

Ethical Dimensions of Islamic Finance: Lessons from the CSR Model of Indonesian Islamic Banks

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Abstract

The Islamic financial system is regarded as a financial system that bases its operations on the values of Islam. However, the practice of the Islamic financial industry has been criticized as it deviates from the theory. This paper aims to explore and analyze the ethical values of Islamic finance and their implementation in Indonesian Islamic commercial banks. The study employs a qualitative research method with the literature study approach and assessment of the annual reports of 14 Indonesian Islamic commercial banks. The literature study explores and analyses Islamic values embedded within the Islamic financial system. In contrast, the exploration and assessment of Indonesian Islamic commercial banks' annual reports provide the study with the practical implementation of the values. The paper found that Indonesian Islamic commercial banks have contributed to facing the current social and environmental issues through some initiatives in their CSR implementations. All Indonesian Islamic commercial banks have been actively participating in CSR programs. However, a number of Islamic banks need to enhance their CSR practices to tackle the ongoing environmental issues. Therefore, the paper comes with some limitations and policy recommendations.

Keywords: Environment; Ethical Values; Islamic Banks; Islamic Finance; Social

INTRODUCTION

Islamic financial system is deemed as a financial system that bases its operations on the values of Islam. The system is well known for the prohibition of usury (*riba*), uncertainty (*gharar*), gambling (*maysir*), and all the prohibited (*haram*) things in Islam (ISRA, 2011). The emergence of the Islamic financial system is also regarded as a solution to the current financial system with embedded ethical values within its operations. Oneness of God in Islam (*tauhid*) as the core value of Islamic finance indicates that Islamic finance products must adhere to the role of Allah as the source of knowledge (Ismail, 2016). Consequently, it is a great responsibility for Islamic scholars, economists, and finance practitioners to embrace the values of Islam in all their activities.

Iqbal & Mirakhor (2017) asserted that achieving the objectives of sharia (*maqashid shari'ah*) as the outcome of Islam's values must be the action of the Islamic financial system. A number of initiatives have been made, such as the implementation of risk sharing method. However, the current application of Islamic finance arguably needs better reform to bring it back to its core values and propositions. There are some issues in the practices of the Islamic financial industry, such as the ineffectiveness of sharia governance, conflict of interest between the Islamic bank subsidiary of conventional banks, and benchmarking on conventional products or indices (Al-Jarhi, 2020; Hassan, 2020).

The State of the Global Islamic Economy reported that Islamic financial assets reached \$3.6 trillion, with 1,553 Islamic financial institutions. There are some dominant countries, such as Iran, with \$838.3 billion. Saudi Arabia with \$826 billion, and Indonesia with \$119.5 billion (Dinar Standard, 2022). In Indonesia, the industry has grown gradually, with Rp446,454 billion in total assets and 12 Islamic banks. The nation's Islamic financial industry has covered all aspects, which consists of Islamic banks, Islamic insurance (*takaful*), Islamic capital market, Islamic social finance institutions, and Islamic microfinance institutions (KNEKS, 2018; OJK, 2022).

Khan (2019) stressed that the ideal economic system would be the one truly based on the objectives of sharia and independent from the current linear economic system, and also free from the circular economic paradigm. The true Islamic economic system will stand independently and bases its theories and operations on Islamic values. To reach the goal of the ideal economic system, Islamic finance as the mean has to re-align its theory and practice to be a better business model. This is due to some issues with the applications of Islamic financial products that are away from their original values.

As the most populous Muslim nation, Indonesia has great potential to develop its Islamic financial market. However, the Indonesian Islamic bank market share remained below 10% throughout the years. Lack of government support and limited funds is among the suspected hindering factors of Indonesian Islamic financial industry growth (Hasan, 2019; Zulfikar, 2020). In addition, Iswanaji (2018) argued that other factors inhibiting the growth of Indonesian Islamic banks are the lack of qualified human resources and the lack of awareness among the society about the terms, products, and Islamic banking principles.

