To what extent does the use of religious language in Islamic banks corporate ESG reporting influence financial performance, and how does this effect differ between Islam-oriented and non-Islam-oriented economies?

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Abstract:

In a world where sustainable development speaks the language of measurement and materiality, we discovered something unexpected when reading ESG reports: the use of religious language. Not only in the policies or measures, but also in the narrative itself. References to moral duty, divine responsibility and religious values are subtly woven into the companies' stories, not as strict doctrine, but as gentle reminders of the goal to be achieved. This sparked a simple yet profound question: does the use of religious language in sustainability reporting make a difference? Can belief, embedded in the language of institutions, influence how a bank is trusted, how it performs, or how it is judged? This study examines this issue across different regions, cultures and expectations. It examines the impact of introducing religious expression into a space traditionally governed by neutral and comparable frameworks. Some audiences see this language as a marker of authenticity, while others may ignore it or even question its relevance. By examining these tensions, we contemplate how religion, when incorporated into corporate communication, can subtly challenge the boundaries of what ESG reporting is meant to convey. In the balancing act between ethics and economics, symbolism and substance, it is often the quietest words that carry the most weight, depending on who is listening.

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Declaration

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Nassima Bouzagou

05/24/2025

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I. Introduction

Despite religion's historical neglect in the area of international relations theory, the world has illuminated the importance of religion in the geopolitics and economies of today. Current conflicts like the Israeli Palestinian issue, demonstrate that countries and actors draw on religious references, either literal or symbolic, in framing and engaging in numerous political discussions and decisions, or in exercising institutions operational behaviors. Religion itself is not responsible for these tensions, but it remains an important variable in future analyses and must be understood, especially if actors choose to invoke religion to legitimize or challenge their decisions (Fox, 2006; Mabille, 2020).

In the financial sector, this relevance can be considered as well, as institutions are becoming increasingly more expected to respect ethical norms (related to abstaining from harmful investments), even within a fragmented global outlook. For example, European banks such as BNP Paribas, became linked with controversial investments in Israeli companies, including alleged investments in defense companies such as Elbit Systems. Even though BNP Paribas potentially denied financing the weaponry used in this conflict, the controversy surrounding this issue demonstrates how sensitive geopolitical issues, particularly those related to religious orientations, can lead to institutional reputational problems (Bouissou, 2024).

Islamic banks have an unusual view as they must always consider common religious rules along with performance expectations. Islamic banks have to operate according to certain Sharia principles (Islamic Law), which consist of prohibitive financial activities such as interest (Riba), excessive uncertainty (gharar), and investing in businesses that are considered unethical (Chapra, 2000). In addition to following Sharia obligations, Islamic banks need to focus on competing in today's market and maintain strong financial performance.

This balance is reflected in corporate disclosures. Many Islamic banks provide, in their annual reports, quotations from the Quran, Islamic ethical standards, and religious justification for their decisions, in addition to traditional financial disclosures (Maali et al., 2006). The aim is to build trust and loyalty among Muslim customers by merging spiritual and commercial discourse (Belal et al., 2015). This can also be problematic, as some international or secular investors may view them as a source of ambiguity or incompatible with international transparency standards (Vinnicombe and Park, 2022).

This tension was manifested during the 2018 liquidity crisis in the Gulf countries. Islamic banks with a strong religious brand were evaluated by the market more unfavorably than their counterparts with similar financial performance, using a more neutral recommendation format (Standard & Poor's, 2019).

Today, the Islamic finance industry is worth over $3 trillion and is expanding into new territories, including sukuk (Islamic bonds) in London and Islamic banking in New York (IFSB, 2023). As this industry grows, an important question increasingly arises: is displaying a strong religious identity an asset or a hindrance in global markets? In some parts of the Middle East, such as in many Gulf countries, religion and business are closely intertwined. In other parts of the world, such as Southeast Asia or many Western financial centers, religious language may not be perceived similarly.

In regard to the above situation, we believe there are important questions around how Islamic banks position themselves and how they communicate their values, and how these choices impact their performance. The difference in understanding about religion and the language of finance can reveal the complexity of the ways in which they intersect, perhaps not only in Islamic banking, but also in the world of finance more broadly.

II. Research question

This study explores the following research question:

"To what extent does the use of religious language in Islamic banks' corporate ESG reporting influence financial performance, and how does this effect differ between Islam-oriented and non-Islam-oriented economies?"

