



Exploring the Nexus Between CSR, Governance, and Financial Performance in Islamic Firms: Review of Their Financial Implications

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ABSTRACT

The relationship between Corporate Social Responsibility (CSR), Good Corporate Governance (GCG), and financial performance in Islamic firms has been widely studied. While CSR and GCG enhance transparency, risk mitigation, and investor confidence, their direct impact on profitability remains debated. This systematic literature review (SLR) analyzes 32 empirical studies on CSR and GCG in Islamic banking and financial institutions. Findings show that strong governance, ethical business practices, and strategic CSR initiatives support long-term financial resilience, particularly in well-regulated Islamic banks. However, challenges like reporting inconsistencies, regulatory disparities, and compliance costs create performance variations across jurisdictions. The study emphasizes the need for standardized Islamic Social Reporting (ISR) frameworks and regulatory harmonization across Islamic financial markets to improve comparability. Future research should develop integrated models that balance financial sustainability with Shariah compliance, ensuring optimized governance without compromising profitability.

INTRODUCTION

The relationship between Corporate Social Responsibility (CSR), corporate governance, and financial performance in Islamic firms has emerged as a critical area of research, reflecting the distinctive characteristics of Islamic finance. Islamic firms operate within an ethical and legal framework dictated by Shariah law, which not only influences their governance structures and financial practices but also dictates their social and ethical responsibilities. Islamic firms must balance profitability with social justice, transparency, and ethical considerations, creating a unique governance model that integrates Shariah compliance with corporate social responsibility (Platonova et al., 2018).

The financial performance of Islamic firms, particularly Islamic banks and financial institutions, is often measured through profitability indicators such as Return on Assets (ROA), Return on Equity (ROE), and overall financial stability. Studies indicate that corporate governance plays a crucial role in shaping the financial performance of Islamic firms, with governance mechanisms such as board size, audit committee effectiveness, and the presence of Shariah Supervisory Board (SSB) contributing to firm profitability (Haider et al., 2015; Ledhem & Mekidiche, 2020). Islamic corporate governance extends beyond financial oversight to encompass religious and ethical compliance, ensuring that business activities align with Shariah principles (Wani & Dar, 2022).

Corporate governance in Islamic enterprises is unique due to the integration of Shariah compliance frameworks such as the Shariah Governance Framework (SGF), which ensures that all corporate decisions adhere to Islamic ethical principles (Sadek et al., 2023). Effective governance structures enhance firm performance, strengthen accountability, and build stakeholder trust, thereby legitimizing Islamic financial products and services. Research by Alam et al. (2019) highlights how corporate governance mechanisms tailored to Islamic finance can mitigate financial risks while promoting ethical business practices.

Beyond financial considerations, CSR is an essential component of Islamic corporate governance, driven by the ethical obligations to contribute to social well-being. Islamic banks and firms are expected to promote socio-economic justice, environmental sustainability, and ethical investment practices (Yaya et al., 2021). Unlike conventional CSR, which is often pursued for reputational or financial gains, CSR in Islamic finance is deeply rooted in the principles of Maqasid al-Shariah, emphasizing fairness, transparency, and wealth distribution. Some scholars argue that CSR is not merely a moral obligation but a strategic imperative that enhances firm reputation, strengthens customer loyalty, and ultimately contributes to financial success (Rosita & Kurniawati, 2022).

Despite the widely acknowledged importance of CSR and governance, their actual impact on financial performance remains a subject of debate. Some studies suggest a positive correlation between CSR disclosure and profitability, particularly in the Islamic banking sector, where transparency and accountability are key to maintaining stakeholder trust (Platonova et al., 2018). However, other studies indicate that CSR initiatives may impose financial burdens, particularly for smaller Islamic firms that lack the resources to integrate comprehensive CSR

strategies (Mutamimah & Saputri, 2023). Moreover, corporate governance effectiveness in Islamic banks can be hindered by financing risks, especially in Shariah-compliant financing models such as murabahah (Hassan et al., 2018).

Regulatory support also plays a crucial role in shaping the landscape of CSR and governance in Islamic enterprises. In Indonesia, for instance, government policies and regulatory frameworks have facilitated the expansion of Islamic finance, ensuring that firms align both with Shariah principles and contemporary corporate governance standards (Nurfadilah & Samidi, 2019). The development of Islamic Social Reporting (ISR) has further emphasized the role of transparency and accountability in firm performance. Research suggests that ISR, which includes disclosures related to social and ethical responsibilities, employee welfare, and zakat contributions, is positively associated with firm performance, reinforcing the notion that ethical compliance can be a driver of financial sustainability (Agustina, 2020).

The interplay between corporate governance, CSR, and financial performance is further influenced by firm-specific characteristics such as size, industry sector, and market conditions. Larger Islamic firms with greater financial resources tend to implement CSR and governance frameworks more effectively, thereby improving their financial standings (Oktaviana et al., 2021). However, smaller firms may face challenges in balancing social responsibility with financial constraints, leading to variations in the effectiveness of governance practices across different industries.

In summary, the nexus between CSR, governance, and financial performance in Islamic firms is complex and multidimensional. While effective corporate governance enhances transparency and accountability, CSR initiatives contribute to social and ethical obligations, creating a sustainable business model that aligns financial success with Islamic ethical principles. Nevertheless, the effectiveness of CSR and governance in driving financial performance remains highly contextual, depending on factors such as firm size, regulatory environment, stakeholder expectations, and the maturity of Islamic financial markets.

This Systematic Literature Review (SLR) aims to synthesize and critically analyze the existing body of research on CSR, corporate governance, and financial performance in Islamic firms. By identifying key trends, theoretical frameworks, and research gaps, this study seeks to provide a comprehensive understanding of how Islamic principles influence corporate decision-making, financial success, and social responsibility in a rapidly evolving economic landscape.