On the practices of their responsibilities, Islamic banks tend to incorporate their ethical responsibilities in their Corporate Social Responsibility (CSR) while also embracing the basic values of Islamic bank principles guided by the National Sharia Board – Indonesian Ulama Council (DSN-MUI) (Darus et al., 2014; Puspitasari & Muhammad, 2019). The implementation of CSR in Islamic banks in Indonesia performs well with some limitations which, one of them is non-optimally play an active role in controlling the environmental impact of financing (Cahyadin et al., 2020; Saridona & Cahyandito, 2015).

The competition between Islamic banks and its counterpart tends to bring their practices deviate from their fundamental values. Such a practice will lead the Islamic banks to more significant growth but lacks in quality (Ainun, 2020). The transformation of *maqashid sharia* into practices is very much needed looking at the current situation of the Islamic financial industry performances. This is to bring Islamic finance back to its origin and offer society the true Islamic financial system.

The aforementioned discussion above indicates that there is an unfinished discussion on the ethical theory of Islamic finance and its practices. Therefore, this paper will re-investigate the core values and fundamentals of Islamic finance and explore its practices in Indonesia's Islamic banking system. The study offers a different approach to looking at the ethical dimension of Islamic finance by analysing the synergies between the values and the practices. The current study humbly attempts to fill the gap in the literature on the Islamic ethical values of Islamic finance. It differs from other studies by employing a qualitative method exploring both the practices and the ethical values and taking Indonesian Islamic banks as the sample.

LITERATURE REVIEW

Islamic financial system bases its operations on Islamic law. Theoretically, the products and services of the Islamic finance industry must be in accordance with Islamic values. Islam teaches that everything related to financial management must also be done in order to expect the pleasure of Allah. The embedded Islamic values within the Islamic financial system differentiate the system from its counterpart. In general, the Islamic financial system is free from usury (*riba*), uncertainty (*gharar*), gambling (*maysir*), and other prohibited things according to Islam (ISRA, 2011).

The core value of Islamic finance, namely the Oneness of God in Islam (*Tauhid*), shows that the products issued must adhere to the role of Allah Almighty as a source of knowledge (Ismail, 2016). Indeed, by setting Allah Almighty as the foundation, making the provisions of Islamic finance unquestionable and cannot change with the times. That means implementing the Islamic financial system is the same as helping the development of society more broadly because this system has a greater social responsibility and has better business ethics.

Islamic finance is then believed to be one of the instruments that play an important role in economic recovery and reducing poverty through community business/economic empowerment. This is due to Islamic finance, which provides ways and frameworks for managing assets or transactions based on the principles of justice and sincerity. All of this can be seen from fair risk financing related to Islamic financing and the presence of Islamic social finance such as zakat, *waqf*, and *infaq* (Febrio, 2022).

The Islamic financial system is also the choice of the public for the current financial system; not even a few people say that the Islamic financial system is able

to become one of the world's solutions for achieving the target of the Sustainable Development Goals (SDGs) launched by the United Nations (UN) (Mualiaman, 2016).

Besides all the fundamental ethical values of Islamic finance that have been mentioned in the Qur'an and Sunnah, the Islamic financial system is predominantly known for its risk-sharing mechanism. Iqbal & Mirakhor (2011) mentioned that the main issue of Islamic finance is its divergence from ideal risk-sharing financing schemes. While some scholars believe that risk-sharing is the ideal model of Islamic finance, other scholars mention that the risk-sharing mechanism leads Islamic finance into serious issues such as agency issues and adverse selection (Farooq, 2007).

Other than the issue of the risk-sharing mechanism, there are some issues pertaining to the practices of the Islamic financial industry, which are the issue of substance over form, amalgamation of contracts, materiality, and equity versus debt (Hassan, 2020). Lack of innovation and mimicking of conventional products, independency of sharia boards, and lack of standardization might be the addition of the Islamic finance problems. There are a number of reforming ways offered by scholars; one of them is Belouafi (2020), who proposed Islamic finance reforms by suggesting that Islamic finance literature need to abandon the totalitarian approach to Islamic commercial bank, a new way of thinking on the nature of the institutions, designing a new reform for Islamic finance, and making profit and loss sharing obsession as a postulate and not as the Islamic theory of finance.

Based on the current practices of ethical businesses, CSR practices dominate the ethical business aspect of companies. However, a view of scholars argues that CSR implementation is merely building the image, promotion, and legitimacy of companies. Hence, the applications are not efficient and do not solve the current social and environmental issues of society (Hudaefi & Noordin, 2019; Ridho et al., 2016).

