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### Financial Innovation and Islamic Financial Institution's Performance: Examining the Mediating Role of Corporate Social Responsibility

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	<b>Abstract</b>
<p><b>Dr. Muhammad Arshad</b> Lecturer Department of Commerce, Thal University Bhakkar <a href="mailto:muhammad.arshad@tu.edu.pk">muhammad.arshad@tu.edu.pk</a></p> <p><b>Umar Akbar</b> Lecturer Department of Commerce, Thal University Bhakkar <a href="mailto:umar.akbar@tu.edu.pk">umar.akbar@tu.edu.pk</a></p> <p><b>Javeria Islam</b> Lecturer Department MFK Noon Business School, University of Sargodha <a href="mailto:javeria.islam@uos.edu.pk">javeria.islam@uos.edu.pk</a></p>	<p>The study focuses on the role of financial innovation on the performance of Islamic financial institutions (IFIs), with CSR being a mediator. Islamic financial institutions are increasingly embracing novel financial practices to become more competitive, efficient and sustainable in the changing financial environment. But there is not much empirical evidence on the direct and indirect effect of financial innovation on institutional performance via CSR. The study uses positivist research philosophy and quantitative research approach with a cross sectional research design to overcome this. Primary data was collected from 532 employees at managerial level from simple random sampling of Islamic financial institutions (IFIs) which included Islamic banks (full-fledged) and Islamic bank branches (conventional banks) in Pakistan. Data analysis was conducted using SPSS and Smart PLS-SEM 4 for preliminary data analysis, measurement and structural model analysis. The findings indicate that the financial innovation has a positive impact on the performance of Islamic financial institutions and that it also positively contributes to enhance the CSR practices. Further, the CSR positively impacts the institutional performance and it is also an important mediator between financial innovation and institutional performance. Based on the findings of this study, it can be concluded that financial innovation and CSR complement each other, both of which are strategic approaches to sustainable growth in the Islamic finance sector. The study contributes to the existing knowledge by conceptually integrating the notions of innovation and social responsibility into one and provides relevant insight for managers and policy makers for enhancing the competitiveness and social legitimacy of institutions. The study makes a few recommendations for Islamic financial institutions to consider to ensure long-term sustainable performance; these recommendations include focusing on technological innovations and enhancing CSR initiatives.</p>



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**Keywords:**

Islamic Finance, Islamic Banking, Performance, Financial Innovation, Corporate Social Responsibility, SMART PLS-SEM.

## 1. INTRODUCTION:

Islamic Financial system encompasses the political, sociological and even the ethical or moral frameworks of the society. Islamic finance is among the industries that have flourished the most in the past few years. Islamic financial sector market share is evenly divided among Islamic financial institutions and even more specifically Islamic Banks (71% share of the market) (Alam et al., 2019, Billah et al., 2024; Zain et al., 2024) . The concern has been growing in recent years in the Islamic economic system according to the Shariah principles and its performance in economic slowdown. H. Ali (2024) he Islamic economic system is built on the principles of Shariah, which endorse the principles of justice, equality and sharing of information and the prevention of oppression, prohibits interest and promotes sharing of risks. The model of financial innovation in Islamic Financial Institutions is a special model of offering financial services, which complies with the Shariah laws. This model not only is about financial inclusion and efficiency, it is also about ethical inclusion and social responsibility. The key difference between Islamic finance and conventional finance would be that the Islamic finance does not permit interest, participation or investment in the permissible (halal) business. So, in this case the financial innovation required is to overcome these constraints and provide effective and viable solutions.

In financial transactions, Financial Innovation, is how the financial system and financial institutions are made available and/or improved in becoming available of official financial services. Rather, the delivery of financial services has beneficial impacts on the economy as it provides opportunities for many to participate in the economic development that the formal economy is bringing to the region (Asad et al., 2021). Lisan Al Ara According to definition of Innovation: "The creation of something new for the first time, whether an idea, action, process or product. Ibn al-Atheer made a distinction between two types of Innovation: the halal ones – the beneficial ones – and the haram ones – the damaging ones – (Huda and Dhalaal). In contrast, if the invention is against the teachings of the Qur'an or the Sunnah of the Prophet Muhammad (PBUH) then it is a forbidden innovation and it is destructive. If there is any invention not included in the above, then it is under the allowed type (Mubah). Second Caliph, Omar Ibn al Khattab (RA) is known to have initiated the state treasury called Bait ul Maal which is a good example of financial Innovation.

The tendency to develop policies allowing the use of fintech solutions in the Islamic finance system without infringing upon the Shariah laws has grown (Al-Busaidi & Al-Muharrami, 2021). Financial Innovation is an important process that is prevalent in the current economy and enhances the efficiency of the financial system and competitiveness of the monetary sector (Assia & Kamel, 2019). Operational efficiency and effectiveness can be enhanced by leveraging and investing more resources (Shafiya et al., 2022). The innovations in Islamic finance are different from the conventional finance because of the Shariah compliance standards. The IFIs have an opportunity to enhance their products and infrastructure based on new financial innovation solutions. (Jamil & Seman, 2019).

Corporate Social Responsibility (CSR) holds significant importance in the Islamic monetary system as it is deeply rooted in the principles of Shariah, which emphasize social justice, welfare, ethical conduct, and equitable wealth distribution. Islamic banking is different from conventional banking in that it combines profit-making with social responsibility, making economic activities work for the good of community. Islamic monetary institutions can encourage transparency, trust, financial inclusion, poverty alleviation, and environmental sustainability through CSR activities, including zakat, sadaqah, and Qard Hasan. These socially responsible practices enhance the stakeholders' trust and the institutional reputation and support the financial operations towards the overall goal of Socio-economic justice and sustainable development.

