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Impact of Financial Inclusion and Corporate Social Responsibility on Islamic Banks Financial stability with the Moderating Role of Corporate Governance

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Abstract: This research work checks the influence of the financial inclusion index (FI) and corporate social responsibility index (CSRI) on financial stability, profitability, and return on equity of the Islamic banks of Pakistan. Further, this research work checks whether the corporate governance index plays a moderating role in the association between the financial inclusion and corporate social responsibility index on Islamic and bank stability, profitability. The corporate social responsibility index was measured through the contribution of social activity to society. Financial inclusion was measure through financial access to the entire society without any discrimination against society. In this paper, samples of the Islamic banks including the Islamic window of the conventional banks over the period of 2005 to 2020 are investigated. Further, the data is selected of the variables from the financial statement and balance sheet of the banks. The fixed effects and generalized moments of the method are employed to check the affiliation between the FI and CSR on the stability and profitability of Islamic banks. The generalized moment of method (GMM) has been employed on the panel data set to control the endogeneity. The empirical consequences of this research study have the following conclusion: Firstly, FI has a constructive and significant impact on the financial stability and profitability of the banks. Secondly, CSR has positive relationship with the banks stability and profitability. Finally, the interaction term corporate governance (CG) strengthens the relationship among the FI and CSR with the stability and profitability.
Keywords: Financial stability; Profitability; Financial inclusion, CSR; Corporate governance index

1. Introduction

Internationally, FI has gain a great momentum from last few decades and promoting of economic growth and stability. FI define, the access to and access and use of financial product and service by the without discrimination and affordable to low section of the society (Demirguc-Kunt et al. 2018). This research study has few purposes, First, it makes an attempt to scrutinize the direct influence of the financial inclusion (hereafter, FI) on the Islamic banks' financial stability and profitability. Secondly, this study also explores the lasting effect of corporate social responsibility (hereafter, CSR) on the Islamic banks' financial stability and profitability. Whether the corporate governance plays a moderating role between financial inclusion and corporate social responsibility on banks financial stability and profitability test or not. FI defined is the financial access to the whole region without any obstacle, easily and affordable (e.g., Olaniyi & Adeoye, 2017). Other research studies also define that FI is the service where the whole population takes benefits from the financial service (Arora, 2010; Ozili, 2018; Bhaskar, 2013).

In the near past, social activities gained a huge Momentum in the research field as well as the international corporation to meet the shareholder expectation. In terms of research works, CSR stated the long-term strategic commitment of the corporation to repay and solve the Societal and environmental issues (Ness, 1992). However, other research studies reveal that organizations must engage and participate in philanthropic and social activities (Carroll, 1979).

Indeed, due to corporate social responsibility organization achieves competitive edge as well financial stability (Freeman, 1988). Stakeholder theory explained the connection between the management of the firm and stakeholders (Hammann et al. 2009). However, the research study reveals that the CSR activities of the organization should be an asset instead of a cost (Wibisono, 2007). CSR has had countless considerations from the last few decades due to the global social and environmental issue (Turker, 2016). It has been defined variously in the research study conducted in the past that CSR is the humanitarian approach to a strategic business for gaining the competitive edge (Latif and Sajjad, 2018). Moreover, the research study also said that engagement in the corporate social responsibility Programs Corporation enhances the firm performance and reduces the information asymmetric (Gul et al. 2017). Indeed, a specific other research study said that Islamic banking is playing a positive role in moral values which directly affect the business (William and Zinkin 2010).

Corporate governance mechanisms attract attention of the research scholar and policymakers due corporate scandal from last few decades (Majumder et al. 2017). The term corporate governance (CG) is define, the proper system by the business are that govern and directed (Dharmadasa et al. 2014). Corporate governance mechanism reduces the information asymmetric between the management and stakeholder (Ji et al., 2015; Mohamed et al., 2017). Numerous, research studies works claim that corporate governance mechanism measure through following indicators such as (i) Board size (ii) CEO duality (iii) members education level (iv) annual meeting of member per