As a country with the most populous Muslims, Indonesia has a great potential to develop an Islamic financial market. However, the market share of Indonesian Islamic banks has not shown significant development and remained below 10% throughout the year. This is due to the lack of government support and limited funds, which are one of the factors that allegedly hinder the growth of Indonesian Islamic financial industry (Hasan, 2019; Zulfikar, 2020).

In addition, Iswanaji (2018) argues that other factors that hinder the growth of Indonesian Islamic banks are due to the lack of quality human resources, lack of literacy, and lack of public awareness of Islamic banking terms, products, and principles. So the current implementation of Islamic finance arguably requires better reforms to bring it back to the core values and propositions of Islamic law.

Commonly, literature has studied the impact of CSR disclosure on companies' value and earnings. Most of the studies found that CSR disclosure has an impact on the earnings and profitability of companies, including Islamic banks (Setiawati et al., 2022; Yuliartanti & Handayani, 2023). Apart from it, Athief & Ma'ruf (2023) found that Indonesian Islamic banks' depositors and not influenced by the raising of interest

rates and are religiously loyal. This means that Islamic banks customers believe in good things done by Islamic banks. This denotes that the literature on Islamic banking and finance has been growing throughout the years with some new areas of research (Hakim & Angraeni, 2022).

Thus, this study attempts to contribute to the vast literature on Islamic economics and finance by analyzing the topic, and it is hoped that the study can complement the Islamic banking and finance literature.

RESEARCH METHOD

This study uses qualitative research methods by exploring ethical practices of Islamic finance and taking several Indonesian Islamic commercial banks as samples. The nature of this research is exploratory and explanatory, which seeks to find CSR performance in Islamic banks as an indicator of ethical values. The paper evaluates several aspects and contributions of CSR of 14 Indonesian Islamic commercial banks namely Bank Aceh Syariah, BPD NTB Syariah, Bank Muamalat Indonesia, Bank Victoria Syariah, Bank BRI Syariah, BJB Syariah, Bank BNI Syariah, Bank Syariah Mandiri, Bank Mega Syariah, Bank Panin Dubai Syariah, Bank Syariah Bukopin, BCA Syariah, BTPN Syariah, and Aladin Syariah, based on their annual reports in 2020 which will then be sorted into several categories and linked into the socio-economic development of the society.

The current study humbly seeks to fill the literature gap on Islamic ethical values of Islamic finance and offers a different approach to looking at the ethical dimension of Islamic finance; it is by analyzing the synergy between Islamic values and its practices. Where this will be seen based on publication data related to the CSR performance of Islamic banks in the annual reports of Indonesian Islamic banks in 2020. Moreover, the study will categorize CSR performance based on its practice in overcoming social and environmental problems.

RESULTS AND DISCUSSION

Development of Indonesian Islamic Financial Industry

Indonesia's economic growth and development of sharia finance in 2020 were also shaken by the Covid-19 pandemic. However, when the study viewed the performance of the Islamic economy and banking in general, Bank Indonesia stated that economic growth and Islamic banking are better than the national economic growth in 2020. Although Islamic economic and financial growth at that time declined by 1.72% yoy, according to central bank records, this development was better than the national economic growth last year (2020), which weakened to minus 2.7% yoy (Bank Indonesia, 2021).

In addition, in December 2020, according to the National Committee for Islamic Economy and Finance (KNEKS), Indonesia's Islamic economy and finance recorded brilliant global achievements throughout 2020. The Islamic Finance

Development Indicator (IFDI) 2020, from The Islamic Corporation for the Development (ICD), the Islamic Development Bank (IsDB), and Revintiv, places Indonesia in the 2nd position of Islamic finance in the world, up from 4th in the previous year (2019).

Refinitiv of Thomson Reuters explained that IFDI refers to instrumental factors grouped into five areas of development which are considered as main indicators, which include Quantitative Development, Knowledge, Governance, Awareness, and also Corporate Social Responsibility (CSR).