This question addresses a crucial intersection between religion, corporate communication, and financial performance. While previous research has identified dimensions of Islamic finance from legal, ethical, or operational lenses, we still have limited knowledge about the implications of religious discourse in corporate reports, and their measurable impact on performance. The existing literature has acknowledged that Islamic banks use religiously based texts in their ESG annual reports as signally legitimacy (Méaali et al., 2006; Belal et al., 2015), but little effort has been made to understand if it has direct financial benefits or risks for actual financial reporting, describing performance, not just an identifier across cultures.

The second dimension of this research explores how the effects of religious language in corporate communication vary depending on cultural and institutional contexts, specifically Islam-oriented and non-Islam-oriented economies. This study examines whether different contexts shape the extent to which religiously framed communication influences financial performance. Therefore, drawing this cross-cultural comparison enables the research to identify whether religious identity is a context-sensitive asset or liability and to what degree this moderate's effectiveness in influencing trust, credibility, and market value.

III. Academic Contributions

This thesis advances different lines of literature connected to ESG communication, Islamic finance, and institutional theory. While ESG research has largely emphasized material disclosures, governance measures or measures of environmental behaviors (e.g., Ioannou & Serafeim, 2015; Khan et al., 2016), very little research has considered the discursive-symbolic aspects of ESG communication especially in a religious context. Our study proposes an analysis of religious language as a unique communicative variable in ESG reporting and thus provides a new avenue for conceptualizing the narrative strategies that Islamic financial institutions employ.

In particular, we build on the literature on Islamic finance and stakeholder perception (Haniffa and Hudaib, 2007, Nawi et al., 2022) by demonstrating that religious framing functions not merely as a signal of compliance but may instead be a performance-enhancing or performance-neutral narrative that is appropriate based on context and cultural setting. Our results demonstrate the contextual nature of legitimacy and corroborate institutional theorist claims that stakeholder interpretations are validated, not solely based on what they are told, but where and how it is told (Meyer and Rowan, 1977; Matten and Moon, 2008).

Finally, this thesis opens up new avenues for interdisciplinary exploration across religion, finance, and corporate communication. It invites future research into the workings of symbolic language transmissions in institutional stories, and where contextually resonant value-laden expressions are potentially influential in shaping understanding of performance in a frame of trustworthiness and ethical orientation. Moreover, this thesis foregrounds the interpretive gap between religious intention and secular reception, which is a new way of considering the limitations of standards in ESG reporting, as well as contributing to the broader debate around value pluralism in global finance.

IV. Challenge

This contribution must be understood within the context of several challenges. First, while information about financial institutions is readily available for the small number of Islamic banks in Europe, few regularly publish ESG reports. For instance, the UK-based Bank of London and The Middle East (BLME), a subsidiary of Kuwait's Boubyan Bank K.S.C.P., does not have a separate ESG report. Still, they provide its non-financial information in their parent company's annual sustainability report (Boubyan Bank K.S.C.P. 2015). Without ESG reporting, the sample from all non-Muslim countries will not necessarily be representative.

Second, data transparency is also a barrier to data collection in the middle east, where Islamic banks undoubtedly exist in greater numbers. Major regional banks such as AhliBank or Qatar Islamic Bank only publish summary reports, usually available only in Arabic and with no detailed statements or indicators of profitability. This lack of disclosure makes it difficult to obtain comparable data and may require paid data services or semi structured interviews to help build an accurate performance picture.

Thirdly, the specialized language of Islamic finance also required the creation of an internal glossary. Terms such as mudaraba, meaning profit sharing; murabaha, meaning financing at a mark-up on cost; and takaful, in the sense of mutual insurance are defined in their orthographic forms as mudarabah versus mudāraba and murabaha versus murābāhah.

Fourthly, another challenge of this study is that there appear to be no previous studies that have examined the role that Islamic religious language and its impact on performance. Although the literature on Islamic finance is well established and there is an abundance of research published by Islamic finance scholars, it mainly deals with Shariah compliance, governance and ethical financial instruments. No study appears to have conceptualized Islamic religious discourse as a facet of sustainability communication. This gap has hampered the identification of a theoretical framework, as there was little in the way of theory on which to draw. However, it is also a testament to the originality of this study, which links academia and the progressive field of faith-based finance to an area of secular audience.