### 1.1. Statement of the Problem

Islamic Financial Institutions (IFIs) are operating in a highly competitive and dynamic financial landscape where innovation is key to sustainability, growth and performance improvement. Financial innovation is essential to increase operational efficiency and competitiveness, and the development of new Shariah compliant products, digital banking solutions and technological innovations. Though financial innovation plays a growing role in economic affairs, its direct effects on the performance of IFIs are still not well studied especially in developing countries such as Pakistan. Meanwhile, IFIs are expected to not only meet their financial goals, but also their social and ethical responsibilities through the Islam standards. Corporate Social Responsibility (CSR) has become an essential strategic weapon that can enhance the trust of stakeholders, reputation of the



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institution and its performance. However, empirical evidence on the role of CSR in the link between financial innovation and IFI's performance is sparse. Most of the existing literature deals with the financial institutions and/or financial innovation and CSR, without considering the combined impacts on Islamic finance. This presents a considerable research void particularly in the context of Pakistan, where the Islamic banking system is growing at a very rapid pace and the issues of innovation adoption, regulatory compliance and social responsibility practices pose challenges. Hence, the objective of this study is to investigate the effect of financial innovation on the performance of Islamic Financial Institutions with the mediation role of CSR. The results of this research will offer useful information for policy makers, managers and regulators to optimize innovation strategies and CSR framework for enhancing overall sustainability and performance of IFIs.

### 1.2. Research Objectives

The objectives of the Research:

- I. This paper aims to investigate the effects of financial innovation on Islamic Financial Institutions performance.
- II. To study the impact of Corporate Social Responsibility in the performance of Islamic Financial Institutions.
- III. To explore the relationship between financial innovation and Corporate Social Responsibility (CSR) in Islamic Financial Institutions (IFIs).
- IV. To identify the Mediating role of CSR between financial innovation and performance of Islamic Financial Institutions.

### 1.3. Significance of the Research

The research would add to the existing literature on Islamic finance by offering some empirical evidence of financial innovation and the institutional performance. It underscores the need to foster innovation for the competitiveness, efficiency and sustainability of Islamic Financial Institutions. In addition, the emphasis is put on the strategic position of Corporate Social Responsibility as a mediator between financial innovation and positive results. The results will be useful for the managers of IFIs, Shariah advisors, policy makers and regulatory bodies in formulating effective innovation strategies, with a commitment to social and ethical responsibility. For Pakistan, the findings of this research will provide practical recommendations to reinforce the Islamic financial industry with a blend of innovation and socially responsible practices. It will also serve as a useful reference for other developing economies seeking to promote sustainable growth in Islamic finance.

## 2. Literature Review

Performance is a multi-dimensional concept and is hard to define. It is the actual success of goals against some targets to achieve some things. Performance is sometimes compared to certain criteria of the accuracy, completeness, time and cost taken. Azizah and Sutardi (2023) That the non-financial part of the firm performance is the ability to establish good relations with the stakeholders, good brand image and high operational efficiency were established. The study also shows how sustainability can be integrated into business to enhance the performance of the company and give it a competitive advantage and better financial results.

Non-Financial Performance Measures (NPMs) are important for an organization's future success as it can be used to improve the operational performance of an organization and to meet the needs of the stakeholders. Thus, NPMs can be utilized to assist organizations in attaining the best practices in management, advance new practices in management and enhance efficiency. This strategic approach helps to meet several stakeholders' expectations, such as customers, employees and investors, and helps to make the organization flexible in the face of change and sustainable. The principles of process improvement and responsibility are important to ensure the long-term survival of any organization, supported by these cultures

(Alshanty & Emeagwali, 2019). Because the objectives of an organization can be captured from multiple dimensions of the organization, the success of an organization should include NPMs in addition to the traditional FPMs. (Gyemang & Emeagwali, 2020).

The Islamic financial innovation also has its origin and foundation in the Schumpeter's theory of Innovation that demonstrates that innovation is the engine of economic growth. In Islamic finance, innovation is very much linked with the legal environment since it is not allowed to deviate from the principles of Shariah. Financial inclusion, as defined by, M. Uddin et al. (2021) is an economic environment that encourages the use of simple financial services. This paper has been able to demonstrate that in reality, the application of



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digital financial inclusion (DFI) makes Islamic financial institutions more profitable, which enhances the economic stability and growth. This implies that financial innovation is a very important determinant of the performance of Islamic financial institutions. Barberis et al. (2019) describe FinTech as a disruptive innovation in financial services which has the ability to increase inclusiveness and effectiveness, HariKrishnan and Kumar (2024) illustrated the revolution of blockchain technology in the financial sector and its transactions in their systematic review of blockchain applications. To demonstrate the ability of the banking industry to adapt to the new technologies. Wang et al. (2021) and Chen and Lin (2022) offered practical evidence of the disruption of the banking industry caused by FinTech. The main purpose of this research is to explore the impact of mobile payment on consumers' behavior and its influence on consumer behavior in the digital economy

Demirgüç-Kunt et al. (2022) carry out a thorough discussion of how the digital technologies can revolutionize financial inclusion and how technology can be used to overcome barriers between the provision of services to the excluded communities. Weill and Zins (2021) provide a systematic literature review of the determinants of financial inclusion, and they conclude that economic development and policy would be one of the most important determinants of financial inclusion. In India, Patel et al. (2021) investigate the relationship between financial literacy and inclusiveness of rural households, and find that there is a positive relationship between the levels of financial literacy and financial services usage.