Social Contributions of Indonesian Islamic Banks

Regarding the practice of ethical responsibility, Islamic banks tend to include their ethical responsibilities in Corporate Social Responsibility (CSR) while embracing the basic values of Islamic banking principles guided by the National Sharia Council – Indonesian Ulama Council (DSN-MUI) (Darus et al., 2014; Puspitasari & Muhammad, 2019). This is based on several Bank Indonesia regulations, which explain that Islamic banks are required to apply the principles of Good Corporate Governance, one of which is accountability. The principle of accountability within the scope of GCG has a broad meaning, one of which can be implemented in Corporate Social Responsibility (CSR).

The implementation of CSR in Islamic banks in Indonesia itself currently appears to perform well with several limitations, one of which is not optimally playing an active role in controlling the environmental impact of financing (Cahyadin et al., 2020; Saridona & Cahyandito, 2015). In addition, looking at current ethical business practices, CSR practices have succeeded in dominating the ethical business aspects of the company. However, scholars argue that the implementation of CSR only builds the image, promotion, and legitimacy of the company. Therefore, the CSR application is considered inefficient and does not solve the current social and environmental problems of society (Hudaefi & Noordin, 2019; Ridho et al., 2016).

Nevertheless, CSR might be one of the best ethical measurements in current times, with a number of initiatives of sustainability in the financial system developing. Below are the social contributions of Indonesian Islamic banks.

Table 1. Implementation of CSR in Indonesian Islamic Bank on Social Aspects (Part 1)

Social Contributions of Indonesian Islamic Banks							
No	Banks	Health Maintenance	Mosque maintenance assistance	SME assistance	Educational place assistance	Help for orphans and dhuafa	Religious activities
1	Aceh syariah	√				√	
2	BPD NTB Syariah	√	√				√
3	Muamalat Indonesia			√			
4	Victoria Syariah						

5	BRI Syariah	√	√		√	√
6	BJB Syariah		√		√	
7	BNI Syariah	√	√	√	√	√
8	Syariah Mandiri			√	√	
9	Mega Syariah					
10	Panin Dubai Syariah		√			√
11	Syariah Bukopin	√	√	√	√	√
12	BCA Syariah	√	√		√	
13	BTPN Syariah	√				√
14	Aladin Syariah				√	

Table 2. Implementation of CSR in Indonesian Islamic Bank on Social Aspects (Part 2)

Social Contributions of Indonesian Islamic Banks						
No	Banks	Natural disaster relief	Community assistance	Student scholarship assistance	Sports assistance	Art and cultural development
1	Aceh syariah	√	√	√	√	√
2	BPD NTB Syariah	√	√	√	√	√
3	Muamalat Indonesia			√		
4	Victoria Syariah					
5	BRI Syariah	√	√	√	√	
6	BJB Syariah	√	√	√		
7	BNI Syariah	√	√	√		
8	Syariah Mandiri		√			
9	Mega Syariah					
10	Panin Dubai Syariah	√	√			
11	Syariah Bukopin	√	√	√	√	
12	BCA Syariah					
13	BTPN Syariah					
14	Aladin Syariah				√	

Source: Annual Reports of Islamic Banks in Indonesia Year 2020

Looking at the realization of CSR in accordance with Islamic principles and values, Islamic banks have several criteria that are used to be indicator points in the implementation of CSR. Banks with a wide market share, such as some of the banks in the table above, should implement CSR in their operations. Although some programs or aspects of each bank may be different, they basically have the same goal, which is to realize welfare and justice based on Islamic principles and values.

Tables 1 and 2 represent data on social problems that exist in Indonesian society and how CSR implementation in several Islamic banks solves these social problems. The tables also present several aspects that are a reference for CSR

performance in several Islamic banks, such as natural disaster relief, assistance to the community, student and college scholarship assistance, and other initiatives.

From the most widely applied aspect, it can be seen that the aspect of assistance to the community occupies the first position, where almost all of the total Islamic banks in the data above have implemented this aspect. However, not a few of the other aspects are also carried out, for example, scholarship assistance to students and educational assistance, which is certainly the initial milestone to advance Indonesia's education by providing educational opportunities for those in need.

Moreover, other than the educational side, health aspects are considered as alternative steps in the provision of integrated and collective health services for the people of Indonesia. CSR programs in the field of health are certainly needed by Indonesian people of various ages, ranging from infants, children, and adults to the elderly. Given Indonesia's low access to health, making CSR health programs is a new solution for underprivileged communities. There are several CSR programs in health aspects, such as the anti-smoking and healthy living movement, the stunting prevention and handling movement, and the Covid-19 pandemic health program.

