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The effect of CSR on the financial performance of Islamic banks in the Middle East: The moderating role of ownership concentration and type

Ahmad Abed Alhaleem Ahmad Alarabeyyat[1*], Mohd Rizuan Abdul Kadir[2], Khairul Anuar Kamarudin[3], Raedah Bte. Sapingi[4], Ahmad Al-Dalaien[5]
[1,2,3]College of Graduate Studies, National Energy University, Malaysia; ahmmadarabiiat1@gmail.com (A.A.A.A.A.) Mrizuan@uniten.edu.my (M.R.A.K.) KhairulKamarudin@uowdubai.ac.ae (K.A.K.)
[4]Faculty of Business, University of Wollongong in Dubai, United Arab Emirates; Raedah@uniten.edu.my (R.B.S.).
[5]Faculty of Science and Information, Jerash University, Jerash, Jordan; a.aldalaien@jpu.edu.jo (A.A.D.).

Abstract: Corporate Social Responsibility (CSR) practices are widely practiced in banks globally. It is deemed more crucial for Islamic banks (IBs) since their establishment is related to the Shariah principle and social justice. However, the approach to implementing CSR differs as they have integrated CSR through Shariah compliance and ethical mandates compared to conventional banks that adopt formalized strategies embedded in their corporate structure. The study is designed to explore the effect of CSR on the IB's performance and the moderating effect of ownership concentration on this relationship in the Middle East. Using samples of Islamic banks in nine countries from 2012 to 2012, a total of 58 IBs were selected. The findings showed that CSR positively affected the ROE and Tobin's Q but not the ROA. In addition, ownership concentration has a higher effect on the ROA of less concentrated banks, while the effect of CSR on ROE and Tobin's Q is higher in concentrated banks. This relationship between CSR and ROE and Tobin's Q is stronger in public banks compared with private banks. This finding suggests that the Middle East IBs should boost CSR implementation through more formalized guidelines since it could enhance their region's market reputation and financial health. However, more studies are still needed to explore the other determinants of a bank's performance.
Keywords: *CSR, Islamic Banks, Ownership concentration, ROA, ROE, Tobin's Q.*

1. Introduction

The studies examining how Corporate Social Responsibility (CSR) affects financial performance (FP) are complex and multifaceted. The mixed results show the complexity of this relationship [1-4]. The Islamic Bank (IB)'s principles that naturally incorporated the CRS into their business model through the adherence to Islamic Shariah have complicated this connection. Islamic bank principles are central to social justice, ethical investment, and interest prohibition, and Middle Eastern countries are major IB centres. Thus, examining the relationship between CSR and FP is critical for IBs in this region. Islamic banks face CSR differently than conventional banks due to elements already embedded in the Shariah principle. IBs must perform ethically to benefit society, harmonising with socio-economic goals. IBs may profit financially from the ethical principles that have been embedded in their business model [5].

In normal business organisations, CSR is used to enhance their image by sharing information about their social actions that benefit all stakeholders [6]. CSR helps companies manage risks, increase brand value, transparency, and FP [7]. CSR includes a company's social, ethical, and stakeholder initiatives [8]. However, the IB research on the implementation of SRC is rather limited as compared to the

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* Correspondence: ahmmadarabiiat1@gmail.com

conventional [9]. Especially for the Muslim countries, they have made little progress in CSR practices, emphasising the need for further study in this area [10, 11].

On the other hand, CSR and FP in Western countries have been the focus of most studies [12, 13]. There are various studies on how CSR affects bank FP where the result shows a two-way relationship [14]. Conflicting results exist on the influence of CSR on company market value [1] and banks' FP [2]. Further, CSR practices affected investment deposits but not metrics like ROE, ROA, ROI, net profit, EPS, and P/E ratio [3]. Banks' CSR efforts negatively impact their finances [4]. Nevertheless, research also found that CSR improves bank FP [15] and this effect is dependent on region, ownership, firm size, and disclosure policies [16].