year (v) Directors independent (vi) board compensation (vii) Experience of board members and (viii) female members etc.
Corporate governance is defines, the organization system from where the company directed and controlled (Cadbury, 1992). However, other research works reveals that the main goal of the corporate governance in organization is to reduce the agency cost and enhance the corporation wealth (Cuervo, 2002). Traditional finance agency theory, explain the relationship among the corporate and performance (Farag et al. 2018; Grove et al. 2011). Numerous, research studies examine the role of corporate governance that influence the financial performance of the banking sectors such as (Naushad and Malik, 2015; Darmadi, 2013). Agency theory of finance, the theory of finance reveals that the main objective of the board size effectively manages management activity (Hegazy and Hagazy, 2010). Large board's size has significant effect the financial performance (Kevit and Malenko, 2016). While other research study examines that board size less efficient (Gao, 2015). CEO duality is define, that type of the person who held the both of position in the organization (Naushad and Malik, 2015).

Significant of the study

Theoretically, this research works contributed to the available literature by the filling the gap of the studies that did not examine theoretically and empirically by the using the Public good theory, financial intermediation theory, Echelon theory, diffusion of innovation, agency theories and financial intermediaries. The finding of this research works are expected to contribute that financial inclusion and corporate social responsibility has positive factor to enhance the financial stability of banking sectors. The findings provided by this research can be used by microfinance providers to improve the financial stability and profitability of Islamic banks of Pakistan. The research also helps of the policy to in the field of academia and policy maker to implement the financial inclusion model in Pakistan. The current research as a source of the further research studies for the future.

2. Literature Review

A growing body of research studies finds dual findings among the access to finance (FI) and banks FS and return of the banking institution. A number of the research works used different proxies to check the impact of financial access and financial stability such as (Khan, 2011; Morgan and Pontines, 2014; Han and Melecky, 2013; Mehrotra and Yetman, 2015). The research study concluded that the increase in ATM will enhance the return of the Nigerian banks (Jegeda, 2014; Alfonse and Florence, 2012; Akhiser et al. 2015; Mohseni, 2017; Olajide et al. 2011; Ditta and Saputra, 2020; Le et al. 2019; Shihadeh et al. 2018; Ikram and Lohdi, 2015).

Panel data regression estimation took from the time frame of 2011 to 2016 the research study reveals that FI increases the financial efficiency of the bank (Muthia et al. 2020). Vo et al. (2021) to check the effect of FI on financial stability collected the data from the 3071 from the time period of 2008—2017 of the Asian region. The study noted that higher levels of financial inclusion enhance the stability of the financial institution and in turn lead to bank resilience of the bank. Secondly, the financial inclusions reduce the transaction cost and poverty and enhance the value of the share.

It has been defined variously in the research study that financial inclusion define, is a process where an individual and firm-level access to formal financial product and service such as formal payment, credit saving, formal payment, insurance, and pension- saving without any discrimination at low cost (Umar et al. 2019; Demirgu-Kunt and Klapper, 2012). The research study also examines those Islamic financial institutions that are much engaged in the financial inclusion service in both Pakistan and Bangladesh (Nawaz, 2018). However, this research works to distinguish how and whether FI is equal for the Pakistan Islamic banks. Still not found research that that examines the influence of FI and Islamic banks returns and with the interaction term effect in the Pakistan environment.

H1: Financial inclusion has a positive association with the financial and Profitability

A developing frame of research studies found different results on the connotation among the social responsibility on FS and profitability. The research shows that good corporate social response can provide substantial benefits increasing innovation and capacity (Russo & Fouts 1997). Many research studies investigate whether CSR performance (Activities) matters for stock market investors. Galema et al (2008) find from the research study that when corporations doing social activities in the market leads to enhance the performance of the firm. The study was conducted on a sample of the 26 top listed corporations of Jordan, the study results reveal that there is an insignificant relationship of CSR in FP (Omar and Zallom, 2016).

CSR illustrates that it is the social responsibility of a company towards the population. A number of the researchers define that in CSR the firm has a responsibility to utilize the society and maximize the profit (Lantos. 2001). Several research studies have scrutinized the influence of CSR on banking stability and profitability and found mixed results. For example, Gong and Ho, 2018) collected the data of the Chinese firm from the period of 2009—2015 and found that this type of firm who are engaged in CSR activities are more stable.