THEORETICAL REVIEW

Corporate Social Responsibility (CSR)

Corporate Social Responsibility (CSR) in the context of Islamic firms, often referred to as Islamic Corporate Social Responsibility (ICSR), is the responsibility of companies to create a positive impact on society and the environment in accordance with Sharia principles. ICSR encompasses activities that not only fulfill legal obligations but also include philanthropic and ethical actions aligned with Islamic values, such as justice, transparency, and social welfare (Pratiwi et al., 2024).

Good Corporate Governance (GCG)

Good Corporate Governance (GCG) in Islamic firms, or Islamic Corporate Governance (ICG), refers to the systems and processes that ensure a company is managed in accordance with Sharia principles. ICG emphasizes the importance of accountability, transparency, responsibility, and fairness in corporate management while ensuring compliance with Islamic law in all operational aspects (Bawono, 2022).

Financial Performance

Financial performance in Islamic firms refers to a company's ability to achieve profitability and economic growth while adhering to Sharia principles. The measurement of financial performance is not solely based on traditional financial indicators such as Return on Assets (ROA) and Return on Equity (ROE) but also considers compliance with Islamic values and contributions to social welfare (Pratiwi, 2021).

METHODOLOGY

This study systematically explores the intersection between Corporate Social Responsibility (CSR), Good Corporate Governance, and financial performance in Islamic enterprises, synthesizing existing literature to assess their financial implications. The review follows a structured methodology, ensuring the inclusion of high-quality academic sources while maintaining transparency in the selection and analysis of studies.

The systematic review process began with an extensive literature search focusing on the relationship between CSR disclosure, corporate governance, and financial performance in Islamic enterprises. This study exclusively considers English-language articles indexed in reputable academic databases, primarily Scopus, ensuring a robust and credible dataset. The search strategy was formulated using Boolean operators to maximize the retrieval of relevant studies. The keyword combination included (“Good Corporate Governance” OR “GCG” OR “Corporate Social Responsibility” OR “CSR”) AND (“Financial Performance” OR “Firm Performance” OR “Company Performance”) AND (“Islamic Business” OR “Islamic Firms” OR “Sharia Companies” OR “Shariah-Compliant Companies” OR “Halal Industry” OR “Islamic Banks” OR “Islamic Financial Institutions” OR “Islamic”).

The initial database search was conducted on 17 February 2025, retrieving a total of 57 documents, including journal articles, conference papers, conference review, and book chapters. To ensure the academic rigor of this review, only peer-reviewed journal articles were considered. Several exclusion criteria were applied to refine the dataset. Studies that solely focus on conventional firms without incorporating Islamic business perspective. Low-quality journals that do not meet academic standards were excluded, as well as conference papers, conference review, and book chapters. Following the application of these criteria, 32 studies were shortlisted for full-text review.

Despite the systematic approach adopted, certain limitations exist. First, database restrictions may result in the exclusion of relevant studies that are not indexed in Scopus. Second, language bias limits the scope to English-language publications, potentially omitting significant contributions from Arabic or other languages. Third, methodological difference across the selected studies introduce variability in the measurement of CSR, good corporate governance, and financial performance. However, by adhering to a structured, transparent, and rigorous review process, this study provides a reliable synthesis of existing literature on CSR, good corporate governance, and financial performance in Islamic enterprises. Table 1 presents the classification of selected articles and outlines the specific inclusion and exclusion criteria applied in the study.

RESULTS AND DISCUSSION

Review of literature

Corporate Social Responsibility (CSR) in the Context of Islamic Firms

Corporate Social Responsibility (CSR) in Islamic firms is not merely a business strategy but an implementation of the principles of justice, balance, and social welfare as prescribed in Islamic teachings (Platonova et al., 2018; Rehman et al., 2020). CSR in Islamic finance extends beyond financial performance to encompass responsibilities towards God (*habluminallah*), society (*habluminannas*), and the environment (Mallin et al., 2014; Yesuf & Aassouli, 2020). Islamic firms are expected not only to pursue profit but also to ensure that their activities comply with Shariah principles, including *zakat* (almsgiving), *waqf* (endowment), and *qard al-hasan* (benevolent loans) (Bhaskaran et al., 2021; Islam et al., 2025).

Empirical studies indicate a positive relationship between CSR and financial performance in Islamic firms, particularly in Islamic banking and finance (A. Ben Ali & Chouaibi, 2024; M. Ali et al., 2023; M. A. Ali et al., 2023; Farag et al., 2018; Irmadariyani et al., 2020; Javaid & Al-Malkawi, 2018; Platonova et al., 2018; Probohudono et al., 2022; Sultan et al., 2024; Zafar et al., 2022). Several studies across GCC countries, Pakistan, Indonesia, and Malaysia demonstrate that higher CSR engagement leads to increased investor trust, enhanced reputation, and long-term financial stability (Ellili & Nobanee, 2023; Islam et al., 2025; Platonova et al., 2018; Probohudono et al., 2022; Zafar et al., 2022). CSR engagement in the banking industry has increased significantly from 2015 to 2019, with key themes focusing on stakeholder impact, financial performance, and the role of CSR in Islamic banking (Zainuldin & Lui, 2022). Islamic banks that

actively disclose their CSR activities through Islamic Social Reporting (ISR) tend to exhibit higher financial resilience and greater stakeholder loyalty (Irmadariyani et al., 2020). CSR in Islamic firms is often deeply rooted in religious principles, where ethical and social responsibilities are guided by Shariah teachings, distinguishing it from conventional CSR, which is primarily influenced by regulatory and market forces (M. Ali et al., 2023; Aziz et al., 2022). Despite the increasing emphasis on CSR in banking, the majority of CSR studies still focus on conventional banks, highlighting the need for further research on CSR in Islamic banking (Tasnia et al., 2023). Furthermore, CSR businesses is increasingly aligned with Sustainable Development Goals (SDGs), reinforcing their commitment to ethical finance, social equity, and environmental sustainability (Yesuf & Aassouli, 2020).