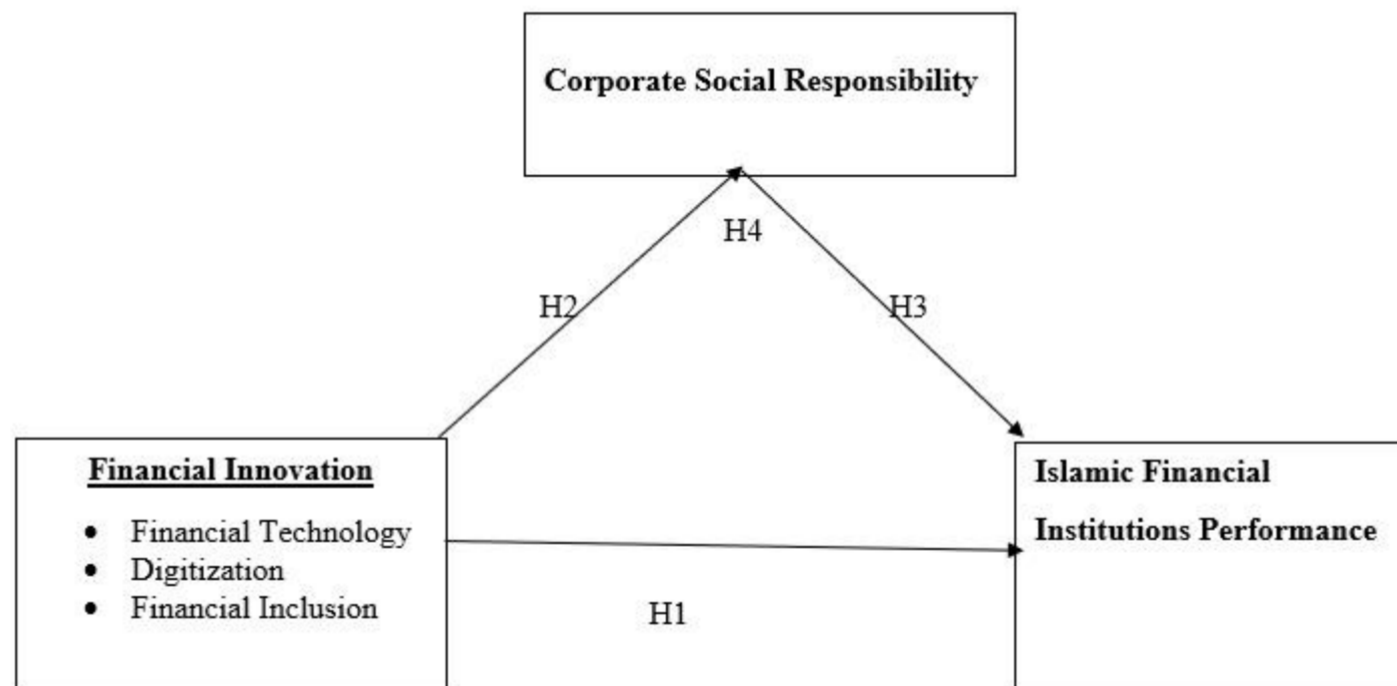
Zafar and Sulaiman (2019) CSR is a company's strategy which emphasizes economic responsibilities of the company as well as the requirement of the society. They stated that CSR is a process, in which enterprises use their production function in a way that improves the social welfare. Zafar and Sulaiman (2020) presented a more in depth conceptualization of CSR; the researchers added the economic and legal aspects of CSR. Then they realized that business has to be political, has to support education, has to protect its employees, and has to contribute to the society. Thus, the company acts as a good citizen, and is a role model for other companies in the future in terms of ethics and corporate citizenship. Some researchers emphasized that the relation between Shariah governance and performance of Islamic financial institutions (IFIs) is mediated by CSR (Usdeldi et al., 2022). Furthermore, the researchers indicated that the CSR influences the financial innovation as an intermediary variable between the Islamic financial institutions performance (Faliza et al., 2020). Based on the above, it can be concluded that the relationship between financial innovation and Islamic financial institutions performance is mediated by the role of CSR.

This Paper has demonstrated that CSR is a mediator between financial innovations and performance of Islamic financial institutions (IFIs). Islamic finance CSR is based on the ethical standard of Islam which include social justice, responsibility and fairness. Nugroho (2022) noted that CSR in IFIs is a way of achieving both the corporate goals of profit making and the social and environmental goals that are in consonance with Islamic values. It also reported that CSR brings about greater trust and transparency which is crucial in the Islamic financial institutions and enhances the financial performance of Islamic financial institutions (IFIs)

The Resource Based View (RBV) and Stakeholder Theory are used to support the relationship between financial innovation, corporate social responsibility (CSR) and performance of Islamic financial institutions (IFIs) as supported by this study. RBV argues that organizational performance is a function of strategic resources and capabilities which are valuable, rare and difficult to imitate (Barney, 2023). In this context, financial innovation serves as a strategic capability that enables Islamic financial institutions to improve operational efficiency, introduce Shariah-compliant financial products, enhance customer satisfaction, and sustain competitive advantage. Recent studies have highlighted that technological advancements such as FinTech, digital banking, and blockchain-based Islamic financial services significantly contribute to the growth and performance of Islamic banking institutions (Meero, 2025; Alsmadi, 2025).

Likewise, the Stakeholder theory serves as a basis to analyze CSR's contribution to the improvement of institutional performance. Its theory is based on the idea that organizations can only be successful in the long term if they meet the needs of their stakeholders such as customers, investors, regulators and society (Freeman et al., 2023). Islamic financial institutions have CSR, which is very similar to the principles of Maqasid al-Shariah where social welfare, justice and ethical accountability are the priorities. The study suggests that financial innovation has significant direct effects on institutional performance, and also has indirect effects on CSR practices through the trust and reputation of stakeholders and companies' sustainability in the long run. Hence, CSR is a moderating factor that links financial innovations with sustainable performance of Islamic financial institutions (Tasnia et al., 2023; Syiami & Muflih, 2024).