Moreover, the study also reveals that CSP attracts many social responsibilities then they improve the financial performance (Bagnolli and Watts (2003). Moreover, the researchers examined the data from 2004 to 2010 there is relation asymmetric information (Lopatta et al. (2016). The research study measures information asymmetry in a different way compared to the last study of the research. The research examines the information asymmetry from abnormal returns that occur when trade inside in the firm. The data was taken over the time frame 1992-2007 using a sample study of 12920 US firms that investigate that when firms are doing CSR the cost of equity is low in the industry (El Ghoul et al. 2011). The firms which are involved in tobacco and nuclear power those types of the firm financing their finance from equity financing costs. The firms are less risky and have low asymmetry information, as a result, leads to a decrease in the cost of equity financing.

H2: Corporate social responsibility has a positive association financial stability and Profitability

The results also found that there is a substantial and affirmative impact on financial access and financial profitability and financial stability (Yussif, 2020). Governance mechanisms play and enhance an important role in the country's financial inclusion (Dalwai & Chugh, 2014). CG has two main achievements in the statement enhance the financial inclusion system and maximizes the stakeholder wealth. FI provided the basic financial service at low, affordable, and without discrimination available to the whole members of the society. The examiner examined that the large board size of the banks is less effective than the small one due to the coordination problem (Jensen, 1993). The Board of directors showed positive signs with the performance of the financial institution (Haniffa and Hudaib, 2006; Jackling and Johl, 2009; Naushad and Abdul Malik, 2015; Srairi, 2015). Numerous research works also show the inverse relationship among financial performance (e.g., Yermack, 1996; Lee and Chen, 2011). According to the research the data was taken of the data of the Indian listed using GMM the research results examine that the CG has a substantial influence on the banks' profitability (Alamaqtari et al. 2020; Aslam and Haron, 2020; Orazalin and Mahmood, 2019; Shabbir et al. 2020; Farag et al. 2018; Abdulazeez et al 2019; Mollah et al. 2017).

H3: Corporate governance has playing moderating role with the financial inclusion and financial stability and profitability

Platonova et al. (2018) collected the figures of GCC nations to examine the effect of the CSR and performance of the banking sectors. The study results examine that social engagement has a major and positive connection with the Islamic banks of GCC. However, few research studies say that there is no significant relationship between CSR and financial performance (Newell and lee 2012; Theodoulidis et al. 2017; Siueia et al. 2019; Vo, 2011; Rettab et al. 2009).

In light of the stakeholder, there is an affirmative association among the social and performance. Waddock and Graves (1997) proposed two theory slack resources and good management theory to enhance financial performance. To check the connection between the corporate social responsibility and corporate governance of Islamic banks, the study finds that there is a positive and significant association between corporate governance and social activities (Mallin et al. 2014). Moreover, the research also investigates that public ownership, foreign and board independence has a positive relationship with CSR while CEO duality has no influence on corporate social responsibility (Khan et al. 2013; Jo and Harjoto, 2011).

Numbers of research works examine that corporate governance has enhanced the banking FP (Hussien et al. 2019; Grassa and Matoussi, 2014; Wasiuzzaman and Gunasegavan, 2013). So, the good corporate governance of any banking sector enhances the performance of the banks and reduces the agency problem between the management and stakeholder. Agency theory supports the links between the CG and the performance of the firm (Fama and Jensen, 1983).

H4: Corporate governance index moderate among the corporate social responsibility and financial stability and profitability

3. Research Methodology

The research study used the unbalanced panel data of Pakistan over the period of 2005 to 2020 listed banks of Islamic banks and conventional banks Islamic branches. The research study uses the generalized moment of method (GMM) to cover and control the endogeneity problem in the model. Generalized moment of the method was proposed by Arellano and Bond 1998. The model empirically checks and explores the influence of access to finance (FI) and CSR on the financial stability and profitability of Islamic banks of Pakistan. The main dependent variables of this research study are Islamic banks' financial stability and profitability. The explanatory variable of the research study is financial inclusion. The moderating variables of the research study are corporate governance. This research uses the two-step system (SYS) estimation GMM method which was developed by Blundell and Bond (1998) and Arellano and Bover (1995) to estimate the relationship among the models of the research. GMM model is to take the lagged value of the outcome variables.