Despite its benefits, Islamic firms face significant challenges. One primary issue is the lack of standardized reporting frameworks, leading to inconsistencies in CSR implementation across different Islamic jurisdictions (Bhaskaran et al., 2021; Erragragui & Revelli, 2016; Irmadariyani et al., 2020; Mahmuda & Mukit, 2023; Probahudono et al., 2022; Rehman et al., 2020; Sultan et al., 2024). Many firms lack structured mechanisms for CSR disclosure, making it difficult for stakeholders to evaluate their commitments (Ellili & Nobanee, 2023; Mahmuda & Mukit, 2023; Mallin et al., 2014; Platonova et al., 2018; Rehman et al., 2020; Zafar et al., 2022). Another empirical research suggests that bank size and financial performance significantly influence CSR disclosure levels, though no substantial differences exist between Islamic and conventional banks in terms of disclosure practices (Menassa & Dagher, 2020). Additionally, while zakat is widely accepted as a CSR mechanism, there is an ongoing debate on whether it should be voluntary or mandatory for Islamic corporations (M. A. Ali et al., 2023; Javaid & Al-Malkawi, 2018). Moreover, cost related concerns often arise regarding CSR adoption. Rehman et al. (2020) suggests that excessive CSR disclosure in Islamic banks may negatively impact financial performance, as it can create unintended stakeholder perceptions and contradict cultural norms regarding philanthropy, while Mahmuda & Mukit (2023) finds that higher profits often lead to reduced CSR investment, particularly in less developed economies where social concerns are deprioritized. This is due to the potential for increased operational costs, shifting corporate priorities, and the perception that CSR expenditures may divert resources from revenue-generating activities, ultimately reducing short-term profitability.

DISCUSSION

The findings in the literature suggest that CSR in Islamic firms serves not only as a social obligation but also as a strategic tool for enhancing corporate reputation and financial resilience. Multiple studies confirm that Islamic banks and businesses that disclose CSR activities tend to attract more investors and customers, especially in regions where ethical finance is gaining traction (Ellili & Nobanee, 2023; Islam et al., 2025; Platonova et al., 2018; Probahudono et al., 2022; Zafar et al., 2022). However, challenges remain. A lack of uniform CSR standards across different Islamic financial markets hinders effective implementation.

While some firms actively engage in Islamic Social Reporting (ISR) (Irmadariyani et al., 2020), others limit their CSR efforts to basic zakat payments (M. A. Ali et al., 2023; Javaid & Al-Malkawi, 2018), resulting in varying levels of transparency. Additionally, while many scholars argue that CSR enhance financial performance, some companies still view it as a costly obligation rather than a strategic asset (Mahmuda & Mukit, 2023; Rehman et al., 2020).

To address these issues, a more integrated and structured approach to CSR in Islamic firms is needed. Standardizing ISR frameworks, improving regulatory enforcement, and aligning CSR with Shariah-compliant Environmental, Social, and Governance (ESG) principles could help bridge the gap between social responsibility and financial sustainability. Furthermore, greater stakeholder engagement—including regulators, Shariah scholars, investors, and consumers—could play a critical role in ensuring the success of CSR implementation in Islamic firms.

Future research should explore how different models of CSR disclosure impact financial performance across various sectors within the Islamic economy, including Islamic banking, halal industries, and fintech-based Islamic finance. By adopting a more harmonized and impactful CSR approach, Islamic firms can effectively balance profitability, social responsibility, and sustainable development goals.

Good Corporate Governance (GCG) in Islamic Firms

Good Corporate Governance (GCG) plays a crucial role in shaping the operational and financial integrity of firms, particularly in the Islamic finance sector, where governance structures must align with both regulatory requirements and Shariah principles. In Islamic firms, corporate governance extends beyond conventional regulatory frameworks by integrating Shariah principles, primarily through the oversight of the Shariah Supervisory Board (SSB), which ensures compliance with Islamic financial ethics and legal guidelines. Studies indicate that SSBs and Boards of Directors have a positive influence on the financial performance of Islamic banks, reinforcing the importance of strong governance mechanisms in ensuring financial resilience (Darwanto & Chariri, 2019). However, not all aspects of Islamic governance demonstrate a direct impact on financial performance, as research finds no significant relationship between AAOIFI governance disclosure and the performance of Islamic banks (Elgattani & Hussainey, 2020).

Several studies highlight the positive impact of GCG on financial performance in Islamic firms. Empirical findings suggest that strong governance mechanisms, including board effectiveness, audit committees, and Shariah compliance frameworks, significantly reduce risk and improve financial resilience (Bujang & Rimin, 2017; Roziq & Ahmad, 2024). Furthermore, the integration of sustainability and ESG practices into Islamic corporate governance has been found to enhance firm performance by aligning governance structures with environmental and social responsibility, particularly in Middle Eastern and North African banks, where ESG significantly mediates the relationship between

executive incentive compensation and financial performance (Ali & Chouaibi, 2024). Additionally, Islamic Corporate Governance strengthens sustainability performance, but there is a growing call to expand Shariah governance to include social and environmental considerations, ensuring a more holistic approach to corporate responsibility (Jan et al., 2021).

However, the relationship between GCG and financial performance is not always straightforward. Roziq & Ahmad (2024) suggests that while GCG helps reduce risk, its direct impact on profitability remains limited. Similarly, Ferriswara et al. (2022) finds that corporate governance has a significant negative effect on financial performance, suggesting that overly stringent governance mechanisms may impose constraints on operational flexibility. Additionally, research on Indonesian Islamic banks during the COVID-19 period shows that while most banks maintained resilience, some faced challenges in balancing profitability with Shariah compliance, indicating potential trade-offs in governance structures (Athief et al., 2024). Furthermore, Al-Malkawi & Pillai (2018) highlights that insider shareholding enhances financial performance, whereas institutional and government ownership have a negative effect, particularly on the Q-ratio, suggesting that ownership structure significantly influences governance efficiency. This aligns with broader findings that ownership structure plays a critical role in shaping governance effectiveness, where family-owned or insider-controlled Islamic firms tend to perform better due to greater alignment of interests between management and stakeholders (Yusoff et al., 2018).

