Sustainability Key Performance Indicators in Islamic Banking Sectors of Malaysia and Pakistan: A Scale Based Evidence

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Abstract

The marvelous development in the Islamic banking necessitates sustainable practices in the emerging industry. This study intends to ascertain the most followed or usual sustainability key performance indicators (KPIs) in the Islamic banking industry of Malaysia and Pakistan. For developing the sustainability KPIs index, the study follows the systematic steps as highlighted by prior such studies. The index composed of 109 items in 7 main sections of sustainability reporting adapted to collect data through content analysis for 21 Islamic banks from both the countries for the year 2016. Despite significant heterogeneity among the Islamic banks of the two countries, it is found that they show good compliance with the sustainability indicators. Though the Islamic banking industry of Pakistan is small than that of Malaysia, but still it is good in reporting sustainable practices except for environment and product responsibility, where the latter has an edge over the former. The study contributes a theoretical deliverable i.e. sustainability KPIs index for the Islamic banking industry through testing it with data from 21 Islamic banks from Malaysia and Pakistan. The findings could be significant for practitioners, regulators, policymakers, and especially the Islamic banking industry of both countries.

Keywords: Sustainability, Key Performance Indicators, Reporting Index, Malaysia, Pakistan

KAUJIE Classification: H47, L25

JEL Classification: C43, G21, L25, Z12

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Introduction

There is tremendous growth in the Islamic financial services industry as the overall asset value had been reached USD 1.5 trillion by 2017 as reported by the Islamic Financial Services Board: Stability Report 2016 (IFSB, 2016). It necessitates measures for sustainable practices in the Islamic banking industry. Moreover, from the Islamic reporting perspective, the stakeholders expect that social concerns should be a principal agenda of disclosures in annual reports. Accordingly, Islamic banks are supposed to be more translucent and sustainable in their disclosure practices. However, in contrast, the studies reported that sustainability practices particularly in the Islamic banking industry are less matured and not fully implemented as compared to conventional banks (World Bank Group & IRTI, 2016). Among the reasons, there are no comprehensive key performance indicators (KPIs) available for the reporting of sustainability-related practices in the Islamic banking industry. Though some studies attempted to fill this gap including Alvarado-Herrera et al., 2017; Amran et al., 2017; Jan et al., 2019; Moisescu, 2015; Rehman et al., 2020, but still space and motivation exist for further research in the area. For instance, despite focusing on sustainability, the studies ignored the integrated reporting mechanisms. Some authors propose to investigate the level of sustainability practices in Islamic banking industries (Rehman et al., 2020). Similarly, in another study, the authors further propose the investigation of other sustainability dimensions such as Governance and Strategic Commitments (GSM), Sharia Compliance (SC), Employees Welfare and Development (EWD), Ethics and Human Rights (EHR), and Product Responsibility (PR) in the Islamic banking industry (Jan et al., 2019). Hence, keeping in view the above discussion, there is a need for a comprehensive index covering all the above aspects for acceptable and comprehensive sustainability reporting. Henceforth, the current study tries to fill this gap by identifying and developing the sustainability reporting KPIs for the Islamic banking industry. The study also attempts to cover the shortcomings of the previous studies by finding answers to the research questions: i) What are the key performance and reporting indicators for sustainability practices among the Islamic banking industry, and ii) What is the trend of sustainability key performance and reporting indicators among the Islamic banking institutions?

To answer, the current study selected the Islamic banking industries of Malaysia and Pakistan for the year 2016. Two major countries like Malaysia and Pakistan could be considered as the best sample for research in Islamic banking practices and performance. The period 2016 of the study could be considered recent as most of the reports of the selected Islamic banks were available online. The data collection procedure of sustainability KPIs is based on Global Reporting Initiative (GRI) framework 2016 and Shariah compliance manuals of both Malaysia and Pakistan. As theoretical deliverables, the study produces a sustainability KPIs index for Islamic banking institutions of Malaysia and Pakistan. The study unveils the factual tendency of these KPIs in the two countries that could be worthy for the practitioners, regulators, and policymakers in the future. The study is also valuable for Islamic banks of both countries to align their sustainability practices reporting with international standards and recommendations.