Measurements and Definition of Variables

Independent Variables

These research works were to bring minor changes to make it suitable for the Pakistani environment. This index covers five broader activities of the corporate governance of the Islamic banks of Pakistan. The research works measure financial inclusion through financial access such as no of atm, no of the card, deposited SME, and atm machines (Sharma and Mandira, 2015). The principal component technique (PCA) is used to construct FI dimensions to normalized variables for the Pakistan Islamic banks. The prior research studies measure corporate social responsibility index through the different techniques such as few kinds of research taken the log to Donation. This research works follow the prior research works by (Gul et al. 2017).

Dependent Variables

A Dependent variable of this research works is the bank's profitability and financial stability. The term profitability is measured through the return on asset (ROA) which was used in past research works (Shihadeh & Liu, 2019). Financial stability is measured through the Z-Score of the banks which have used numerous research studies in prior literature (Anarfo et al. 2020 and Van et. al 2020).

Moderator Variables

This research works make the index of the corporate governance of the Islamic banks such as board size, board independence, Number of the board meetings (BM), duality of CEO. The research studies examine that CG has an optimistic and substantial influence on the access to finance and profitability of the banking sectors (Iqbal et al. 2019; Abdallah and Ismail 2017). Similarly, limited prior research works were published to examine the role of corporate governance index on the corporate financial performance likewise (Clacher et al. 2008).

Model Specification

In order to explore the impact of financial inclusion on the bank's financial stability and profitability, this research works adapted the **model I, II, III of** the prior research works (Siddik et al. 2018). The research studies to check the impact of financial inclusion on the banks' financial stability and profitability use Pooled Ordinary least square method, fixed, random effect, and generalized moment of the method. Second, this research works adapted the second **model 1V, V, VI** for this research study used by the earlier research studies (Ramazan et al. 2021; Lin et al. 2009).

$$FS= \beta + \beta 1FI_{it} + \beta 2CGI + \beta 2Banks\ size + \beta 3\ banks\ age + \varepsilon \ldots\ldots\ldots\ldots I$$

$$ROA= \beta + \beta 1FI_{it} + \beta 2CGI + \beta 2Banks\ size + \beta 3\ banks\ age + \varepsilon \ldots\ldots\ldots\ldots II$$

Model (2) below is the extension of the main model, which shows that the corporate governance with the relation on the above models I.II.III.

$$FS= \beta + \beta 1FII_{it} + \beta 2CGI + \beta 2FII{*}CGI + \beta 2BA + \beta 2BS+ \varepsilon \ldots\ldots\ldots\ldots III$$

Influence of CSR on FS and return of banks

$$FS= \beta + \beta CSR_{it} + \beta 2CGI + \beta 2Banks\ size + \beta 3\ banks\ age + \varepsilon \ldots\ldots\ldots\ldots IV$$

$$ROA= \beta + \beta CSR_{it} + \beta 2CGI + \beta 2CSR{*}CGI + \beta 2BA + \beta 2BS+ \varepsilon \ldots\ldots\ldots\ldots V$$

Model (3) below is the extension of the main model, which shows that the corporate governance corporate governance with the relation on the above models I.II.III.

$$FS= \beta + \beta 1CSRI_{it} + \beta 2CGI + \beta 2CSRI{*}CGI + \beta 3BA + \beta 4BS+ \varepsilon \ldots\ldots\ldots\ldots VI$$

Generalized moment of method (SYS GMM)

$$ROA = \beta + \beta 1FIit + \beta 2CGI + \beta 2Banks\ size + \beta 3\ banks\ age + \varepsilon \ldots\ldots\ldots\ldots 01$$

$$FS = \beta + \beta 1FIit + \beta 2CGI + \beta 2Banks\ size + \beta 3\ banks\ age + \varepsilon \ldots\ldots\ldots\ldots 02$$

$$ROA = \beta + \beta CSRit + \beta 2CGI + \beta 2Banks\ size + \beta 3\ banks\ age + \varepsilon \ldots\ldots\ldots\ldots 03$$

$$\mathrm{FS} = \beta + \beta\mathrm{CSRit} + \beta2\mathrm{CGI} + \beta2\mathrm{Banks\ size} + \beta3\ \mathrm{banks\ age} + \varepsilon \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots 04$$