### 2.1. Conceptual Framework:



### 2.2. Research Hypothesis:

**H1:** Financial Innovation has significant positive impact on IFI, s Performance.

**H2:** Financial Innovation has significant positive impact on the Corporate Social Responsibility

**H3:** Corporate Social Responsibility has a significant positive impact on the Performance Islamic Financial Institutions.

**H4:** Corporate Social Responsibility significantly mediates the relationship between Financial Innovation and the performance of Islamic Financial Institutions.

### 3. Research Methodology

The research philosophy applied in this study is positivist research which focuses on objective reality, empirical observation and testing hypothesis about the relationship between financial innovation and Islamic financial institutions performance with the role of corporate social responsibility (CSR) as the mediator. A quantitative research method was used, consistent with positivist paradigm, to measure and analyze the constructs systematically using statistical methods. The study adopted a cross-sectional research design, which was a study that involves collecting data at the same time to find out what the attitudes and behaviors of the people were about the financial innovation, CSR and organizational performance at the time of the study. The target population included all Islamic financial institutions in Pakistan including conventional banks with Islamic branches and full-fledged Islamic banks. The sample size was 532 respondents obtained by simple random sampling for the purpose of equal representation and reduce sampling



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bias. The managerial level employees were used as the unit of analysis because managers have enough information about institutional innovation strategies, CSR initiatives and organizational performance outcomes.

The primary data were obtained by using a structured questionnaire which was adapted from the scales used in the previous literature to guarantee the content validity and reliability. The questionnaire items were closed-ended and had a Likert scale response format, which allowed for standardized responses and quantitative analysis. SPSS was used for preliminary statistical procedures such as data screening, demographic Analysis, descriptive analysis, and Correlation Analysis, and Smart-PLS-4 (SEM) was used for the analysis of the direct and mediating relationships between the variables by analyzing the data of the data measurement model and data measurement model. Partial Least Squares Structural Equation Modeling (PLS-SEM) was thus selected as the method appropriate for the present study because it was capable of addressing the complexity of the model, mediation analysis and predictive research model.

#### 4. Analysis and Results

##### 4.1. Demographic Analysis

Table: 1

Gender of Respondent	Frequency	Percent	Valid Percent	Cumulative Percent
Man	415	78.0	78.0	78.0
Female	117	22.0	22.0	100.0
Total	532	100.0	100.0	
<b>Age of Respondent</b>				
25 years and below	39	7.3	7.3	7.3
26 - 40 years	261	49.1	49.1	56.4
41 to 55 years	208	39.1	39.1	95.5
56 years and above	24	4.5	4.5	100.0
Total	532	100.0	100.0	
<b>Name of IFI</b>				
Meezan bank Limited	100	18.8	18.8	18.8
Al-Barka Bank	94	17.7	17.7	36.5
Bank Islami	160	30.1	30.1	66.5
Dubai Islamic Bank	65	12.2	12.2	78.8
Faysal Bank	56	10.5	10.5	89.3
Madarbah Company	25	4.7	4.7	94.0
Takaful Company	19	3.6	3.6	97.6
Commercial Bank Islamic Window	13	2.4	2.4	100.0
Total	532	100.0	100.0	
<b>Job title of Respondent</b>				
Top Manage	24	4.5	4.5	4.5

Middle Manager	475	89.3	89.3	93.8
Islami Scholar	33	6.2	6.2	100.0
Total	532	100.0	100.0	
<b>Professional Experience</b>				
IFI	130	24.4	24.4	24.4
CFI	105	19.7	19.7	44.2
Both IFI,s and CFI,s	297	55.8	55.8	100.0
Total	532	100.0	100.0	
<b>Islamic education</b>				
Formal	479	90.0	90.0	90.0
Informal	53	10.0	10.0	100.0
Total	532	100.0	100.0	

The demographic profile of the respondents in this study is presented in Table 1. The sample comprised 532 respondents from different Islamic Financial Institutions (IFIs). The Islamic finance workforce has a strong male presence as revealed by the 78.0% of male respondents compared to 22.0% of female respondents. The age distribution shows that the majority of the respondents were in the age group 26–40 years (49.1%) followed by the age group 41–55 years (39.1%). Only 7.3% of the respondents were between 25 years; those between 56 years and above were 4.5%. As far as institutional representation is concerned, Bank Islami received the highest representation (30.1%) followed by Meezan Bank Limited (18.8%) and Al-Baraka Bank (17.7%). Having respondents from diverse IFIs adds to the diversity and external validity of the study.

In terms of job positions, most of the respondents were Middle managers (89.3%), then Islamic scholars (6.2%), and last top managers (4.5%). It indicates that the study concentrated on the opinions of those operating and managing in an organization, who are crucial for evaluating financial innovation and organizational performance. As far as professional experience is concerned, more than half of the respondents (55.8%) indicated that they had experience both in Islamic and conventional financial institutions, 24.4% had experience solely in Islamic financial institutions and 19.7% had experience solely in conventional financial institutions. This is indicative of a more general professional view, which can further enrich the concept of innovation and CSR practices. Finally, the findings of the education experience showed that most of the people (90.0%) received formal Islamic education and 10.0% received informal Islamic education. This suggests that the overall level of understanding about Islamic financial principles among the respondents is good, which is aligned with the relevance and reliability of the information they answered in the context of Islamic financial principles.