The paper is further structured as the literature review from a theoretical perspective, followed by the research methodology, findings, discussion, and conclusion of the study.

Theoretical framework

The literature review here aims to ascertain the theoretical underpinning/perspective for the study. For decades, scholars have been stressing over the positive role of business towards society. This role led to the consensus for rethinking about corporate social responsibility (CSR). The role further manifested when the world started to face new environmental challenges such as global warming. To face these challenges, the traditional CSR agenda has now transformed into business sustainable practices with a focus on social, economic, and environmental issues. The classical school of thought about business responsibility represented by Friedman (1970) assumed that corporations had the only obligation to make a legitimate profit. Also, it assumed that CSR activities cause extra cost and hence affect firms' sustainability and performance (Pinkston & Carroll, 1996). However, some other scholars enumerated a variety of firms' responsibilities towards their stakeholders. Moreover, these scholars also cascaded many categories of stakeholders and their responsibilities (Donaldson & Preston, 1995; Freeman, 1984). Given that, the current study underpins the theoretical framework based on stakeholder theory as against the shareholders' or shareholders' primacy theory. The theory postulates that the business organizations need to manage positive relationships with the stakeholder for their claims (Pérez et al., 2013). The cases in focus here are the banking institutions, and the welfare they extend or supposed to extend for the betterment of all stakeholders through their actions. These stakeholders included employees, customers, shareholders, society, the environment, and regulatory bodies. The stakeholders' theory impeccably suits to the banking industry for their sustainability practices and benefitting all their stakeholders. Traditionally, the banking industry took good care of the interests of shareholders only to overcome the problems of financial exclusion. However, nowadays, the banking institutions are encouraged to consider sustainability practices into their strategic agenda to focus on social, environmental, and economic sustainability (Alvarado-Herrera et al., 2017; Dissanayake et al., 2016).

Context of Islamic Banking in Malaysia and Pakistan

Sustainability – Items generation and identification

The Islamic banking industry has received substantial introspection and pushes from various stakeholders to peruse operations ethically and responsibly. However, some previous studies noted that the social responsiveness of the Islamic banks has negative implications on their overall performance and reputation (Rehman et al., 2020). Still, the stakeholders now a day are increasingly demanding social responsibility and sustainability practices of the firm. Among others, the investors are also focusing on sustainable practices of the firms where they invest their funds. Subsequently, the management of the Islamic banking industry is in tremendous pressure to adopt sustainability practices in their routine operations (Khan et al., 2011). However, as discussed earlier, the management is encountered with the problems of adopting comprehensive and accepted sustainability indicators for the industry. Some studies have attempted to fill this gap. Nevertheless, they also leftover some unexplored aspects creating avenues for further research. Thus, this study fills the evident gap by developing the sustainability reporting KPIs for the Islamic banking industry. The study also attempts to cover the shortcomings of the previous literature.

Corporate disclosures disseminate appropriate and important information to existing and prospective stakeholders, who can affect or be affected by the company's current and future operations/performance (Ho & Wong, 2001). Moreover, these disclosures serve two purposes for the stakeholders; first, to evaluate the current state of an organization's social, environmental, and economic activities, and second, to communicate these disclosures to the stakeholders (GRI, 2013). Sustainability disclosures are voluntary both in Malaysia and Pakistan (Aliyu et al., 2017; SBP, 2018b, 2018a). Voluntary disclosures that may have a substantial influence on the decision-making of the users are the information not mandatory to report. It is the discretion of the firms or their management to voluntarily determine both the quality and quantity of these disclosures or their reporting (Meek et al., 1995).