On the other hand, from the least implemented aspect, it can be seen that art and cultural assistance occupies the position of the least implemented aspect, where there are only two banks that implement this aspect, namely Bank Aceh Syariah and BPD NTB Syariah. The other least implemented aspect than art and cultural assistance, there is the aspect of religious activities. Religious activities such as preaching, *da'wah*, or others are less visible. It can be inferred that the main focus of CSR is more on the maintenance of the mosque, which will then lead to emerging religious activities.

Furthermore, from the banks that cover the most related aspects of social problems, the study finds that there are several banks that cover approximately 8-9 aspects of social problems, namely Bank Bukopin Syariah, BNI Syariah, BRI Syariah, and BPD NTB Syariah. Not only that, the four banks have also made adjustments to their CSR activities in order to contribute directly to the community during the Covid-19 pandemic. However, not only the four banks but other Islamic banks also do the same initiatives to contribute to handling Covid-19, such as making adjustments to working time and providing masks and multivitamins to their employees.

Environmental Contributions of Indonesian Islamic Banks

The environmental contributions of Indonesian Islamic banks vary among the banks. The environmental dimensions cover most of the current environmental issues and initiatives, such as waste management, eco-friendly operation, energy saving, and green financing. Table 3 illustrates the overall contributions of Indonesian Islamic banks toward current environmental issues. From the most widely implemented aspects, the study finds several aspects that occupy the position of the most implemented aspects, such as energy saving, efficient use of paper, and waste

management. Where from these three aspects, there is a total of 6-8 banks that implement it. However, some Islamic banks have good applications for CSR programs but not covering those three areas.

Table 3. Implementation of CSR in Indonesian Islamic Bank on Environmental Aspects (Part 1)

Environmental Contributions of Indonesian Islamic Banks							
No	Banks	Tree Planting	Garden maintenance	Ecotourism maintenance	Waste Management	Construction of toilet	Environmental cleaning volunteers
1	Aceh syariah		√	√	√	√	√
2	BPD NTB Syariah				√		
3	Muamalat Indonesia				√		
4	Victoria Syariah						
5	BRI Syariah						
6	BJB Syariah						
7	BNI Syariah						
8	Syariah Mandiri						
9	Mega Syariah						
10	Panin Dubai Syariah						
11	Syariah Bukopin				√		
12	BCA Syariah				√		
13	BTPN Syariah				√		
14	Aladin Syariah						

No	Banks	Procurement of clean water pipes	Eco-friendly operations	Paper use efficiency	Energy saving	Environmental conservation activities	Bio Pori	Green financing
1	Aceh syariah	√						
2	BPD NTB Syariah		√					
3	Muamalat Indonesia				√			
4	Victoria Syariah							
5	BRI Syariah		√	√	√	√		
6	BJB Syariah							
7	BNI Syariah				√		√	
8	Syariah Mandiri		√	√	√			
9	Mega Syariah							
10	Panin Dubai Syariah		√			√		
11	Syariah Bukopin			√	√			√
12	BCA Syariah			√	√	√		
13	BTPN Syariah			√	√			√
14	Aladin Syariah			√	√			

Source: Annual Report of Islamic Banks in Indonesia Year 2020

On the contrary, from the least implemented aspect, it can be seen that there are still a lot of Islamic banks that have not implemented their CSR in the area of environment, such as park maintenance, ecotourism maintenance, environmental hygiene volunteers, and procurement of clean water pipes. This is because there are still many companies or Islamic banks that do not understand the main focus of CSR in the environmental sector, and also, the tendency of Islamic banks/companies in implementing CSR is to overcome social and economic problems.

Furthermore, the banks that cover the most related aspects of environmental problems, we will find several banks that cover approximately 4-6 aspects of environmental problems, namely Bank Aceh Syariah, BRI Syariah, BCA Syariah, BTPN Syariah, and Bank Bukopin Syariah where these 4-6 aspects are included in the most implemented aspects. It can be seen that Bank BRI Syariah and Bank Bukopin Syariah are among the most stable in CSR performance related to social and environmental issues.