The relationship between CSR and the FP of Islamic banks is inconsistent and can be significantly affected by factors such as ownership concentration and type [17]. Ownership concentration refers to the extent of shareholding by major shareholders, which can impact corporate governance and strategic decision-making [18]. Greater ownership concentration has the potential to enhance oversight and align management with shareholder interests, thereby potentially improving the financial returns from CSR activities [19]. However, when there are numerous owners involved, it can lead to a lack of accountability and impede the successful execution of CSR [20].

Furthermore, the ownership type, whether it is state-owned, privately owned, or foreign-owned, can also exert a substantial influence [21]. Private and foreign-owned banks promote profitability and shareholder gain, whereas state-owned banks prioritise national development and social welfare. Ownership arrangements greatly impact CSR and financial success. This research adds to the field by examining how ownership concentration and type affect Islamic bank FP and CSR. This study offers worldwide perspectives while considering the Middle East, where Islamic banking is influential. Understanding the link between CSR and financial success might help decision-makers enhance Islamic bank performance. This article covers a literature review, methodology, results, discussion, implications, and conclusion.

2. Literature Review

2.1. Financial Performance of Islamic Banks

Islamic banks are Shariah-compliant institutions. Shariah emphasises justice, equality, and fairness in financial transactions. In Islamic transactions, interest (*riba*) and unethical transactions are forbidden. Islamic banks conduct contracts and transactions differently than non-Islamic banks. Avoiding *riba* and supporting ethical businesses are essential. Islamic banks finance via equity, whereas traditional banks use debt [22]. Equity finance, like profit and loss sharing and markup, underpin Islamic banks' financial operations. Generally, the FP studies measured in commercial banks use accounting-based indicators such as ROA and ROE. This study adds to the literature by including Tobin's Q, a market-based indicator for measuring FP. These measurements (ROA, ROE, and Tobin's Q) are widely used in previous studies to evaluate performance [23].

2.2. Theoretical Framework

Studying Middle Eastern IBs requires a good theoretical foundation to grasp the relationship between CSR and FP. This study uses legitimacy theory and stakeholder theory to examine this link. Legitimacy requires companies to obey societal norms, values, and beliefs [13]. They communicate financial and non-financial information to maintain this alignment, which is vital to their survival [24]. Shariah-compliant IB that promotes ethics, social justice, and economic equality follow legitimacy theory. Islamic banks employ CSR to maintain trust, particularly in Islamic-valued areas. These banks exhibit ethical, social, and environmental responsibility via CSR. Increasing stakeholder trust and credibility enhances legitimacy and profits.

Islamic bank annual reports typically discuss CSR practices such as community development, environmental sustainability, and business ethics. Disclosures strengthen public perception and recruit ethical bankers, strengthening the market base and increasing financial profitability. Following Islamic and cultural values decreases the risks of being rejected by communities and gains regulatory and public support for this adherence [25, 26]. Legitimacy theory was deployed to demonstrate CSR increases FP [16]. CSR actions that match political and social expectations may increase firm legitimacy and financial success in underdeveloped countries [27].

The stakeholder theory [28] emphasises managing relationships with all workers and stakeholders. This idea helps customers, workers, suppliers, shareholders, and the community. IBs in Muslim-majority countries with high cultural norms must actively participate in CSR to address different stakeholder demands. Based on the stakeholder theory, IBs may improve reputation, loyalty, and financial success by considering all stakeholders [29]. Islamic bank stakeholders include customers, investors, the community, the economy, and the environment. CSR activities, including ethical financing, community development, and environmental sustainability, can help Islamic banks build stakeholder trust. This comprehensive stakeholder management method can enhance financial success by increasing customer loyalty, employee satisfaction, and community support.

Therefore, bank performance increases with CSR, and several stakeholder studies using stakeholder theory have addressed this relationship. The explanation of how CSR affects financial organisations [30] and how stakeholder-focused CSR increased ROE, ROA, and EPS [4] confirmed that these initiatives improved FP by connecting stakeholders. Management decisions are more credible and effective with stakeholder input [31]. This research uses stakeholder and legitimacy theories to understand CSR's impact on FP. These theories explain how CSR influences Middle Eastern Islamic banks' FP.