To achieve the objective, this study focuses on identifying the most followed disclosures of Islamic banking sustainability practices. Accordingly, the study utilizes a sustainability disclosure index - an instrument to gauge the reported information under a specific disclosure by a particular entity against a list of certain items or information (Marston & Shrives, 1991). The disclosures index has been widely used in prior studies as a proxy to identify and measure the level of firms' disclosures (Madi, 2012).

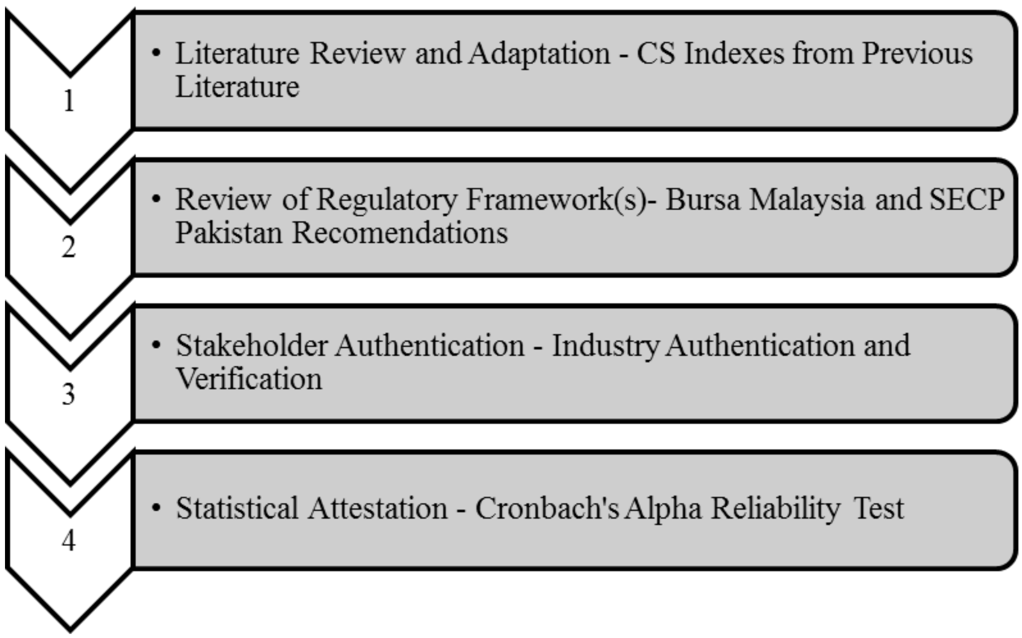

Figure 1 Steps for CS Disclosure Index Development

A four steps approach depicted in Figure 1 was followed to develop sustainability disclosure index for the Islamic banking industry as recommended by previous authors (Anas et al., 2015; Dissanayake et al., 2016; Kansal et al., 2014; Othman et al., 2011; Zahid et al., 2019). Firstly, an extensive literature review was employed to identify sustainability indicators. A review of the literature is beneficial to identify, adopt or adapt sustainability indicators and determine the level of their reliability to be used as a proxy for firm sustainability practices (Bonilla-Priego et al., 2014; Lozano & Huisingh, 2011; Roca & Searcy, 2011). For the development of this index, the current study focused on sustainability indicators based on the GRI sustainability reporting guidelines (GRI, 2013) and recommendations for the Islamic banking industry. The "GRI sustainability reporting guidelines were developed as a way of helping organizations to report on their environmental, social and economic performance increasing their accountability, through the implementation of the transparency, inclusiveness, suitability, completeness, relevance, sustainability context, accuracy, neutrality, comparability, clarity, and timeliness principles"

(Bonilla-Priego et al., 2014, p. 153). Moreover, GRI reporting is considered as a helpful tool to gain international confidence, the trustworthiness of corporate reporting, and positive perception among the broader spectrum of stakeholders (Clarkson et al., 2008; GRI, 2013; Othman et al., 2011). To examine the level of sustainability practices, most of the previous studies used sustainability disclosure index based on GRI which has produced consistent and substantiated results across many countries, like the United States of America, Mexico, Malaysia, Australia, Hong Kong, New Zealand, Sweden, Spain, the United Kingdom, China, Kenya, Denmark, Bangladesh, Italy, Pakistan, Malaysia, and Turkey, etc. (Alvarado-Herrera et al., 2017; Amran et al., 2017; Jan et al., 2019; Moisescu, 2015; Rehman et al., 2020).