$$\mathbf{FS_{it}} = \boldsymbol{\beta_0} + \boldsymbol{\beta_1}\,\mathbf{FS_{it-1}} + \boldsymbol{\beta_2}(\mathbf{FI_{it}})(\mathbf{CG_{it}}) + +\boldsymbol{\beta_3}(\boldsymbol{CSR})(\boldsymbol{CG}) + \boldsymbol{\beta_4}(\mathbf{CV_{it}}) + \boldsymbol{\beta_5}(\boldsymbol{\varepsilon_{it}}) \ldots\ldots\ldots \mathbf{05}$$

$$\mathbf{BP_{it}} = \boldsymbol{\beta_0} + \boldsymbol{\beta_1}\,\mathbf{BP_{it-1}} + \boldsymbol{\beta_2}(\mathbf{FI_{it}})(\mathbf{CG_{it}}) + +\boldsymbol{\beta_3}(\boldsymbol{CSR})(\boldsymbol{CG}) + \boldsymbol{\beta_4}(\mathbf{CV_{it}}) + \boldsymbol{\beta_5}(\boldsymbol{\varepsilon_{it}}) \ldots\ldots\ldots \mathbf{06}$$

Table 1: Summary Statistics of Islamic Banks Stability and Profitability

Variables	*Observation*	*Mean*	*Std. Deviation.*	*Minimum*	*Maximum*
Financial Stability	288	2.057	0.462	-0.205	1.900
ROA	288	0.0025	0.012	-0.0251	0.0391
ROE	288	0.0631	0.475	0.0310	2.034
CG Index	288	0.002	1.000	-0.03871	1.492
CSR Index	288	0.013	1.68	-1.010	2.006
Financial Inclusion index	288	0.023	1.000	-1.075	1.960
Banks Age	288	16.021	1.308	2.400	31.41
Banks Size	288	21.005	16.01	17	21.101

Source: Authors analysis

Tables 2: Correlation of Matrix of Islamic Banks Stability and Profitability

Variables	*ROA*	*ROE*	*FS*	*FI*	*CSR*	*CGI*	*BA*	*BS*
Return on asset	1							
Return on equity	0.681***	1						
FS	0.528***	0.457***	1					
FI	0.530***	0.345***	0.391***	1				
CSR	0.371***	0.230***	0.478***	0.619***	1			
CGI	0.43***	0.376***	0.398***	0.341***	0.291***	1		
BA	0.596***	0.512***	0.412***	0.527***	0.670***	0.577***	1	
BS	0.491***	0.460***	0.312***	0.371***	0.621***	0.390***	0.671**	1

4. Note *** level at 1%, ** level at 5% and * showed at 10%

The table **3** is consistent with may report findings of the direct/ linear regression model and moderating using the static panel data and dynamic panel data analysis with the main independent financial inclusion and CSR where the dependents variables of the research works are financial stability and profitability of the Islamic banks Pakistan. The main moderating variables of the research works are corporate governance. Financial inclusion and CSR in the fixed effect significant impact at 5% level with the financial stability and profitability in Islamic banks of Pakistan. The result of the independent variables with the dependents variables is significant impact at 1% level. The results of the research study same as the prior results works that financial inclusion has a positive and significant influence on financial stability and profitability. The results of the research study examine that CSR has a positive and substantial influence on financial stability and profitability. Prior research works have found the same research results that corporate governance has a positive and noteworthy influence on the bank's financial stability and profitability.

Firstly, this research effort makes a theoretical justification and contribution among the FI and social activities on the financial stability and profitability. Previous inquiry works found miscellaneous outcomes in the literature such as (Okpara 2011; Siddik et al. 2018: Khan, 2011; Hannig and Jansen, 2010; Flammer, 2013; Aras et al. 2010; Sheikh, 2019; Samy et al. 2010; Oyewumi et al. 2018). Secondly, this research examines that corporate governance mechanism is foremost and contingent factor interaction relationship among the financial inclusion and CSR with the financial stability and profitability. Prior research works found mixed results in the literature (Claessens, 2006). This research works also found empirical support from the positive and significant impact among the financial inclusion and CSR on the bank's financial stability and profitability from the national and international studies such as (Ramazan et al. 2021; Anarfo et al. 2020; Lu et al. 2021).