2.3. CSR and Financial Performance

CSR disclosure in corporate reporting informs internal and external decision-makers about socially responsible operations. Previous studied [32] include social involvement, consumer interactions, environmental issues, and HR statistics as CSR disclosure. CSR disclosure has transformed accounting and business reporting practices. Banks are incorporating CSR for beyond-profit [33] in line with the stakeholders valuation ethics, sustainability, and social responsibility [34]. Banks realised the CSR disclosure's role in meeting stakeholder expectations and societal obligations [35]. By sharing CSR initiatives with more stakeholders, companies boost operational transparency beyond financial disclosures [35].

The communication through CSR that successfully expresses the firm's values, long-term goals, and operational hazards has been identified as a factor that boosts a company's share price [36]. Investors consider social and ethical norms when making long-term investments, which are part of CSR [6]. CSR disclosure also boosts reputation and corporate image, giving companies an advantage. Investors often use CSR data to value a firm [37]. However, some studies claim that CSR initiatives are driven by profit or public image rather than community welfare. Thus, CSR might affect FP differently. CSR of Indonesian banks [38] Egyptian firms [30] and Malaysian takaful companies improved the profitability. However, a negative association between CSR and FP was found in Turkish financial organisations [4]. A study also observed no effect of CSR on FP [16]. This study expects CSR to improve Middle Eastern Islamic banks' FP. Therefore, the following is proposed:

H_1: CSR has a significant positive effect on the FP of IB in the Middle East.

2.4. Ownership as Moderator

Ownership concentration and type greatly affect a company's performance [39, 40]. Studies suggest that institutionally owned companies perform better. Disclosure influences performance based on ownership size, which affects management actions [41]. It also affects the company's efficiency and crisis performance [40]. In particular, national banks outperformed international banks. A previous study explored how ownership type affects risk-taking and found that institutional ownership affects risk-taking [42]. The low ownership concentration potentially reduces the risk [43]. Ownership concentration also plays a significant role in moderating the impact of activity limitations and performance [44]. However, Agyei-Mensah [45] found no effect of ownership concentration or type on performance.

There was a study that examined Islamic and conventional banks in 21 MENA countries from 2006 to 2013 using 268 bank data [46]. The research found that bank type affects stability and profitability. Islamic banks were more profitable than commercial banks, but commercial banks were more stable. However, the literature revealed limited studies on the moderating role of ownership. As there is high ownership concentration in the Middle East, further research on its moderating impacts is suggested [47]. A study in Jordanian ownership concentration found it affects the relationship between BOD, AC, and FP. This research suggests that concentration and ownership type, such as public vs. private, can affect the relationship between CSR and FP in Middle Eastern IB. Accordingly, the following is hypothesised:

H_2: Ownership concentration and type moderate the relationship between CSR and FP of IB.

2.5. Specifically

H_{2a}: Banks with ownership concentration will exhibit a stronger positive relationship between CSR and FP.

H_{2b}: Banks with ownership type will exhibit a stronger positive relationship between CSR and FP.

3. Research Framework

Based on legitimacy and stakeholder theories, this study proposed that the effect of CSR measured using an index on the FP of IB is positive. This study includes nine MENA countries. Control variables were selected at the macro level, including gross domestic product (GDP) and inflation and micro levels, such as terms of size, age, and leverage level. Accordingly, these three micro or bank-level variables are controlled in this study. The study also proposed that ownership concentration and ownership type (private vs. public) are moderating variables between CSR and FP. Figure 1 shows the conceptual framework of this study.