After the identification and listing of the items of sustainability disclosures in the second step, these disclosures were randomly checked with the selected annual reports of the Islamic banks from both Malaysia and Pakistan. The existing literature related to CS practices mainly focused on the existing indexes developed from past studies to measure sustainability practices (Lozano & Huisingh, 2011; Roca & Searcy, 2011) without considering the country-specific context and industry requirements. However, the current study uses sustainability indicators which are based on the five dimensions approach of sustainability practices proposed and specifically recommended for the Islamic banking industry, (Anas et al., 2015; Bursa Malaysia, 2006), as discussed below.

Environmental sustainability

The environmental aspect of sustainability addresses the impact of a firm on both the living and non-living natural systems which include land, air, water, and ecosystems, among others. It also accounts for the firms' impact on inputs (energy and water) and outputs (emissions, effluents, and waste). Biodiversity, transport, product pertaining impacts along with environmental compliance and expenditures are those topics covered under the subject (GRI, 2013,).

Social sustainability

The social dimension of sustainability addresses the impacts of firms on the social systems of the area where they are located or operate. Labor Practices and Decent Work, Human Rights, Society, and Product Responsibility are the key areas of interest under the subject (GRI, 2013).

Governance and strategic commitment

Transparency and governance structure, among others, are the characteristics of the firm crucial for ensuring liability, responsibility, and accountability of the bodies and individuals. These Standard Disclosures explain the establishment of the highest governance body to support a firm's purpose and its alignment with economic, environmental, and social dimensions (GRI, 2013).

In the third step, this index was verified from the various industries as recommended by the previous studies (Madi, 2012; Othman et al., 2011). After identification of the most followed items of sustainability practices (including environmental, social, and governance & strategic commitments), a reliability test was conducted using Cronbach's alpha score for all the items to assess the reliability/internal consistency of the disclosure index. The value of Cronbach's alpha of 109 items is 0.947 (combined), 0.949 for Malaysia, and 0.899 for Pakistan. Moreover, there was no item excluded from the index consequent upon zero variance.

Table 1 Reliability and Scale Statistics

Cronbach's alpha	Cronbach's alpha based on standardized items	Items	Mean	Variance	Data
0.947	0.942	100	.571	.082	Combine
0.949	0.945	100	.543	0.82	Malaysia
0.899	0.896	100	.471	0.060	Pakistan

The final score of sustainability indicators consists of 109 items (Exhibits in Appendix A), including environmental, social, and governance & strategic commitments categories. Cronbach's alpha score reported in Table 1 is below the recommended threshold (Anas et al., 2015; Kansal et al., 2014).

Methodology

This study relied on the published annual reports of the Islamic banks in Malaysia and Pakistan for the year 2016. The content analysis method of data collection is less expensive and less obtrusive as compared to some other data collection methods. It has been used frequently and applied in studies related to CS practices (Delai & Takahashi, 2013). The content analysis has been defined as "a technique for gathering data that consists of codifying qualitative information in anecdotal and literary form into categories to derive quantitative scales of varying levels of complexity" (Abbott & Monsen, 1979) cited in (Said et al., 2009, p. 218). The study relied on the un-weighted scoring approach as recommended by previous studies (Eccles, Loannou, & Sarafeim, 2013; Esa & Ghazali, 2012; Gao & Bansal, 2013; Haniffa & Cooke, 2005; Nazli et al., 2013). In the unweighted scoring method, a dichotomous procedure is applied, where disclosure is assigned a value 1 if an item is disclosed in the report of a company, and 0 otherwise. For recording each disclosure, the CS disclosures index -Appendix A was used. Based on the CS disclosure index, a total score for each company was measured as CSP = Σ di Where d = 1 if the sustainability item is disclosed; and d = 0 if the item is not disclosed and *i* represents the year(s). The highest score of the content is implied as the highest performance (Singal, 2013). A list of the selected Islamic banks from both the countries (Malaysia and Pakistan) is given in Table 2.