Despite these limitations, this study provides an important empirical and conceptual contribution to the understanding of the strategic use of religious language in ESG reports, its ties to financial performance, and the ways in which context can mediate efficacy.

V. Literature review

1. The Role of Legitimacy in Islamic Banks' Reporting Strategies

Legitimacy theory is an informative lens for understanding how Islamic banks communicate their values and commitments through ESG disclosures. According to Suchman (1995), legitimacy is the generalized perception that the actions of a particular entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions. In Islamic banking, legitimacy encompasses not only financial transparency but also religious compliance; in our context, compliance with Islamic law (or Shariah). The duality of legitimacy helps us understand why Islamic banks utilize Shariah Supervisory Boards (SSBs) and Shariah audits as institutional mechanisms that not only convey compliance with religious standards and enhance internal accountability, but they also contribute to trust externally (Emerald Group Publishing, 2024; Sciendo, 2024).

This kind of religious signaling has a double-edged character in the bank's ESG communication. On the one hand, it reinforces the ethical foundation of the bank's value proposition and clearly signals its commitment to ethical principles to both clients and regulators. On the other hand, it can be seen as a strategic manoeuvre intended to strengthen the bank's position in Islamic financial markets and, to a certain extent, in the global financial sector. In Muslim-majority economies, such communication often aligns with societal norms and can foster value congruence among stakeholders. However, in secular or religiously diverse economies, the use of Islamic terminology requires careful consideration, particularly when engaging with stakeholders who may be unfamiliar with these concepts. In such contexts, strong formal Shariah governance is essential to reassure Islamic investors of compliance and demonstrate to the wider public that the religious dimensions of ESG communication are institutionally embedded and not merely symbolic (Gezgin et al., 2024; Nawi et al., 2022).

For many Muslim investors, aligning with an Islamic ethical framework is more than just best practice, it is a religious requirement. Therefore, investment decisions are made with confidence and certainty that the institution has followed Islamic laws and ethical values. Thus, detailed disclosures by the Shariah audit and religiously contextualised ESG content reinforce trust and minimise perceived risk, which are both major factors in investment decisions. Importantly, this applies to Shariah-compliant funds, Islamic charities and faith-oriented investors, whether they are Muslim or reside in a Muslim economy. Even for non-Muslim investors, verified ethical frameworks provide additional transparency and reputational capital on the institution, which raises investor confidence and expands access to capital (Haniffa & Hudaib, 2007; Maali et al., 2006; Vinnicombe & Park, 2022).

2. Alignment of ESG with Islamic principles

There exists a relationship between Islamic values and the ESG framework as both are the values that drive ethical practice. Islamic finance is based on the Maqasid al-Shariah which are the higher objectives of Islamic law. These five values (life, religion, intellect, lineage and wealth) are meant to protect the interest of humanity as they are closely related to the three pillars of ESG; environmental protection, social responsibility, and governance (Md Husin et al., 2023).

Both Islamic finance and ESG are based on ethical decisions, benefit individuals and communities, and are focused on sustainability over the long term. The first area of common alignment between ESG principles and the Maqasid al-Shariah is the objective of Hifz al-Nasl (Protection of Lineage) which is about the protection of family units, nurturing generations to come and enhancing community welfare. Therefore, Takaful (Islamic insurance) is a financial safety net and a way to help to operationalise the Maqasid al-Shariah in action to protect lineage and build social cohesion (Harahap et al., 2023; Muhamad et al., 2022).

Secondly, the concept of Hifz al-Mal (Protection of Wealth) parallels the governance (G) and environmental (E) dimensions of ESG in that both deal with responsible stewardship and ethical protection of resources. In the context of Islamic finance, protecting wealth means avoiding extravagance, mandatorily exercising transparency, and asserting that investment opportunities are supportive of the community and future generations. In Islam, there is an obligation to accumulate wealth solely in support of socially responsible ventures that maintain ethical conduciveness while assuring long-term sustainable practices thereby preserving wealth. (Muhamad et al., 2022).

Additionally, in Islamic finance, the principle of Hifz al-'Aql (Protection of Intellect) represents the provision of protection of a person's mental and intellectual safety through ethical practices as a business which includes treating the policyholder fairly as well as the protection of customer privacy, data, and fully explainable terms and conditions that are ethical. Finally, the principle of Hifz al-Nafs (Protection of Life), is closely related to the environmental part of ESG and relates to Takaful operations. To conclude, Islamic principles examined through the ESG parameters represent a solid model for promoting sustainability, ethical governance, and social responsibility in their financials.