#### 4.2. Descriptive Statistics

**Table 2: Descriptive Statistics**

	N	Minimum	Maximum	Mean	Std. Deviation	Skewness		Kurtosis	
						Statistic	Std. Error	Statistic	Std. Error
IFIs Performance	532	5.00	25.00	18.7368	3.24492	-.879	.106	1.789	.211
Corporate Social Responsibility	532	5.00	25.00	19.6184	2.82894	-1.103	.106	2.720	.211
Financial Innovation	532	19.00	72.00	57.6823	7.09570	-1.396	.106	5.493	.211

**Table 2: Descriptive Statistics**

	N	Minimum	Maximum	Mean	Std. Deviation	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
IFIs Performance	532	5.00	25.00	18.7368	3.24492	-.879	.106	1.789	.211
Corporate Social Responsibility	532	5.00	25.00	19.6184	2.82894	-1.103	.106	2.720	.211
Financial Innovation	532	19.00	72.00	57.6823	7.09570	-1.396	.106	5.493	.211
Valid N (list wise)	532								

The descriptive statistics of the study variables are given in table 2. The analysis of the results shows that the highest mean value in the results was of Corporate Social Responsibility (M = 19.62; SD = 2.83), followed by IFIs Performance (M = 18.74; SD = 3.24), and Financial Innovation had the highest absolute score (M = 57.68; SD = 7.10). The relatively low standard deviations indicate a moderate level of consistency in the responses of the respondents with regards to the constructs. In addition, all the variables have negative skewness values, meaning that all the responses tend to be at the top end of the scale. The Kurtosis values are all positive indicating a relatively peaked response distribution. Overall the data are satisfactory in terms of distributional properties and supported in a preliminary way for further inferential analysis.

### 4.3. Correlations

**Table 3: Correlations**

		Financial Innovation	IFIs Performance	Corporate Social Responsibility
Financial Innovation	Pearson Correlation	1	.493**	.438**
	Sig. (2-tailed)		.000	.000
	N	532	532	532
IFIs Performance	Pearson Correlation	.493**	1	.556**
	Sig. (2-tailed)	.000		.000
	N	532	532	532
Corporate Social Responsibility	Pearson Correlation	.438**	.556**	1

	Sig. (2-tailed)	.000	.000	
	N	532	532	532

\*\* . Correlation is significant at the 0.01 level (2-tailed).

Based on correlation analysis, there is a significant positive correlation between all the study variables at 0.01 significance level. In particular, IFIs' performance is moderately positively related to financial innovation ( $r = 0.493$ ,  $p < 0.01$ ), suggesting that the more firms adopt innovative financial practices, the better they perform. Further, financial innovation is also positively correlated with CSR ( $r = 0.438$ ,  $p < 0.01$ ), indicating that the higher the financial innovation of financial institutions, the more active they are in CSR activities. In addition, corporate social responsibility shows the highest positive correlation with IFIs' performance ( $r = 0.556$ ,  $p < 0.01$ ), suggesting that such good CSR practices have a significant influence on IFIs' performance. In general, the results reported here suggest preliminary support for the proposed relationships, and call for additional hypothesis testing.

#### 4.4. Measurement Model:

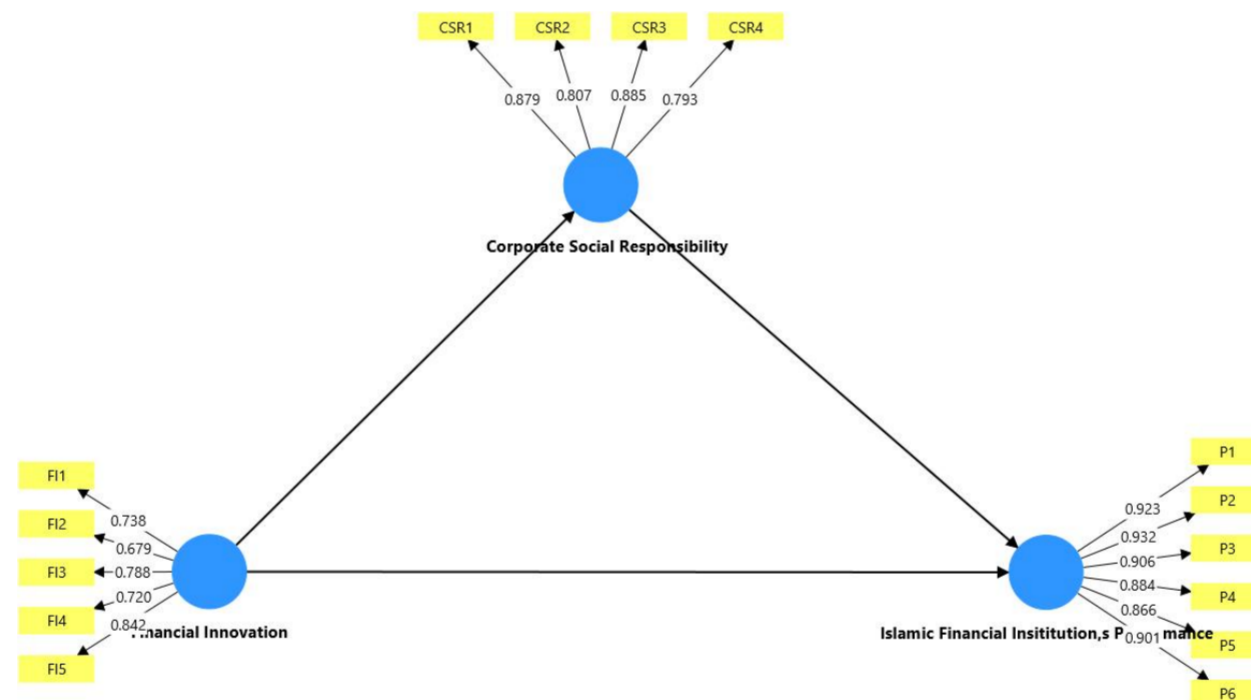


Table 4: Outer Loading

	Corporate Social Responsibility	Financial Innovation	Islamic Financial Institution's Performance
CSR1	0.879		
CSR2	0.807		
CSR3	0.885		
CSR4	0.793		
FI1		0.738	
FI2		0.679	
FI3		0.788	
FI4		0.720	