Table 2 List of Islamic Banks

SNo	Name of the Bank	Country
1	Affin Islamic Bank Berhad	Malaysia
2	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad	Malaysia
3	Alliance Islamic Bank Berhad	Malaysia
4	AmBank Islamic Berhad	Malaysia
5	Asian Finance Bank Berhad	Malaysia
6	Bank Islam Malaysia Berhad	Malaysia
7	Bank Muamalat Malaysia Berhad	Malaysia
8	CIMB Islamic Bank Berhad	Malaysia
9	HSBC Amanah Malaysia Berhad	Malaysia
10	Hong Leong Islamic Bank Berhad	Malaysia

11	Kuwait Finance House (Malaysia) Berhad	Malaysia
12	Maybank Islamic Berhad	Malaysia
13	OCBC Al-Amin Bank Berhad	Malaysia
14	Public Islamic Bank Berhad	Malaysia
15	RHB Islamic Bank Berhad	Malaysia
16	Standard Chartered Saadiq Berhad	Malaysia
17	Bank Islami Pakistan	Pakistan
18	Islamic commercial bank (Al Baraka)	Pakistan
19	Meezan Bank	Pakistan
20	Bank Alfalah Limited	Pakistan
21	Dubai Islamic Bank Pakistan Ltd	Pakistan

Results

Table 3 reports descriptive statistics of sixteen Malaysian Islamic banks regarding sustainability practices for 2016. It combines range, minimum, maximum, mean, standard deviation, skewness, and kurtosis. SPSS Compute command employed to combine each category namely Governance and Strategic Commitments (GSM), Sharia Compliance (SC), Employees Welfare and Development (EWD), Environmental (ENV), Ethics and Human Rights (EHR), Product Responsibility (PR) and Social (SOC) Sustainability. For GSM, the Malaysian Islamic banks reported a minimum of 6, maximum 18, with a mean value of 13.24. Similarly, Pakistani Islamic banks reported a minimum of 12, a maximum 17, and a mean value of 15.40 for GSM. As compared to Malaysian Islamic banks, Pakistani banks report higher mean value and hence lead in GSM. In SC category minimum values are 4 and 8 while maximum values are 11 and 10 with mean values of 8.31 and 9.00 for Malaysian and Pakistani Islamic banks respectively. These statistics also suggest that the mean value for Pakistani banks is higher than that of Malaysia. For EWD, EHR, and SOC the mean value of Islamic banks in Pakistan is higher than those of Malaysia. However, in the ENV and PS categories, the Malaysian Islamic banks have higher mean values than that of Pakistani banks. The overall results reveal that heterogeneity exists between the Islamic banks of the two countries regarding reporting sustainability practices. However, for environmental and product responsibility, Malaysian banks have an edge over their Pakistani counterparts.

Table 3 Descriptive statistics Malaysia

Descriptive Statistics of Malaysia

	N	Range	Min	Max	Mean	S.D	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
GSM	16	12.00	6.00	18.00	13.8750	3.24294	-.811	.564	.775	1.091
SC	16	7.00	4.00	11.00	8.3125	2.27211	-.754	.564	-.260	1.091
EWD	16	7.00	7.00	14.00	10.5000	2.19089	.261	.564	-.997	1.091
Env	16	14.00	4.00	18.00	10.0000	4.57530	.339	.564	-1.037	1.091
EHR	16	10.00	1.00	11.00	5.1250	2.60448	.620	.564	.285	1.091
PS	16	15.00	3.00	18.00	11.8125	3.37083	-.842	.564	2.374	1.091