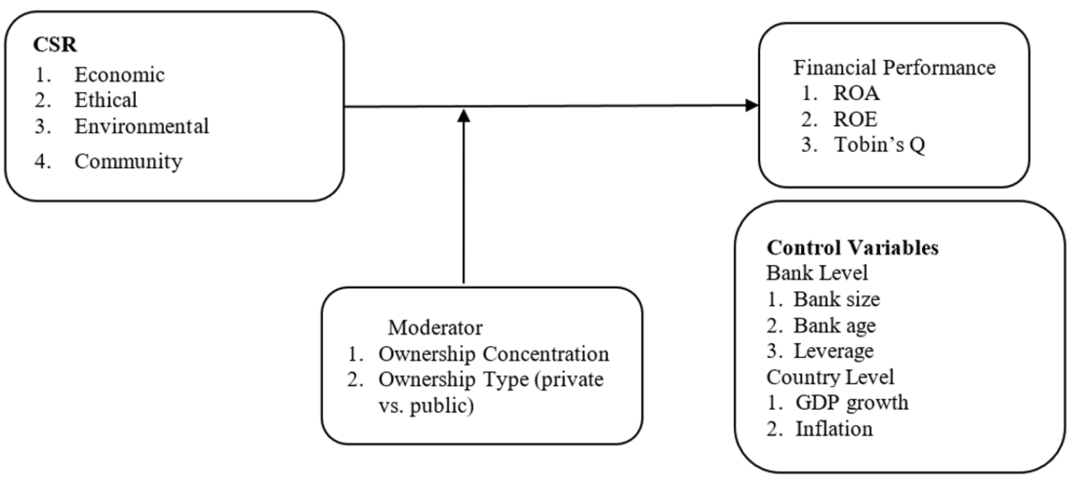

Figure 1.
Conceptual framework.

4. Methodology

This research analyses how CSR affects Middle Eastern banks' FP. Saudi Arabia, Kuwait, Bahrain, Qatar, UAE, Oman, Iraq, Jordan, and Turkey are the populations of the research. The existence of several IBs in various countries explains their considerable engagement in Islamic banking. The 2008-2009 financial crisis raised Middle Eastern corporate governance concerns. This emphasis escalated during the 2011 Arab Spring, causing political instability and major economic and social impacts.

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Islamic or Shariah-compliant banks have become popular due to economic and political difficulties. Therefore, this study focuses on the period between 2012-2022. All IBs in these countries are selected to ensure the study's credibility. A minimum active period since 2012 and financial and governance data were required. A homogeneous and broad dataset allows for a thorough analysis of trends and patterns across the ten years. Following these criteria, 58 Islamic banks satisfied inclusion requirements. Therefore, the data was collected from 58 banks in the selected countries.

4.1. Measurement and Data Collection

This study includes dependent variables, independent variables as well as moderating variables and control variables.

4.2. Dependent Variable (DV)

Financial indicators like the Return on Assets (ROA) formula, ROE, and Tobin's Q measure FP. Researchers have used these measures [39, 40, 48-51]. Table 1 shows the details of the measurement.

4.3. Independent Variable (IV)

CSR is measured using an index of four components: economic, ethical, environmental, and community. These measures were adopted from Stobierski [52]; Al Mubarak, et al. [53] and Jo and Harjoto [54]. Table 1 shows the details of the measurement.

4.4. Moderating Variable

Ownership concentration is when some of shareholders owns more than 5% of shares. One (1) is ownership concentration, zero otherwise.

Ownership type: 0-1 indicates private vs. public ownership. Public ownership gets one (1) and private ownership 0. Table 1 shows the details of the measurement.

4.5. Control Variables

Bank Size: Measured by total assets or total deposits [55].

Bank Age: Number of years since the bank's establishment [56, 57].

Leverage Ratio: Total debt divided by total assets [58].

Economic Conditions: Macroeconomic indicators *like GDP growth rate (natural log of GDP)* [59] *inflation rate (consumer price index)* [59].

Table 1 Shows the detailed measurement of the variables.

Table 1.
Measurement of the variables.