<b>FI5</b>		0.842	
<b>P1</b>			0.923
<b>P2</b>			0.932
<b>P3</b>			0.906
<b>P4</b>			0.884
<b>P5</b>			0.866
<b>P6</b>			0.901

All factor loadings of measurement model are within acceptable range of indicator reliability. The item loadings for the Corporate Social Responsibility (CSR) are in the range of 0.793 to 0.885, which shows that all the loadings are greater than 0.70, indicating good convergent validity. In the same way, the loadings of the Financial Innovation (FI) construct are acceptable, ranging from 0.679 to 0.842. One indicator (FI2 = 0.679) is slightly below the ideal threshold, but still acceptable as it is close to 0.70 and has theoretical relevance to the construct. In addition, the Islamic Financial Institutions' Performance (IFIP) construct has high loadings ranging from 0.866 to 0.932, which shows high level of internal consistency and high level of measurement reliability. Results indicate that all constructs have good indicator reliability and convergent validity, which validates the use of constructs in further structural model analysis with PLS-SEM.

#### 4.5. Construct Reliability and Validity

Table: 5

	<b>Cronbach's alpha</b>	<b>Composite reliability (rho_a)</b>	<b>Composite reliability (rho_c)</b>	<b>Average variance extracted (AVE)</b>
<b>Corporate Social Responsibility</b>	0.865	0.881	0.907	0.709
<b>Financial Innovation</b>	0.811	0.826	0.869	0.571
<b>Islamic Financial institution's Performance</b>	0.954	0.971	0.963	0.814

Reliability and validity assessment reveals all constructs with recommended threshold criteria. Cronbach's alpha values of Corporate Social Responsibility (0.865), Financial Innovation (0.811) and Islamic Financial Institutions' Performance (0.954) are above the acceptable limit of 0.7, suggesting the good internal consistency of the scales. Likewise, the composite reliability values (rho\_a and rho\_c) of all constructs are more than 0.80, indicating good construct reliability. Additionally, Average Variance Extracted (AVE) values between 0.571 and 0.814 exceed the criterion of 0.50, which indicates good convergent validity. From the constructs, Islamic Financial Institutions' Performance is more reliable and convergent valid, which can be explained by having a strong measurement structure. Overall, the results showed that the measurement model has good reliability and validity, which makes it suitable for the next step of the structural model analysis.

#### 4.6 Discriminant Validity (HTMT: Heterotrait–Monotrait)

Table 6: Discriminant Validity (HTMT: Heterotrait–Monotrait)

	<b>Corporate Social Responsibility</b>	<b>Financial Innovation</b>	<b>Islamic Financial Insitution,s Performance</b>
<b>Corporate Social Responsibility</b>			
<b>Financial Innovation</b>	0.120		
<b>Islamic Financial institutions Performance</b>	0.135	0.124	



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The Heterotrait–Monotrait ratio (HTMT) was used to assess the discriminant validity of the constructs. The results show that the correlations among the three variables, namely: Corporate Social Responsibility and Financial Innovation (0.120), Corporate Social Responsibility and Islamic Financial Institutions' Performance (0.135) and Financial Innovation and Islamic Financial Institutions' Performance (0.124) are significantly lower than the recommended level of 0.85 (or the more liberal 0.90 criterion). Such low values for HTMT suggest good separation between the constructs, and that each captures a conceptually different phenomenon. The results thus confirm the satisfactory discriminant validity and their distinctiveness of the measurement model constructs.

#### 4.7. Discriminant Validity (Fornell–Larcker Criterion)

**Table:7 Discriminant Validity (Fornell–Larcker Criterion)**

	<b>Corporate Social Responsibility</b>	<b>Financial Innovation</b>	<b>Islamic Financial institution's Performance</b>
<b>Corporate Social Responsibility</b>	0.842		
<b>Financial Innovation</b>	0.107	0.755	
<b>Islamic Financial Institution's Performance</b>	0.126	0.115	0.902

To test discriminant validity of the constructs, the Fornell\_Larcker criterion was used. The results show that the square root of the Average Variance Extracted (AVE) of the construct for Corporate Social Responsibility (CSR) (0.842), Financial Innovation (0.755) and Islamic Financial Institutions' Performance (0.902) are higher than their respective inter-construct correlations. In particular, the correlation numbers among CSR, Financial Innovation (0.107), CSR, Islamic Financial Institutions' Performance (0.126), Financial Innovation, Islamic Financial Institutions' Performance (0.115) are significantly lower than the diagonal numbers. This indicates that there is acceptable discriminant validity because each construct has more variance with its respective indicator than with other constructs. In general, the results confirmed the uniqueness and suitability of the measurement model.

#### 4.8. Multicollinearity: Variance Inflation Factor (VIF)

**Table 8: Multicollinearity: Variance Inflation Factor (VIF)**

	<b>VIF</b>
<b>CSR1</b>	2.370
<b>CSR2</b>	2.155
<b>CSR3</b>	1.627
<b>CSR4</b>	2.677
<b>FI1</b>	1.478
<b>FI2</b>	1.315
<b>FI3</b>	2.163
<b>FI4</b>	1.530
<b>FI5</b>	2.276
<b>P1</b>	3.046
<b>P2</b>	2.626
<b>P3</b>	2.353



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<b>P4</b>	2.351
<b>P5</b>	2.914
<b>P6</b>	3.011

To check for any potential multicollinearity among the measurement items, the Variance Inflation Factor (VIF) was computed. The results show that all VIF values are below 5.0 (and even below 3.3 in some cases) which is the suggested value. In detail, the VIF values for the items of Corporate Social Responsibility vary between 1.627 and 2.677, Financial Innovation items vary between 1.315 and 2.276, and Islamic Financial Institutions' Performance items vary between 2.351 and 3.046. The results indicate that the indicators are not multi-collinear, which means that the items in each indicator are independent from one another and do not overlap too much. Thus, the measurement model doesn't have a collinearity problem and is appropriate for further analysis of the structural model.