SOC	16	12.00	.00	12.00	3.0000	4.00000	1.450	.564	.509	1.091

Descriptive Statistics of Pakistan

	N	Range	Min	Max	Mean	S.D	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
GSM	5	5.00	12.00	17.00	15.40	2.30	-1.016	.913	-1.007	2.00
SC	5	2.00	8.00	10.00	9.00	.70	.000	.913	2.000	2.00
EWD	5	5.00	11.00	16.00	13.60	2.40	-.473	.913	-3.086	2.00
Env	5	8.00	2.00	10.00	5.20	3.11	.933	.913	.762	2.00
EHR	5	2.00	13.00	15.00	13.60	.89	1.258	.913	.312	2.00
PS	5	2.00	7.00	9.00	8.00	1.00	.000	.913	-3.000	2.00
SOC	5	3.00	10.00	13.00	11.60	1.516	-.315	.913	-3.081	2.00

Descriptive Statistics Combined

	N	Range	Min	Max	Mean	S.D	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
GSM	21	12.00	.00	12.00	3.5238	3.85511	1.085	.501	-.302	.972
SC	21	7.00	4.00	11.00	8.4762	2.01542	-1.015	.501	.653	.972
EWD	21	7.00	7.00	14.00	10.7619	2.07135	.016	.501	-1.042	.972
Env	21	14.00	4.00	18.00	10.8571	4.39643	-.074	.501	-1.164	.972
EHR	21	10.00	1.00	11.00	5.8095	2.61952	.026	.501	-.676	.972
PS	21	15.00	3.00	18.00	12.2381	3.04803	-1.198	.501	3.422	.972
SOC	21	12.00	.00	12.00	3.5238	3.85511	1.085	.501	-.302	.972

Discussion and Conclusion

To answer the first research question i.e. what are the key performance and reporting indicators for sustainability practices between the Islamic banking industries, the study selected full-fledged Islamic banks from two Islamic countries - Malaysia and Pakistan. The data was collected from the annual reports of these banks. A total of 21 annual reports were utilized in the study combining 16 from Malaysia and 5 from Pakistan. After applying for a comprehensive literature review, 100 indicators were identified under seven major headings. The identified indicators were then verified through a relevant test for reliability. The results disclosed and validated the identified indicator for sustainability, as the most followed by the Islamic banks of both countries.

To answer the second research question of the study i.e. what is the trend of sustainability key performance and reporting indicators among the Islamic banking industry, the descriptive statistical inquiry provided evidence for a noteworthy heterogeneity regarding sustainability practices in Islamic banks of the two countries. Despite a limited number of Islamic banks in Pakistan, they reported better sustainability practices than Malaysian banks except for environment and product responsibility, where the latter has edge over the former. The study identified the most followed sustainability indicators among the Islamic banking industry of Malaysia and Pakistan. Hence, it contributed a theoretical deliverable i.e. sustainability KPIs index for the Islamic banking industry through testing it with data from 21 Islamic banks from

Malaysia and Pakistan. The findings could be significant for practitioners, regulators, policymakers, and especially the Islamic banking industry of both countries. For further robustness, the index of the current study should be further tested in the longitudinal nature of data. Moreover, it is also recommended to test the index in other countries where the Islamic banking industry exists, is expanding, or has prospects.