Despite the benefits, several challenges remain in implementing GCG in Islamic firms. One significant issue is the lack of a standardized governance framework across different jurisdictions, leading to inconsistencies in implementation (Bujang & Rimin, 2017). Additionally, some firms adopt GCG principles merely as a symbolic compliance measure rather than as a genuine effort to improve governance and financial stability, particularly when governance frameworks fail to incorporate meaningful social and environmental dimensions (Jan et al., 2021). Furthermore, Rahman & Bukair (2013) notes that the characteristics of SSBs significantly influence CSR disclosure levels, where larger SSBs with cross-membership tend to enhance transparency, further underscoring the role of governance structures in shaping firm disclosures.

Discussion

The literature underscores that Good Corporate Governance (GCG) in Islamic firms serves a dual function: ensuring Shariah compliance while enhancing financial performance. Strong governance mechanisms, particularly effective board structures and independent Shariah Supervisory Boards (SSBs), contribute to financial stability and investor confidence (Bujang & Rimin, 2017; Darwanto & Chariri, 2019). However, challenges persist, particularly in standardizing governance frameworks across jurisdictions, as the absence of a unified model leads to inconsistencies in implementation and reporting (Bujang & Rimin, 2017). Furthermore, some studies indicate that GCG reduces financial risks but does not necessarily improve short-term profitability, suggesting that

its benefits may be more long-term and indirect (Ferriswara et al., 2022; Roziq & Ahmad, 2024).

One critical issue is the impact of ownership structures on governance effectiveness. Research suggests that institutional and government-controlled Islamic banks often experience bureaucratic inefficiencies, limiting managerial flexibility and negatively affecting performance (Al-Malkawi & Pillai, 2018). Conversely, insider-controlled and family-owned Islamic banks tend to exhibit stronger financial performance due to better alignment between management and stakeholder interests (Yusoff et al., 2018). Additionally, while Islamic Corporate Governance has been found to enhance sustainability performance, there is a growing call to expand Shariah governance frameworks to include social and environmental aspects, ensuring a more holistic governance approach (Jan et al., 2021).

To enhance the effectiveness of GCG in Islamic firms, several measures can be considered. First, harmonizing governance frameworks across Islamic financial markets is essential to reduce regulatory inconsistencies and promote a standardized approach to corporate governance (Bujang & Rimin, 2017). Additionally, strengthening the role of the Shariah Supervisory Board (SSB) can help maintain a balance between compliance with Islamic principles and financial performance, ensuring that firms do not view governance merely as a regulatory obligation but as a strategic advantage (Rahman & Bukair, 2013). Lastly, encouraging greater board independence and institutional transparency is crucial to prevent symbolic governance practices, enabling Islamic firms to demonstrate a genuine commitment to ethical business conduct and accountability (Ali & Chouaibi, 2024).

Future research should focus on the long-term impact of GCG on financial sustainability, particularly how governance mechanisms interact with ESG principles in Islamic finance (Ali & Chouaibi, 2024). Moreover, further studies should explore how Shariah-compliant governance models can be optimized for efficiency without compromising Islamic ethical values. By strengthening governance structures and addressing these challenges, Islamic firms can ensure both financial resilience and adherence to ethical business practices, reinforcing their unique position in the global financial landscape.

The Interplay Between CSR, GCG, and Financial Performance in Islamic Firms **CSR and GCG Theories in the Study of Islamic Firms**

From a scholarly perspective, Corporate Social Responsibility (CSR) and Good Corporate Governance (GCG) have been widely examined through various theoretical frameworks. These theories provide insight into the underlying mechanisms through which CSR and governance practices influence financial performance, risk management, and stakeholder relationships. A review of 32 selected journals reveals that the most commonly applied theories include Stakeholder Theory, Agency Theory, Legitimacy Theory, Institutional Theory, Capital Structure Theory, Signaling Theory, Instrumental-Stakeholder Theory, Maqasid al-Shariah Theory, Structuration Theory, Shariah Enterprise Theory,

Good Management Theory, and Slack Resource Theory. While some studies apply a single theoretical framework, others adopt multiple perspectives to explain the relationship between CSR, GCG, and financial performance. Additionally, several empirical studies lack an explicit theoretical foundation but rely on previous research findings.

1. Stakeholder Theory

Stakeholder Theory, introduced by Freeman (2010), argues that corporations should consider the interests of multiple stakeholders—including investors, employees, customers, and society—rather than focusing solely on shareholder value. This theory is particularly relevant in Islamic finance, where Shariah principles emphasize ethical business conduct, social justice, and transparency (Ali et al., 2023). Prior studies confirm that CSR and GCG contribute to long-term financial stability by building trust, enhancing corporate reputation, and reducing operational risks (Ellili & Nobanee, 2023; Jan et al., 2022; Mallin et al., 2014; Probahudono et al., 2022). Moreover, Islamic CSR initiatives such as zakat and waqf further reinforce the stakeholder-oriented approach of Islamic firms (Ali et al., 2023; Javaid & Al-Malkawi, 2018).

2. Agency Theory

Agency Theory, developed by Jensen & Meckling (1976), examines conflicts of interest between principals (owners) and agents (managers), particularly regarding decision-making and governance. This theory is crucial in Islamic firms, where Shariah Supervisory Boards (SSBs) function as additional governance mechanisms to ensure compliance with Islamic financial ethics (Darwanto & Chariri, 2019; Rahman & Bukair, 2013). Research suggests that strong governance structures, such as independent boards and audit committees, help reduce agency costs and improve financial performance (Bujang & Ramin, 2017; Jan et al., 2021, 2022; Roziq & Ahmad, 2024). However, some studies indicate that overly rigid governance frameworks impose compliance costs that may negatively impact profitability (Al-Malkawi & Pillai, 2018; Elgattani & Hussainey, 2020; Ferriswara et al., 2022).