Table: 3 Direct and moderating role of corporate governance index with financial stability and profitability

Variables	*GMM (M1 FS)*	*GMM (M2 (ROA)*	*GMM (M3) (ROE)*	*Variables*	*M1 GMM (FS)*	*M2 GMM (ROA)*	*M3 GMM (ROE)*
Lagged FS	0.701*** (0.067)			Lagged FS	0.390*** (0.059)		
Lagged ROA		0.573*** (0.068)		Lagged ROA		0.401*** (0.345)	
Lagged ROE			0.878*** (0.047)	Lagged ROE			0.418*** (0.025)
FI	0.416*** (0.198)	0.571*** (0.228)	0.361*** (0.223)	FI	0.085*** (0.644)	0.074*** (0.285)	0.027*** (0.034)
CSR	0.389*** (0.230)	0.219*** (0.057)	0.287*** (0.235)	CSR	0.081*** (0.576)	0.056*** (0.687)	0.035*** (0.046)
CGI	0.371***	0.381***	0.398***	CGI	0.068***	0.076***	0.034***

	(0.451)	(0.286)	(0.324)		(0.055)	(0.191)	(0.035)
BS	0.518***	0.167**	0.469**	**FI *CGI**	0.0561***	0.069***	0.045***
	(0.349)	(0.123)	(0.181)		(0.056) ***	(0.057)	(0.040)
BA	0.491**	0.189***	0.478**	**CSR * CGI**	0.0678***	0.0987***	0.021***
	(0.671)	(0.782)	(0.678)		(0.032)	(0.086)	(0.051)

Source: Authors Analysis

Table: 3 Diagnostic Tests

	Direct Diagnostic test		
Banks Dummy	Yes	Yes	yes
NO, Groups	18	18	18
No, Instrument	18	17	17
AR2	0.277	0.268	0.190
Hansen- J test	0.193	0.27	0.291

Source: Authors Analysis

Table: 4 Diagnostic Tests

	Diagnostic test of moderating role		
Banks Dummy	Yes	Yes	yes
NO, Groups	18	18	18
No, Instrument	18	17	17
AR2	0.231	0.168	0.210
Hansen- J test	0.211	0.201	0.260

*Note: *** represents that the p value is less than 0.01, P<0.01/1%, ** show that the P< 0.05/5%, * mean that the P<0.10/10%. The main dependent variables of the research study is financial stability which were measured through the z- score, Banks profitability were measure through the return on asset divided the total asset, financial inclusion index measure through the financial access by the prior research like (Sharam, Demirgu-kunt et al.), CSR was measure through index of the banks donation in the different sectors of the society. Corporate governance was measure through the corporate governance of the board.*

5. Conclusion

This research works not just to check the direct influence of FI on the stability and profitability of the Islamic of Pakistan. Secondly, they also not only check the linear relationship of the CSR with FS and profitability of both Islamic banks of Pakistan. But this research works investigate whether corporate governance has a linear relationship with financial stability and profitability. The research study drawing on the institutional theory, contingency theory, agency theory, the research work proposes that corporate governance. Secondly, the research checks the interaction effect of the corporate governance index with the connection of financial stability and profitability of banks. The works finding suggest that financial inclusion has a progressive and noteworthy influence on the financial stability of both Islamic banks. The results also find that financial inclusion has a positive and significant impact on Islamic as will banks' profitability. The research works finding also examine that CSR has a positive and significant impact on the financial stability and profitability of Islamic banks. The positive impact of CSR reveals that when banks and firms are engaged in CSR activates it creates a positive image in the society. The positive ultimately enhance the profitability of the banking sector. The results of the research work examine when banking sector engaged and spend more CSR create positive image and build up the relationship with customer in the society which decrease the financial risk of the banks and enhance the financial stability and profitability of the Islamic banks. Corporate governance is the moderating factor among the financial inclusion and CSR with financial stability and profitability of the banks. The main finding this research works is to analyze that corporate governance positively and significantly moderates the relationship between financial inclusions, CSR, and financial stability and profitability.

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