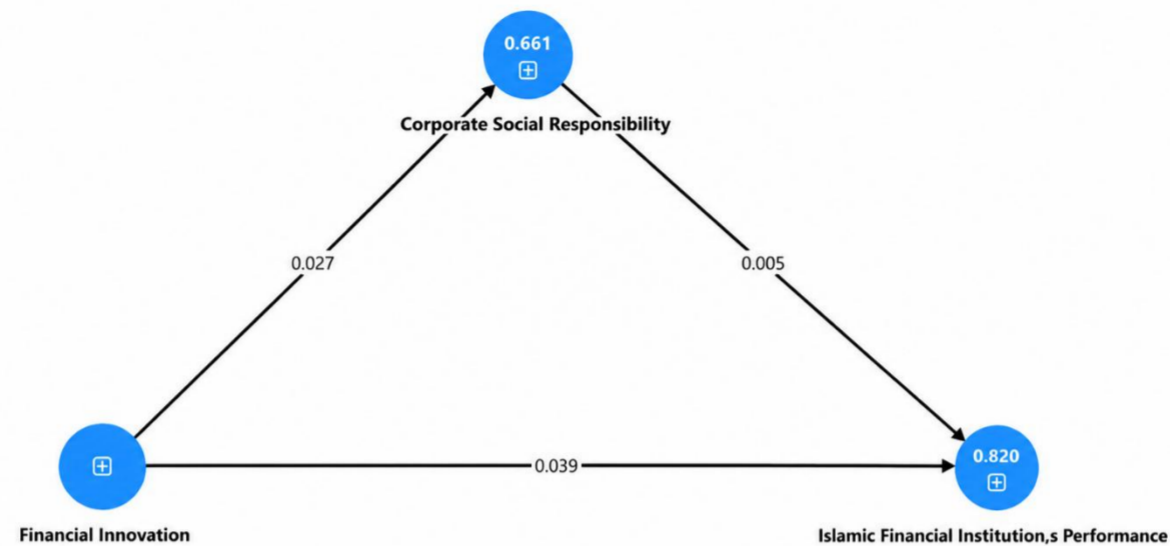
#### 4.9. MODEL FIT

**Table 9: Model Fit**

	<b>Saturated model</b>	<b>Estimated model</b>
<b>SRMR</b>	0.073	0.073
<b>NFI</b>	0.942	0.952

Based on the model fit assessment, the proposed model has a satisfactory fit. The SRMR value of both models (saturated and estimated) is 0.073, which is below the recommended value of 0.08, thus suggesting an acceptable model fit. In the same way, the Normed Fit Index (NFI) of the saturated model is 0.942 and that of the estimated model is 0.952, which is also above the recommended value of 0.90 indicating a good comparative fit of the model. In general, the fit indices validate the correspondence between the data observed and the measurement and structural model, thereby substantiating the suitable and robustness of the research framework.

#### 4.10. Structured Model:



#### 4.11. Direct Effect

Table 4.11 Path Coefficient Direct Effect

	Original sample (O)	Sample mean (M)	Standard deviation (STDEV)	T statistics ( O/STDEV )	P values
Corporate Social Responsibility -> Islamic Financial Institution's Performance	0.115	0.120	0.041	2.793	0.005
Financial Innovation -> Corporate Social Responsibility	0.168	0.114	0.061	2.754	0.027
Financial Innovation -> Islamic Financial Institution's Performance	0.103	0.109	0.050	2.063	0.039

According to the results of the structural model, all the hypothesized relationships have positive and statistically significant results. The results reveal that CSR has a positive impact on IFIP ( $\beta = 0.115$ ,  $t = 2.793$ ,  $p = 0.005$ ), indicating that better performance of IFIs is correlated with higher CSR practices. Likewise, Financial Innovation (FI) has a significant effect on CSR ( $\beta = 0.168$ ,  $t = 2.754$ ,  $p = 0.027$ ), which suggests that the higher the level of financial innovation, the greater the level of CSR engagement. Moreover, Financial Innovation also impacts positively on Islamic Financial Institutions' Performance ( $\beta = 0.103$ ,  $t = 2.063$ ,  $p = 0.039$ ) which shows that innovative financial practices benefit the performance of the Islamic Financial Institutions. In general, all the direct hypotheses were supported by the findings, which showed that financial innovation and CSR play an important role in improving the performance of Islamic financial institutions.

### 4.12 Mediating Effect:

**Table 12: Indirect Effect**

	Original sample (O)	Sample mean (M)	Standard deviation (STDEV)	T statistics ((O/STDEV))	P values
<b>Financial Innovation -&gt; Corporate Social Responsibility -&gt; Islamic Financial Institution's Performance</b>	0.022	0.014	0.010	2.295	0.020

The mediation analysis findings show that Financial Innovation (FI) fully and significantly mediates the relationship between Islamic Financial Institutions' Performance (IFIP) and the Corporate Social Responsibility (CSR). The indirect effect is positive ( $\beta = 0.022$ ) and has a t value of 2.295, a p value of 0.020 that is lower than the significance level of 0.05. It means that financial innovation can directly and indirectly boost the performance of institutions, by positively impacting the CSR practices. The results validate that CSR plays an important mediating role between financial innovation and overall performance of Islamic financial institutions.