Moreover, banks that cover the least related to environmental issues, there are Bank Muamalat Indonesia, BNI Syariah, Aladin Syariah, Panin Dubai Syariah, and BPD NTB Syariah. The bank, on average, covers at least two aspects of environmental problems that occur in the community. However, it is possible that in the future, Islamic banks continue to carry out reforms to improve the performance of each bank's CSR and begin to pay more attention to environmental issues.

In optimising the implementation of CSR, Islamic banks are assisted and supervised by the Sharia Supervisory Board of each bank to ensure the Shariah compliance of all programs. The Sharia supervisory board is tasked with supervising the running of Islamic banks, whether it is in accordance with Islamic principles and values or whether its implementation supports the purpose of sharia (Maqashid Syariah). In the implementation of CSR, the Sharia supervisory board is guided by the National Sharia Council—the Indonesian Ulama Council (DSN-MUI); this is because there are still many obstacles faced in realizing the implementation of CSR in accordance with the Islamic economy (Muslihati, Siradjuddin, & Syahrudin, 2018).

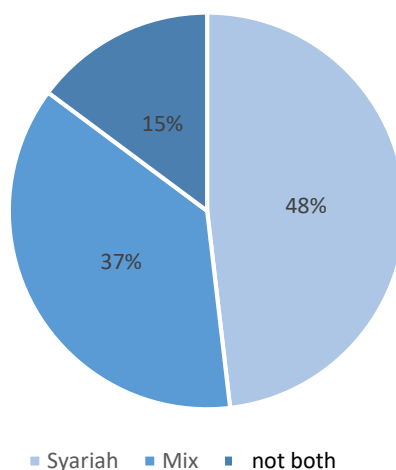


Figure 1. Educational Background of Sharia Supervisor Board (DPS)

Figure 1 shows that the educational background of DPS are not all graduates of Sharia or Islamic economics. Although the majority of DPS are Sharia graduates, there are also many from Sharia supervisor boards who turned out not to be a graduate of Sharia or Islamic economics, not even from both, such as Development Counselling, Legal Sciences, Management, Accounting, and Education.

The different backgrounds of the sharia committee meant to oversee the implantation of CSR of Islamic banks to cover all aspects of issues in society and its accordance with sharia principles. In the implementation of CSR, a sharia committee needs to be guided and also supervised by the National Sharia Council—the Indonesian Ulama Council (DSN-MUI).

From the tables related to social and environmental contributions, there are several Islamic banks that contribute the most to the implementation of their CSR and look stable in the implementation, namely Bank Bukopin Syariah and Bank BRI Syariah, where in social issues, the two banks have implemented at most eight aspects of social problems and environmental issues, and the two banks have succeeded in implementing four environmental aspects in second place after Bank Aceh Syariah.

Furthermore, the Sharia supervisory board is not the only benchmark of whether or not the CSR performance of an Islamic bank is; there are many other aspects, such as differences in market share between one bank and another, the commitment of the board of directors, and their business management. Therefore, to support the performance of CSR, it needs support from all Indonesian Islamic banks stakeholders.

CONCLUSION

Islamic finance is one of the financial management systems which uses the basis and principles of Islamic law as its guideline, where the basis and principles of Islamic law are not only applied to the system but also to the implementation and products offered. The implementation of CSR in Islamic banks in Indonesia itself currently appears to perform well with several limitations, one of which is not optimally playing an active role in controlling the environmental impact of financing. In addition, looking at current ethical business practices, CSR practices have succeeded in dominating the ethical business aspects of the company.

A number of Islamic banks have optimized their CSR performance to contribute to facing social and environmental issues. However, it cannot be denied that Islamic banks in Indonesia need to improve their CSR programs targeting the ongoing social and environmental issues in order to realize good CSR performance based on Islamic values. Other than that, the commitment of the board of directors is needed to realise the direction of the bank's CSR activities. The important role of government can be denied in these initiatives; a robust policy guideline on the role of the Islamic financial industry in contributing to socio-economic development is highly demanded. However, this study carries some limitations, such as the coverage of the year of study and the measurement of Islamic banks' social and environmental contributions, which might be done in a different methodology in future studies.

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