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Appendix A: Index for Sustainability Reporting in Islamic Banking

SNo.	Sustainability Reporting Indicators
	Governance and Strategic Commitment
1	Focus on maximizing stakeholders returns
2	Operating within the Shariah principles
3	Appreciating the stakeholders and the customers
4	Commitment to engage only in permissible financing activities
5	Name of the board of directors
6	Position holding the board of directors
7	Shareholding of the board of directors
8	remuneration of the board of directors
9	Head of the audit committee observing the AAIOFI standards
10	Profile for the board of directors
11	Various sub-committees exist
12	Name and position of the sub-committees exist
13	Any internal committee for the customer's grievance mechanism
14	Academic qualification of the management team
15	Members of the sub-committee of the management team
16	Remuneration committee
17	Any human resource management committee
18	Proper functional Research and development
	Shariah Compliance
1	Names of the SSB members
2	Qualification of the SSB members
3	Remuneration of the members
4	Proper report signs by the members
5	Numbers of meetings held
6	Examination of the documents based on the sample
7	Examination of all the documents
8	No defect in the products
9	Report defects in the products
10	Report of the SSB
11	Nature of unlawful transactions
12	certification of the distribution of profits and loss complying with principles of Shariah
13	zakat calculated according to the shariah

Social Sustainability

1 Funding to organizations that provide benefits to the community for social equity
2 Fostering strong links with the community/public service
3 Creating job opportunities
4 Amount spent in community activities
5 participation in government-sponsored social activities
6 Zakah payment – monetary
7 Zakah payment – beneficiaries
8 SSB attestation that sources and uses of zakat are according to Shariah
9 SSB attestation that zakat has been computed according to shariah
10 Qardh-Hassan – monetary
11 Qardh-Hassan – beneficiaries
12 Sadaqah – monetary
13 Sadaqah – beneficiaries
14 Regular performance and career development report
15 Strategy formulation and decision-making support to the top management standardize training curriculum
16 Database management

Employees Welfare and Development

1 Equal opportunities policy
2 Employees' welfare
3 Ensuring diversity
4 Any promotion mechanism/policy for the employees
5 Training: *Shariah* awareness
6 Training: professional skill
7 Encouraging talent
8 Keeping the policy of international labor standard
9 Reward for employees
10 Employees' appreciation
11 Any health, education facilities for the employee
12 Any promotion mechanism/policy for the employees
13 Any online or offline grievances mechanism for the employees
14 Gender equality
15 Measures for the staff safety
16 Occupational health and education facilities to employees
17 Equal remuneration for men and women

Ethics and human rights

1 Non-discriminative policies irrespective of age, sex, and ethnicity
2 Policies regarding sexual harassment
3 Dealing with the legal items only
4 Paying the taxes to the government
5 Comprehensive code of conduct
6 Whether the bank prevents corruption and other financial irregularities

7	Protects human rights
8	Whether provides accurate information to the customers
9	Provides secure transactions
10	The proper security mechanism for employees and customers
11	Whether following rules and regulations prescribed by the state bank of Pakistan
12	Whether observing the labor laws practices
13	Supplier human rights assessment
14	Gender equality
15	Anti-corruption and anti-money laundering policies
16	Proper code of ethics for the employees
17	Proper code of ethics for the internal auditors
18	Human rights grievances mechanism
	Product and Services
1	Basis of shariah concept on the new product
2	Introduction of SSB approved new products
3	Definition of the new product
4	Safe and Secure internet facilities available for banking
5	No investment in non-permissible products
6	Fair dealing with those in the supply chain
7	Secure internet banking facility provided to the customer/stakeholders
8	Any customer grievances mechanism
9	Nature of the unlawful transaction
10	Promotion of research and development
11	Customers secrecy and privacy
12	Customers health and safety
	Environmental Sustainability
1	Introduction of the green product
2	Glossary/definition of the green product
3	The amount of donation in environmental awareness
4	Financing in any project which may lead to environmental damage
5	Initiatives to mitigate environmental impacts of product and services
6	Focus on risk-based corrective actions
7	Environmental grievances mechanism
8	Investment in environmentally friendly products
9	Energy conservation
10	Measures for providing clean water to the stakeholders
11	Water conservation
12	Biodiversity
13	Measures for reduction of greenhouse gases
14	Measures to ensure pollution-free transport to the employees and stakeholders
15	Supplier environmental assessment

Source: Authors Compilation