study uses the index developed by (Florio and Leoni., 2017). The authors calculated the index using a two-step approach. They used six binary variables to represent the ERM components. After scoring the variable individually, the outcome was attached to produce the ERM result. The financial performance will be measured using both accounting and market performance indicators. This study employs STATA version 16.0 to examine the direct and indirect effect relationships incorporating the mediating factor. Baron and Kenny's (1986), approach will be employed to investigate the relationships between variables.

Discussion

Using stakeholder and signalling theories, this research proposes a direct link between CSR and FP of Islamic banks. Furthermore, the study proposes that ERM to be the mediating variable in the relationship between CSR-FP. Hence, this research develops a conceptual framework explaining how the financial performance of Islamic banks can be improved with CSR practices through ERM. As noted in the literature review, past findings on the CSR-financial performance relationship are mixed. Nevertheless, research on moderating and mediating effects within the CSR-FP nexus in the context of banking institutions is limited. Specifically, it remains unclear how CSR practices promotes ERM efficiency and how these effects improve the financial performance of Islamic banks. In the context of Islamic banks, research on CSR-FP nexus is still lacking and numerous studies have highlighted the need for effective ERM practices of Islamic banks. In response, this study aims to examine the mediating effects of ERM on the CSR-FP relationship of Islamic banks. In fact, such research is limited to developing countries and within the Islamic context. Hence, the current study aims to fill the gap by focussing on Islamic banks in the GCC region.

Implications

The theoretical and practical implications are discussed in this section.

Theoretical Implications

Previous research has extensively investigated the direct relationship between CSR and FP, yielding mixed findings. Yet to date, only limited studies have explored the influence of firm's internal mechanism such as ERM in investigating the relationship between CSR and financial performance, specifically employing ERM as a mediator in explaining the CSR-FP nexus of Islamic banks. While researchers have found that CSR practices affect various business performance outcomes, little attempt has been made to link CSR practices to value creation from risk management perspective. Therefore, this research contributes to the existing CSR literature by investigating the CSR-ERM link and by exploring how ERM mediates the CSR effects on the financial performance of Islamic banks, which is less studied, hence potentially providing new insights into the underexamined aspect of CSR impacts. (e.g., Naseem et al., 2020; Lu et al., 2022). Furthermore, this research discusses on how Islamic banks can improve their financial performance by focusing on CSR practices and ERM implementation. This conceptual article expands the CSR literature related to Islamic banks by providing new insights that effective internal mechanism such as ERM plays important role to improve and enhance the financial performance of Islamic banks. This study brings together the religious perspective (Islamic perspective) philosophy and cultural management in exploring the ERM impact in the CSR-FP nexus of Islamic banks in the GCC region, an area which has not been previously examined. According to Freeman's (1984), theory of stakeholder, CSR activities are expected to influence financial performance when firms address stakeholders' concerns through risk management practices. This, consequently reduces the variability of business returns, suggesting effective risk management which, in turn, improve financial performance. Therefore, this study brings together research on CSR, ERM, and FP underpinned by stakeholder theory and signalling theory to explain the intervening process that influence the CSR-FP relationship.

Implications for Practice

The findings of the study would be insightful to policymakers, managers and stakeholders of Islamic banks. The expected findings may assist policymakers and regulators in designing targeted policies and programs to improve CSR framework and risk management practices in enhancing FP and maintaining incentives for Islamic banks to boost CSR actions further. The study highlights that CSR is associated with low risk and volatility, leading to improved capital efficiency, enhanced reporting quality and reduced compliance risk related rules and regulations. These improvements contribute to promoting the growth and sustainability of Islamic banks in the GCC regions and other developing countries with similar socio-economic conditions. In addition, the expected findings are useful to the managers of Islamic banks in understanding how CSR practices improve financial reporting through the recognition and supervision of not only the negative risks such as threats, but also the positive risks in the form of business opportunities (Callahan & Soileau, 2017). Thus, effective integration of ERM into corporate strategy helps to promote business sustainability. Similarly, understanding that CSR is a strategic tool to enhance ERM and firm's financial performance, managers would be able to make well-informed decisions. Furthermore, the stakeholders of Islamic banks are

increasingly interested in CSR practices and their impact on business performance. Investors and creditors may view banks that actively engage in CSR activities as more transparent and trustworthy, and having a lower risk profile and more robust ERM system, which could guide them in making well-informed investment and lending decisions, leading to enhanced bank performance.

Conclusion

The current research proposed a unique conceptual framework that aims to establish proposition regarding the link between CSR and FP along with the mediating role of ERM within the context of GCC Islamic banks. Thus, the research has yet to empirically investigate the associations between the variables. As a way forward, this paper plans to investigate empirically the proposed research model for Islamic banks in the GCC region. The link between CSR and ERM is a promising researchable area. Future research could empirically test the proposed relationships suggested in this paper in different regions and countries. Additionally, future studies could investigate other possible factors or moderating variables such as roles of audit committee, risk committee, and other corporate governance factors in explaining the impact of CSR on ERM and FP. This could provide a deeper understanding of the relationships. Finally, future studies could compare the proposed framework of this paper in developed and emerging economies and also between traditional and Islamic banks to examine how the CSR-ERM link impacts financial performance across different institutional contexts hinders or enhances financial performance.

Theoretical and Contextual Contribution

The topic of CSR has become increasingly popular among academics and practitioners alike, who view it as a value creation strategy for developing long-term relationships with stakeholders and for promoting business sustainability. Companies engage in CSR practices to manage their risk holistically by mitigating exposures to environmental and social risks alongside financial risks, thereby increasing their sustainable value. However, research on CSR as a strategy for holistic risk management has not been fully explored, particularly within the context of Islamic banking sector. Hence, through the lens of stakeholder theory and signalling theory, the present study contributes to the literature by shedding light on the relationship between CSR practices and ERM of Islamic banks in the GCC region. The study conceptualizes the theoretical implications of ERM's mediating role in the relationship between CSR practices and financial performance which is consistent with empirical evidence that integrating CSR with ERM enhances the financial performance of Islamic banks.

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