Variable	Measurement	Source	Source of data
Tobin's Q	(Market capitalisation + Total assets - shareholders' funds)/Total assets	Anwar and Murwaningsar [39]; Husna and Satria [40]; Heikal, et al. [48]; Talamati and Pangemanan [49]; [50] and Hayes [51].	Annual report
ROE	Profit after Tax/Shareholders' Funds"	Anwar and Murwaningsar [39]; Husna and Satria [40]; Heikal, et al. [48]; Talamati and Pangemanan [49]; [50] and Hayes [51].	Annual report
ROA	Profit after Tax/Total Assets"	Anwar and Murwaningsar [39]; Husna and Satria [40]; Heikal, et al. [48]; Talamati and Pangemanan [49]; [50] and Hayes [51].	Annual report
CSR	Measured using an index of four components: economic, ethical, environmental, and community	Stobierski [52]; Al Mubarak, et al. [53] and Jo and Harjoto [54].	Annual report
Ownership concentration	A value of 1 is given if there is few owns more than 5% of the shares and zero otherwise.	Anwar and Murwaningsar [39]; Husna and Satria [40]; Heikal, et al. [48]; Talamati and Pangemanan [49]; [50] and Hayes [51].	Annual report
Ownership type	Dummy variable where 1 indicates public ownership and zero otherwise	Anwar and Murwaningsar [39]; Husna and Satria [40]; Heikal, et al. [48]; Talamati and Pangemanan [49]; [50] and Hayes [51].	Annual report
GDP	Natural logarithm of real GDP in USD.	Bley, et al. [59]	World development indicator
Inflation rate	Percentage inflation rate averaged for the period of study	Bley, et al. [59]	World development indicator
Bank size	Book value of total assets	Ayadi and BoujÁ? lbÁ? ne [55]	Annual report
Bank age	Number of years since the establishment	Talpur, et al. [56] and Buallay and Al-Ajmi [57].	Annual reports
Leverage	The ratio of a bank's net income to revenue	Goktan, et al. [58]	Annual report

5. Data Analysis

This study utilises a dataset of 638 observations that delves the analysis into descriptive statistics, correlation matrices and regression models. It is designed to uncover underlying patterns and relationships. The following discusses the findings from the analysis conducted.

5.1. Descriptive Statistics

The descriptive information of the variables is shown in Table 2. The CSR score accounts for 0.45, indicating that, on average, there are 45 out of 100, with a range between 0.21 and 0.65 of CSR disclosures among the IB in the Middle East. The mean of ROA (1.97) and ROE (10.49) with high Std of 1.96 and 6.69 indicate that the variation is high among the sampled companies. The standard deviation is less than 1.96, indicating low variation among the sampled companies. Tobin's Q ranged between 0.56 and 1.6, with a mean of 1.14, indicating that these banks have a market value higher than the book value. The GDP ranged between 30 billion and 833 billion. Inflation ranged between -2.54 and 19.59, with a mean of 2.90 and high std, indicating variation in the sampled countries.

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The bank size ranged between $290,000,000 to $80.80 billion, with a mean of $1.27 billion and large std, indicating extremely high variation among the sampled banks. Bank age also ranged between 4 and 95 years, with a mean of 28.96 years and a high std of 24.02. The leverage also ranged between 0.041 and 0.74, with a mean of 0.31. Ownership concentration is high among all sampled banks, with a range of 0 to 1 and a mean of 0.80, indicating a high level of ownership concentration. Lastly, the ownership type ranged between 0 to 1 with a mean of 0.39 and small std.

Table 2.
Descriptive information of variables.

Variable	Obs.	Mean	Std. dev.	Min.	Max.
CSR	638	0.45	1.19	0.21	0.65
ROA	638	1.97	1.96	-0.19	10
ROE	638	10.49	6.69	-1.43	31
Tobin's Q (TQ)	638	1.14	0.15	0.56	1.6
GDP	638	107 billion	2.26 billion	30 billion	833 billion
Inflation (IN)	638	2.90	3.55	-2.54	19.59
Bank size (BS)	638	1.27 billion	4.12 billion	290000000	80.80 billion
Bank age (BA)	638	28.96	24.02	4	95
Leverage (L)	638	0.31	0.13	0.041	0.74
Ownership Concentration (OC)	638	0.80	0.39	0	1
Ownership Type (OT)	638	0.39	0.48	0	1

5.2. Correlation Analysis

The correlation matrix offers valuable insights into the linear associations among crucial economic and financial indicators. Significant relationships can be seen between CSR and many financial indicators. Specifically, CSR shows a weak positive relationship with ROA, ROE, TQ, GDP, bank size (BS), and IN. The variables leverage (L) and Bank Age (BA) have positive correlations with several parameters, indicating that both leverage and maturity may have a beneficial relationship with economic indicators.