3. Legitimacy Theory

Legitimacy Theory, formulated by Suchman (1995), posits that organizations engage in CSR and governance disclosures to gain societal acceptance and maintain legitimacy. Islamic firms must not only comply with conventional financial regulations but also adhere to Islamic ethical principles (Jan et al., 2021). Studies show that Islamic banks with high CSR transparency tend to attract greater investor confidence and financial stability (Ellili & Nobanee, 2023; Menassa & Dagher, 2020). While CSR undeniably enhances corporate legitimacy, its financial impact remains contingent on country-specific conditions, as seen in developing nations where CSR activities can sometimes reduce financial performance due to high implementation costs and regulatory inefficiencies (Mahmuda & Mukit, 2023).

3. Institutional Theory

Institutional Theory, introduced by DiMaggio & Powell (1983), explains how external regulatory and cultural pressures shape corporate behavior. Governance practices in Islamic firms are influenced by national financial regulations, religious guidelines, and global sustainability trends (Jan et al., 2021; Menassa & Dagher, 2020). Research finds that Islamic banks operating in jurisdictions with strong CSR and governance regulations tend to perform better financially due to higher investor confidence and reduced risk exposure (Ali et al., 2023). However, in some cases, stringent institutional pressures and regulatory burdens may lead to increased compliance costs and operational constraints, which can negatively impact profitability, particularly in developing markets where firms struggle to balance regulatory demands with financial sustainability (Al-Malkawi & Pillai, 2018; Islam et al., 2025).

Capital Structure Theory

The Capital Structure Theory, based on the Modigliani-Miller (1958) approach, suggests that increasing debt financing leads to higher financial risk. However, this principle does not fully apply to Islamic banks, as their capital structure relies on profit-sharing instruments rather than conventional debt (Roziq & Ahmad, 2024). Studies indicate that Shariah-compliant financing models may limit financial flexibility, potentially constraining profitability in highly competitive markets (Roziq & Ahmad, 2024).

4. Signaling Theory

Signaling Theory, introduced by Spence (1973), explains how firms communicate financial strength and governance quality to investors and stakeholders. CSR and governance disclosures serve as positive signals, enhancing corporate reputation and long-term financial stability (Ellili & Nobanee, 2023). However, excessive CSR disclosure may backfire in conservative Islamic markets, where philanthropic activities are traditionally seen as private, rather than publicly advertised (Elgattani & Hussainey, 2020; Ferriswara et al., 2022).

5. Instrumental-Stakeholder Theory

A variant of Stakeholder Theory, Instrumental-Stakeholder Theory (Donaldson & Preston, 1995) argues that CSR is not merely an ethical obligation but a strategic tool for financial performance. Empirical studies suggest that Islamic banks adopting strategic CSR initiatives tend to gain competitive advantages, particularly in markets with strong ethical finance preferences (Platonova et al., 2018; Zafar et al., 2022).

6. Maqasid al-Shariah Theory

Maqasid al-Shariah Theory, rooted in Islamic jurisprudence, extends governance principles beyond financial performance to include social welfare, sustainability, and ethical obligations (Yesuf & Aassouli, 2020). Research suggests that firms aligning their governance and CSR strategies with Maqasid

principles tend to achieve higher long-term financial stability (Yesuf & Aassouli, 2020).

7. Structuration Theory

Structuration Theory, developed by Giddens (1984), explains how organizational structures interact with social and institutional factors to shape firm performance. Studies in Islamic finance suggest that CSR and governance practices influence consumer trust, corporate reputation, and business outcomes in Muslim-majority markets (Aziz et al., 2022).

8. Shariah Enterprise Theory

Shariah Enterprise Theory (SET) expands the traditional stakeholder model by incorporating God, humanity, and nature as stakeholders. Islamic CSR goes beyond corporate profits, aiming to balance economic growth with social justice and environmental sustainability. Firms applying SET principles tend to achieve higher corporate value due to strong ethical commitments (Irmadariyani et al., 2020).

9. Good Management Theory

Good Management Theory (Waddock & Graves, 1997) suggests that firms with strong governance and CSR practices achieve superior financial performance. Research on Islamic banks in GCC countries confirms that well-structured CSR disclosures correlate with stronger financial outcomes (Platonova et al., 2018). Further supporting this theory, Yusoff et al. (2018) find that ownership structure significantly influences CSR disclosure, whereas financial performance and Shariah supervisory boards do not exhibit a direct impact. Additionally, Mallin et al., (2014) highlight a bidirectional relationship, showing that while CSR disclosure positively affects financial performance in Islamic banks, financial performance itself plays a determining role in the extent of CSR engagement.

10. Slack Resource Theory

Slack Resource Theory, introduced by Bourgeois (1981), posits that firms with greater financial flexibility are better positioned to invest in CSR and governance initiatives. Studies indicate that firms with high retained earnings tend to allocate more resources toward CSR, leading to enhanced long-term financial performance (Mallin et al., 2014; Yusoff et al., 2018).

11. Studies Without Explicit Theoretical Frameworks

While many studies employ established theories, some research lacks an explicit theoretical foundation, relying instead on previous empirical findings. For instance, Sultan et al. (2024) and Tasnia et al. (2023) examine the CSR–financial performance relationship using historical data and case studies without grounding their analysis in a specific theory. Similarly, Athief et al. (2024) explores Islamic banks’ resilience during economic downturns, while Zainuldin & Lui (2022) analyze CSR trends in Islamic banking, both without explicitly linking their findings to theoretical frameworks. Additionally, studies by Bhaskaran et al. (2021) on employee satisfaction and firm performance, Erragragui & Revelli (2016) on ESG screening in Shariah-compliant investments, and Rahman & Bukair (2013) on SSB characteristics and CSR disclosure offer empirical insights but do not anchor their discussions in formal theoretical perspectives.