## 5. Discussion

This study's results offer sound empirical evidence for the proposed relationships between financial innovation and corporate social responsibility (CSR) and the performance of Islamic financial institutions (IFIs). The findings validate that financial innovation has a positive significant influence in Islamic financial institutions' performance (H1). This means that the introduction of new financial technologies, digital banking systems and Shariah compliant financial products, significantly improves the efficiency of the institutions and their quality of service and competitiveness. The results are also aligned with the recent studies which revealed the high level of impact of financial innovation on the operational and financial efficiency of Islamic banks in the era of FinTech and artificial intelligence (AI) (Kmt Lasmiatun & Nikzad Manteghi, 2025; Meero, 2025; Zainudin & Hidayatulloh, 2025). Moreover, the growing mainstreaming of sustainable financial products and digitalization have further enhanced the resilience and performance of Islamic banks in competitive markets.

The study also shows that financial innovation has a positive and significant effect on CSR practices, thus supporting H2. The finding also reflects the fact that innovative financial approaches can create a more effective Islamic financial system to better fulfill its social and ethical obligations, such as by offering green sukuk, digital zakat platforms and inclusive financial services. The recent evidence indicates that sustainable finance and innovation in banking models play a great role in improving the engagement and social accountability of Islamic banks in CSR (Didin Purniawan, 2026). This is in line with the nature of Islamic banking that innovation is not just about profits but also about the greater welfare of society.

Likewise, the results support H3, which posits that CSR holds an important positive effect on Islamic financial institutions' performances. This serves as a proof of the fact that CSR practices have the power to build the reputation of the institution, build trust to the stakeholders and build sustainability. Further research on Islamic banking has revealed that CSR and other ethical banking practices have a significant impact on the cost efficiency and performance of institutions (Cahya Jati & Mohamad Irsyad, 2024; Syiami & Muflih, 2024). This shows that CSR could be a strategic tool for Islamic financial institutions on achieving legitimacy and enhancing customer loyalty under the competitive financial market.

Most importantly, the mediation analysis supports H4, revealing that CSR significantly mediates the relationship between financial innovation and Islamic financial institutions' performance. The results indicate that financial innovation benefits the performance of institutions, both directly and indirectly through strengthening CSR activities. Innovative practices are shown to have a mediating effect between them and organizational outcomes, namely through their enabling relations with socially responsible financing. The conclusion matches recent literature, which focuses on the significance of sustainable and socially responsible financial approaches as one of the main avenues for innovation to manifest and impact long-term performance and competitive sustainability in Islamic finance (Tasnia et al., 2023).



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The study overall adds to existing Islamic finance literature by identifying financial innovation and CSR as complementary strategic drivers to enhance the performance of Islamic institutions. The policy insight is that there is the need to invest in technological innovation and enhance CSR frameworks for sustainable growth and social legitimacy, and the long-term competitive advantage for Islamic financial institutions (IFIs).

### 6. Research Implications

The findings of this research paper have important theoretical and practical implications to the Islamic finance literature. From the theoretical perspective, it aims to build upon the expanding knowledge base of the financial innovation literature by introducing financial innovation issues as part of corporate social responsibility (CSR) and institutional performance in the context of Islamic financial institutions (IFIs). The results support the hypothesis that financial innovation does not only contribute to the efficiency of institution's operations, but also to the social responsibility of the innovation, which leads to better institutional performance. This adds both stakeholder and sustainability values to Islamic finance, highlighting the strategic importance of innovation-based CSR practices. Recent studies also pointed out that CSR disclosure and financial innovations have a positive impact on improving the sustainability and profitability in the Islamic banking sectors (Al-Asfour, 2025; Alsmadi, 2025).

The study offers some practical implications for the management, policy and regulation of Islamic financial institutions. The results indicate that institutions which have invested in the financial technologies and sharia-compliant digital solutions can improve their financial performance and commitment to social responsibility at the same time. The results indicate that managers need to incorporate innovation and CSR in their strategy in order to gain sustainable growth and competitiveness. In addition, these results will allow policies to be formulated based on which digital transformation will be encouraged, taking into account the Islamic moral values.

### 7. Recommendations

The recommendations are that Islamic financial institutions invest more on financial innovation, such as using digital banking platforms and integrating FinTech, Sharia-compliant transactions using blockchain, and new Islamic financial products. This can lead to better institutional performance, operational efficiency and satisfaction for customers. Also, IFIs could enhance their CSR programs in the spirit of welfare for the community, sustainability for the environment and financial inclusion, which have been found to be desirable for their performance.

Policymakers need the notion of formulating conducive regulatory systems that foster technological innovation and meet Shariah requirements. There is also a need to enhance the CSR reporting requirements for Islamic Financial Institutions, with a requirement to become more transparent and accountable. Future research is encouraged to further strengthen this model with other mediators which are also found to be increasing in importance in recent years in the changing financial environment such as green innovation, Islamic governance, sustainability orientation etc.

### 8. Conclusion

Based on the study it is concluded that financial innovation and CSR are two strategic determinants which have significant contribution to the performance of Islamic financial institutions. The empirical findings show that the financial innovations have a positive direct impact on institutional performance and also have a significant positive impact on CSR practices. CSR, on the other hand, in turn, affects the performance of the institutions, and is an important intervening variable between financial innovation and performance. Those findings demonstrate that there is considered to be no difference between innovation and social responsibility; they are both complementary in achieving sustainable organizational success.

Islamic financial institutions have to adapt their business models to the digitalized and ethical world of finance and a broader focus on social socio-economic objectives in order to remain competitive and to fulfill their wider objectives. Therefore, it could be argued that integrating financial innovation into CSR can provide a sustainable way to improve efficiency, trust and long-term institutional development of Islamic finance.

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