The connection between ROA and ROE is positive with CSR, ROE, and Leverage (L), but negative with GDP, IN, and OC. OC and ROA have a negative correlation, suggesting a possible unfavourable association. TQ positively correlates with CSR, ROE, IN, BS, and BA, suggesting the probable relationship between financial success and these variables. The GDP has negative correlations with IN and positive correlations with other variables. The highest correlation is between bank size and inflation, with a value of 0.31, followed by the correlation between BA and IN. This low correlation implies that there are no multicollinearity issues among the variables of this study.

Table 3.
Correlation among the variables.

	CSR	ROA	ROE	TQ	GDP	IN	BZ	BA	L	OC	OT
CSR	1										
ROA	0.09	1									
ROE	0.13	0.24	1								
TQ	0.14	0.09	0.07	1							
GDP	0.11	0.14	0.11	0.04	1						
IN	0.09	-0.08	0.13	0.20	-0.16	1					
BS	0.11	0.08	0.11	0.09	0.31	0.06	1				
BA	0.06	0.19	0.13	0.11	0.07	0.29	0.09	1			
L	0.03	0.11	0.04	0.10	0.10	0.11	0.07	0.05	1		
OC	0.05	0.13	0.03	0.09	0.21	0.12	0.11	0.31	0.11	1	
OT	0.07	0.14	0.04	0.13	0.11	0.21	0.08	0.26	0.07	0.22	1

5.3. Regression Analysis

Two equations were developed to examine the hypotheses of this study. The following formulas were developed to test the direct effect of the CSR index on the FP (ROA, ROE, TQ).

The regression model for H1:

$FP_i = \beta_0 + \beta_1(CSR_i) + \beta_2 (ControlVariables_i)+\epsilon_i$

Table 4 shows the results of testing the first hypothesis. The dependent variable is three indicators of FP. For the first hypothesis, CSR has a statistically insignificant effect on ROA at a significance level greater than 1%. However, CSR positively impacts ROE and Tobin's Q. Therefore, CSR's effect on FP is accepted for ROE and Tobin's Q, while it is rejected for ROA.

GDP positively influences ROA, ROE, and TQ, demonstrating a significant relationship between GDP growth and FP. Inflation is statistically significant at 1%, with only TQ but no impact on ROE and ROA. Bank age positively impacts ROA and TQ but not ROE. Leverage affected ROE, ROA, and TQ, emphasising its key role in explaining FP. Table 4 shows the results of testing the hypotheses.

Table 4.
Effect of CSR on FP.

Variable	ROA	ROE	TOBIN'S Q
CSR	0.08	0.13**	0.39***
GDP	0.49***	0.43***	0.27***
Inflation	-0.06	0.04	0.19***
Bank size	-0.03	-0.04	0.03
Bank age	0.49***	-0.08	0.15**
Leverage	0.11**	0.06*	0.12**
_cons	0.39**	0.41***	0.32***
R-square	0.39	0.34	0.31

The regression model for H2 is given as follows:

$FP_i = \beta_0 + \beta_1(CSR_i) + \beta_2(OwnershipConcentration_i) + \beta_3(PubliclyTraded_i) + \beta_4(CSR_i \times OwnershipConcentration_i) + \beta_5(CSR \times PubliclyTraded_i) + \beta_6(ControlVariables_i) + \epsilon_i$

The moderating was tested using the interaction effect in which the publicly traded banks are assigned 1 and zero for private banks. The result of testing OC and OT as moderators is shown in Table 5. It shows the effect of OC and OT and their moderating effect on CSR.