Discussion

Theories help to hypothesize situations, assumptions, and behaviours, providing a structured approach to analyzing the relationship between CSR, GCG, and financial performance in Islamic firms. Most studies in this field rely on Stakeholder Theory, Agency Theory, and Legitimacy Theory, emphasizing how corporate governance and social responsibility contribute to financial stability. Some research incorporates Institutional Theory, explaining how external regulations and cultural norms shape governance practices in Islamic firms. Another use Shariah Enterprise Theory, which integrates Shariah compliance and ethical finance as core governance principles.

While these theories provide a strong foundation, some studies lack an explicit theoretical framework and rely solely on empirical analysis. Additionally, Signaling Theory is sometimes applied to explain how CSR and governance disclosures influence investor perceptions and stock performance. Another study employ Maqasid-al-Shariah Theory, arguing that corporate decisions should align with Islamic values of social justice, sustainability, and economic welfare.

Overall, the dominant theories – Stakeholder, Agency, and Legitimacy – frame the discussion on CSR, GCG, and financial performance in Islamic firms, while Shariah Enterprise and Maqasid-al-Shariah Theories offer a unique ethical and religious dimension. Some studies remain empirically driven, highlighting a gap where further theoretical development is needed to strengthen the analytical depth of research in this field.

Empirical Evidence on the Interplay Between CSR, GCG, and Financial Performance in Islamic Firms

Empirical research extensively examines how CSR and GCG impact financial performance in Islamic firms, with findings indicating both positive and conditional relationships. While many studies establish a direct link between CSR and financial performance, the role of GCG in influencing financial

outcomes is more complex, often depending on regulatory environments, board effectiveness, and firm-specific governance structures.

1. CSR and Financial Performance in Islamic Firms

Various studies confirm that CSR positively influences financial performance, particularly in Islamic banks and financial institutions. Research on GCG-based Islamic banks indicates that institutions with higher CSR disclosures and strong governance frameworks tend to achieve improved Return on Assets (ROA) and Return on Equity (ROE) (Probohudono et al., 2022; Zafar et al., 2022). Similarly, studies on Malaysian and Indonesian Islamic banks suggest that firms integrating Islamic Social Reporting (ISR) with structured governance mechanisms demonstrate greater financial resilience, especially during economic downturns (Athief et al., 2024). Additionally, CSR activities such as zakat contributions have been found to significantly enhance financial performance in Islamic banks, reinforcing the idea that Islamic CSR serves both ethical and financial purposes (M. A. Ali et al., 2023). Other studies highlight that Islamic firms with well-established CSR practices attract more investors and maintain higher customer loyalty, translating into improved financial stability and reduced financial risks (Ellili & Nobanee, 2023; Jan et al., 2022; Platonova et al., 2018).

Despite these findings, some research suggests that CSR's impact on profitability is indirect, with effects materializing over the long term rather than as immediate financial gains (A. Ben Ali & Chouaibi, 2024). Empirical evidence from Indonesia indicates that while CSR improves risk management and stakeholder trust, it does not always lead to higher short-term profits (Roziq & Ahmad, 2024). Additionally, studies on ESG in Islamic finance reveal that its social component can sometimes reduce bank stability, as firms prioritize social impact over financial returns (Islam et al., 2025). Similarly, research finds that CSR disclosure has a significant negative relationship with ROA in some Islamic banks, particularly in cases where firms operate in developing economies with high compliance costs (Mahmuda & Mukit, 2023; Rehman et al., 2020). These mixed results indicate that CSR primarily functions as a tool for risk mitigation and reputational enhancement, rather than as a direct driver of profitability (Zainuldin & Lui, 2022).

2. GCG and Financial Performance in Islamic Firms

The relationship between GCG and financial performance in Islamic firms presents a more nuanced picture. While good governance is generally associated with enhanced transparency, risk reduction, and long-term financial growth, its direct effect on profitability varies depending on governance mechanisms, ownership structures, and regulatory conditions (A. Ben Ali & Chouaibi, 2024; Roziq & Ahmad, 2024).

Prior research confirms that Islamic firms with strong corporate governance frameworks tend to experience better financial performance (Jan et al., 2022). Studies highlight that firms with independent board structures, effective audit committees, and active Shariah Supervisory Boards (SSBs)

demonstrate lower financial risk and increased investor trust (Darwanto & Chariri, 2019). Additionally, governance structures that prioritize ethical decision-making and compliance with Shariah principles tend to attract more long-term investments, strengthening financial sustainability (Jan et al., 2021). However, empirical findings also suggest that GCG's impact on financial performance is contingent upon firm size, ownership concentration, and regulatory oversight (Menassa & Dagher, 2020). Some studies indicate that firms with larger, more independent boards tend to perform better due to enhanced strategic oversight and risk management (Ellili & Nobanee, 2023). Conversely, research on state-owned Islamic firms reveals that excessive bureaucratic oversight can hinder managerial efficiency, resulting in weaker financial outcomes despite strong governance policies (Al-Malkawi & Pillai, 2018).

Another key finding is the trade-off between regulatory compliance and managerial flexibility. While governance mechanisms such as board independence and external audits improve transparency and investor confidence, they may also impose administrative burdens that limit profitability, especially in highly regulated Islamic financial markets (Ferriswara et al., 2022). Additionally, studies indicate that firms with highly rigid Shariah compliance frameworks often face operational constraints that limit their ability to pursue profit-maximizing strategies (Elgattani & Hussainey, 2020). Ownership structure further influences governance effectiveness. Research suggests that Islamic firms with high institutional ownership tend to have weaker financial performance due to greater regulatory interference and reduced managerial autonomy (Al-Malkawi & Pillai, 2018). In contrast, family-owned or insider-controlled Islamic firms often perform better, as management is more aligned with long-term business sustainability goals (Yusoff et al., 2018).

In summary, empirical evidence supports the notion that CSR and GCG contribute to financial stability and firm resilience, though their direct impact on profitability remains context-dependent. While CSR enhances reputation and risk management, GCG's effectiveness depends on board structure, regulatory conditions, and ownership influence. Strong governance frameworks generally lead to better investor confidence and long-term financial growth, but their short-term financial impact is shaped by firm-specific factors and market conditions (A. Ben Ali & Chouaibi, 2024; Jan et al., 2022).

Discussion

Empirical findings on the relationship between CSR, GCG, and financial performance in Islamic firms present a complex but insightful pattern. Research generally supports the notion that CSR enhance firm reputation, investor confidence, and risk mitigation, contributing to long-term financial stability. However, the immediate impact on profitability remains mixed, with some studies suggesting that CSR's financial benefits are indirect and materialize over time. This aligns with the argument that CSR primarily serves a strategic asset rather than a short-term profitability driver.

On the governance side, GCG has a significant influence on financial performance, but its impact depends on firm-specific characteristics and regulatory conditions. Research highlights that Islamic firms with stronger board oversight, independent audit committees, and effective Shariah Supervisory Boards (SSBs) exhibit lower financial risk and greater investor trust. On the other hand, rigid regulatory frameworks can sometimes restrict managerial flexibility, limiting the ability of firms to maximize profits. Additionally, state-owned firms or those with high institutional ownership often struggle with excessive bureaucratic oversight, reducing governance effectiveness.

Despite these variations, empirical evidence generally supports the idea that strong CSR and governance frameworks contribute to financial resilience. Firms that effectively integrate CSR with governance structures tend to outperform their counterparts in terms of sustainability and stakeholder engagement. Nevertheless, the short-term profitability of these initiatives depends on external factors such as market conditions, industry dynamics, and regulatory environments.

Overall, the empirical evidence suggests that CSR and GCG function as complementary mechanisms in enhancing financial performance, with CSR focusing on long-term sustainability and ethical responsibility, while governance ensures strategic oversight and risk management. The effectiveness of these mechanisms, however, is contingent on regulatory flexibility, ownership structures, and the ability to balance compliance with financial objectives.

Challenges in Measuring the Impact of CSR and GCG on Financial Performance in Islamic Firms

Despite the extensive research on the relationship between CSR, GCG, and financial performance, several challenges remain in accurately assessing their impact in Islamic firms. These challenges arise due to variations in governance structures, regulatory frameworks, reporting standards, and market conditions across different jurisdictions. While many studies establish a positive correlation between CSR, GCG, and financial stability, inconsistencies in measurement approaches and external influences complicate the ability to draw definitive conclusions.

One of the primary challenges is the lack of standardized CSR and governance reporting frameworks in Islamic finance. Unlike conventional firms, where CSR disclosures follow widely accepted guidelines such as the Global Reporting Initiative (GRI) or ESG metrics, Islamic firms operate under diverse regulatory and religious guidelines. The absence of a unified Islamic Social Reporting (ISR) framework results in inconsistencies in how CSR and governance activities are disclosed, making cross-country comparisons difficult. While some Islamic financial institutions provide detailed reports on zakat contributions, ethical investment practices, and Shariah compliance, others limit their disclosure to basic financial statements, reducing transparency.

Another key challenge is the regulatory disparity among Islamic financial markets. Governance requirements for Islamic firms vary significantly depending on jurisdictional regulations, the role of Shariah boards, and national

financial policies. Countries such as Malaysia and the GCG region have well-established regulatory bodies overseeing Islamic corporate governance, whereas other markets lack strict governance enforcement. This leads to uneven implementation of governance practices, affecting financial performance comparisons between firms operating in different markets.

Additionally, the trade-off between compliance and profitability poses a major challenge. While robust governance mechanisms—such as independent board oversight, audit committees, and Shariah Supervisory Boards (SSBs)—enhance risk management and investor trust, they may also impose higher operational costs on firms. Some studies suggest that firms with overly rigid governance structures struggle to maintain profitability, as compliance requirements restrict their ability to adopt flexible business strategies. Conversely, firms with weaker governance controls may achieve higher short-term profitability but are more exposed to reputational risks and financial instability.

Another notable challenge is the difficulty in isolating the direct financial impact of CSR and GCG. Many external factors, such as economic conditions, industry dynamics, and investor sentiment, influence a firm's financial performance. Studies suggest that while CSR and governance contribute to financial resilience, their true financial benefits may take years to materialize, making it difficult to establish a direct and immediate causal relationship.

Lastly, ownership structure and political influences further complicate governance effectiveness in Islamic firms. Research indicates that firms with high institutional or government ownership tend to face greater regulatory scrutiny, which may limit managerial autonomy and financial flexibility. In contrast, family-owned and insider-controlled Islamic firms often perform better due to better alignment of interests between management and stakeholders. These variations create inconsistencies in governance efficiency, impacting financial performance outcomes across different firms.

In summary, while empirical evidence supports the positive role of CSR and GCG in enhancing financial resilience and long-term sustainability, challenges related to reporting inconsistencies, regulatory disparities, compliance costs, and external economic factors, make it difficult to establish a universal financial model for Islamic firms. Addressing these challenges will require greater standardization of reporting frameworks, regulatory harmonization across Islamic financial markets, and further research on optimizing governance structures without compromising profitability.

Research Gap

Despite extensive research on the relationship between CSR, GCG, and financial performance, several challenges remain in accurately assessing their impact on Islamic firms. These challenges arise due to variations in governance structures, regulatory frameworks, reporting standards, and market conditions across different jurisdictions (Ben Ali & Chouaibi, 2024; Menassa & Dagher, 2020). While many studies establish a positive correlation between CSR, GCG, and financial stability, inconsistencies in measurement approaches and external influences complicate the ability to draw definitive conclusions (Zafar et al., 2022).