Table 5.
OC and OT as moderators.

Variables	ROA		ROE		Tobin's Q	
CSR	0.07	0.05	0.11**	0.12**	0.39***	0.41***
OC	0.08		0.13**		0.13**	
OC*CSR	0.03		0.09*		0.13**	
OT		0.7		0.15**		0.13**
OT*CSR		0.04		0.13***		0.14**
GDP	0.35**	0.21**	0.33**	0.199**	0.31**	0.28**
Inflation	-0.04	0.06	0-.04	-0.04	0.15**	0.17**
Bank size	-0.01	0.03	-0.05	-0.04	0.05	0.08*
Bank age	0.39***	0.40***	0.08	0.07	0.16**	0.14**
Leverage	0.12**	0.07*	0.07*	0.08*	0.13**	0.14**
_cons	0.33***	0.34***	0.29**	0.25**	0.30***	0.31***

Note: *,**, *** indicates significance at the 10%, 5%, 1%, levels.

The marginal effect of ownership concentration between CSR and ROA is insignificant, indicating no evidence that concentrated banks outperform those with less concentration. In addition, the ownership concentration positively moderated the effect of CSR on ROE and Tobin's Q indicates that banks with concentrated ownership gain greater benefits gain greater benefits from CSR activities regarding profitability and market valuation. For the bank types, the effect of CSR on ROA is more pronounced in private than publicly traded banks, suggesting that private ownership may better leverage CSR to improve asset efficiency. On the other hand, the effect of CSR on enhancing ROE and Tobin's Q is stronger in publicly traded banks than in private banks. This suggests that the public ownership may enhance the positive effects of CSR activities on profitability and market valuation.

6. Discussion and Implications

CSR has a demonstrably beneficial effect on FP, as evidenced by key metrics such as ROE and Tobin's Q. This indicates that CSR activities in IBs are crucial. IBs are responsible for assisting society and following ethical standards. CSR activities and reporting boost the company's ethical and socially responsible image. As a result, it will boost stakeholder confidence and enhance financial performance. The favourable relationship between CSR and FP might also be due to ethical alignment, managerial expertise and dedication, and effective internal controls. The positive result of CSR activities is a multifaceted societal responsibility for INS to perform beyond profitability and Shariah adherence. CSR efforts increase shareholder interest and the bank's ethical reputation, enhancing FP.

Ownership concentration significantly moderates the relationship between CSR on Tobin's Q and ROE but not ROA. Complex linkages exist between ownership concentration and CSR's FP impact. The ownership concentration coefficients for ROE and Tobin's Q indicate that the positive relationship between CSR and these financial performance indicators strengthens as ownership concentration increases. Thus, with high ownership concentration, CSR initiatives are particularly effective at enhancing ROE and Tobin's Q. However, the insignificant relationships between OC and ROA might suggest that the level of ownership concentration does not affect how CSR impacts the efficiency of IB assets. Furthermore, ownership type (OT) influences the value of CSR activities as publicly held banks see enhanced benefits of CSR in ROE and Tobin's Q. However, the experience of privately owned banks benefited more in ROA. In brief, the ownership concentration significantly shaped the relationship between CSR and financial performance. This insight is important to tailor ownership-specific decision-making and management strategies within the IBs.

These findings underscore the necessity of understanding how ownership concentration and type impact CSR and FP in the Islamic banking sector. IBs must consider their ownership concentration carefully when designing and implementing CSR policies to enhance social and financial outcomes. Understanding how ownership concentration impacts CSR and financial measures may help management design the right CSR activities to improve performance. This strategic alignment between ownership characteristics and CSR policies may maximise both social and financial benefits for IBs.

Transparency:

The authors confirm that the manuscript is an honest, accurate, and transparent account of the study; that no vital features of the study have been omitted; and that any discrepancies from the study as planned have been explained. This study followed all ethical practices during writing.

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