One of the primary challenges is the lack of a standardized CSR and governance reporting framework in Islamic finance (Ellili & Nobanee, 2023; Mahmuda & Mukit, 2023). Unlike conventional firms, where CSR disclosures follow widely accepted guidelines such as the Global Reporting Initiative (GRI) or ESG metrics, Islamic firms operate under diverse regulatory and religious guidelines (Jan et al., 2022). The absence of a unified Islamic Social Reporting (ISR) framework results in inconsistencies in how CSR and governance activities are disclosed, making cross-country comparisons difficult (Zainuldin & Lui, 2022). While some Islamic financial institutions provide detailed reports on zakat contributions, ethical investment practices, and Shariah compliance, others limit their disclosure to basic financial statements, reducing transparency (Ali et al., 2023).

Another key challenge is the regulatory disparity among Islamic financial markets, which significantly affects governance and financial performance comparisons (Roziq & Ahmad, 2024). Governance requirements for Islamic firms vary significantly depending on jurisdictional regulations, the role of Shariah boards, and national financial policies (Menassa & Dagher, 2020). Countries such as Malaysia have well-established regulatory bodies overseeing Islamic corporate governance, whereas other markets lack strict governance enforcement, leading to uneven implementation of governance practices (Jan et al., 2021). Research also indicates that while some Islamic banks in Indonesia demonstrated resilience during economic crises, others struggled to balance profitability and Shariah compliance due to weak regulatory structures (Athief et al., 2024).

Additionally, the trade-off between compliance and profitability poses a major challenge (Ferriswara et al., 2022). While robust governance mechanisms—such as independent board oversight, audit committees, and Shariah Supervisory Boards (SSBs)—enhance risk management and investor trust, they may also impose higher operational costs on firms, potentially reducing profitability (Roziq & Ahmad, 2024). Some studies suggest that firms with overly rigid governance structures struggle to maintain profitability, as compliance requirements restrict their ability to adopt flexible business strategies (Elgattani & Hussainey, 2020). Conversely, firms with weaker governance controls may achieve higher short-term profitability but are more exposed to reputational risks and financial instability (Ali & Chouaibi, 2024).

Another notable challenge is the difficulty in isolating the direct financial impact of CSR and GCG (Zafar et al., 2022). Many external factors, such as economic conditions, industry dynamics, and investor sentiment, influence a firm's financial performance (Sultan et al., 2024). Some studies indicate that while CSR and governance contribute to financial resilience, their true financial benefits may take years to materialize, making it difficult to establish a direct and immediate causal relationship (Islam et al., 2025). Furthermore, ESG-related research on Islamic finance suggests that its social component can sometimes reduce bank stability, as firms prioritize social impact over financial returns (A. Ben Ali & Chouaibi, 2024).

Ownership structure and political influences further complicate governance effectiveness in Islamic firms (Al-Malkawi & Pillai, 2018). Research indicates that firms with high institutional or government ownership tend to face greater regulatory scrutiny, which may limit managerial autonomy and financial flexibility (Yusoff et al., 2018). In contrast, family-owned and insider-controlled Islamic firms often perform better, as management is more aligned with long-term business sustainability goals (Al-Malkawi & Pillai, 2018). These variations create inconsistencies in governance efficiency, impacting financial performance outcomes across different firms (Menassa & Dagher, 2020).

CONCLUSIONS AND RECOMMENDATIONS

The literature review has provided comprehensive insights into the interplay between CSR, GCG, and financial performance in Islamic firms, highlighting both theoretical foundations and empirical findings. CSR has been found to enhance firm reputation, stakeholder trust, and long-term financial resilience, while GCG plays a crucial role in ensuring risk management, ethical business conduct, and investor confidence. However, the financial impact of CSR remains context-dependent, with research suggesting that its benefits are subtle at first and become more pronounced in the long run. Similarly, the effectiveness of governance mechanisms in improving financial performance varies based on ownership structures, regulatory environments, and market conditions.

Empirical findings indicate that while CSR and GCG contribute to financial stability, their direct impact on profitability is influenced by factors such as firm size, regulatory frameworks, and industry-specific challenges. Moreover, the literature reveals several challenges, including inconsistencies in reporting frameworks, variations in governance effectiveness across jurisdictions, and the trade-off between compliance costs and profitability. These issues make it difficult to establish a universal model for understanding the financial implications of CSR and GCG in Islamic firms.

Furthermore, this review has identified research gaps that require further exploration, particularly in longitudinal studies on the financial impact of CSR and governance, the comparative analysis of governance structures in different ownership models, and the examination of CSR and GCG in non-Muslim-majority countries. Additionally, the need for more diverse methodological approaches – including qualitative studies and behavioural finance models – has

been highlighted to better capture the broader effects of governance and CSR beyond financial metrics.

In conclusion, while the literature confirms the importance of CSR and GCG in strengthening financial resilience in Islamic firms, ongoing challenges and research gaps indicate the need for further empirical validation and theoretical refinement. Future studies should focus on standardizing governance and CSR reporting frameworks, analyzing governance mechanisms in diverse market conditions, and assessing the long-term financial sustainability of CSR initiatives in Islamic finance. Addressing these areas will contribute to a more comprehensive and standardized understanding of CSR, GCG, and financial performance in Islamic firms globally.

FURTHER STUDY

This study has several limitations, including the reliance on secondary data, which may not fully capture the evolving dynamics of CSR and corporate governance in Islamic firms. Future research should incorporate primary data through surveys or case studies to provide more comprehensive insights. Further studies can also explore other sectors beyond Islamic finance, such as halal industries and fintech, or conduct comparative analyses with conventional firms. Additionally, longitudinal studies are needed to assess the long-term financial impact of CSR and governance, considering regulatory differences across jurisdictions.

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