The clear conceptual congruence between Islamic principles (as expressed in Maqasid al Shariah) and the pillars of ESG provides a strong ethical underpinning to sustainability in Islamic finance. However, while this is theoretically clear, the practical translation of this basic congruence has been neglected, especially in understanding how the religious framing of ESG reports may shape the actual operation of Islamic banks. It is important to explore whether faith-based values in ESG disclosures lead to improved stakeholder trust and performance, financial improvement and institutional resilience. This intersection is the focus of our study and aims to go beyond normative alignment to assess whether religiously framed ESG practices provide an observable strategic advantage.

3. Comparative Analysis of ESG Reports from Islamic Banks: Structure, Similarities, and Differences

As part of this research, we examined a representative sample of 122 ESG reports from Islamic banks worldwide. Then, we decided to conduct a comparative analysis of the banks' structure, methodology, and religious references, and selected six banks as case studies: Dubai Islamic Bank (DIB); Kuwait Finance House (KFH); Faisal Islamic Bank of Egypt (FIBE); Jordan Islamic Bank (JIB); Al Rayan Bank and Gatehouse Bank (both Islamic banks in the UK) to see how ESG reporting might differ in a secular and highly regulated and mixed cultural environment. This focused and comparative approach will allow us to identify typical project trends in reporting, identify unique practices of the different banks as institutions, and enable us to reflect on how Islamic principles translate and integrate into contemporary sustainability regimes in Muslim-majority and non-Muslim contexts.

Islamic banks typically use the same type of ESG report layout: an introduction with details about the reporting period and frameworks used (GRI, SASB, TCFD), a letter from the leadership to stress continued ethical practices, a governance section, a social responsibility section, and finally an environmental section. The governance section of the ESG report always includes reference to Sharia compliance. Details about the Sharia Supervisory Board's SSB's responsibilities (utilized to cover, internal audit program, risk assessment program, and anti-corruption program) should be reported. The social section usually stressed financial inclusion, charitable donations that include zakat (alms giving) and sadaqah (voluntary giving). The report includes support for small and medium enterprises. The environmental section included green finance (the amount of money spent with green suppliers), sustainable sukuks (loans), emissions reduction plans, and environmental improvement policies in organizations.

Although every Islamic bank works from Sharia principles to avoid interest (riba), uncertainty (gharar), and investment in forbidden businesses, each bank incorporates this logic differently. For example, the institution of the Islamic bank is more religiously based in Middle East where they include religious references, often quoting Qur'anic verses along with some Hadiths (sayings of the Prophet Muhammad), when explaining their ethical vision. In contrast, banks in the UK such as Al Rayan adopt a similar framework but do not reference it in religious terms. Instead, UK based banks refer to their ethics in terms of wider global contexts such as "purpose, people, and planet" and have ethical investment goals without referencing scripture directly.

The themes of social responsibility vary according to region. FIBE and JIB emphasize zakat funds, support for Islamic education, access to healthcare, and Qur'an memorization competitions. As one example, JIB incorporates the idea of Islamic identity into its community engagement initiatives by funding religious education and providing support for orphans. On the other end of the spectrum is Al Rayan which emphasizes broader inclusion initiatives that are not strictly Islamic including "Educate a Child" fixed-term deposit, which has similar ethical motivations, but applies a framework that utilizes socially impactful but secular messaging.

The governance disclosures also vary: KFH provides extensive disclosure regarding the activities of its SSB, the ESG risks it faces, and external audits of SSB activities. JIB takes a more narrative approach, focusing on the moral reasoning behind actions that is less quantitative in terms of ESG data. These differences are likely to be informed by differences in institutional maturity and regulatory obligations. Similarly to the above, environmental priorities also vary. DIB and KFH take more emphasis on renewable energy and green sukuks aligned to the UN SDGs, reflecting the ESG strategies of the respective countries. Meanwhile, FIBE and JIB take a more pronounced social development emphasis which is reflective of local economic issues and the relatively early stage of ESG regulation (Boukhatem & Moussa, 2023; Morgan Lewis, 2024). Al Rayan is bound by the UK framework and therefore it also placed less emphasis on social issues and more on measurable climate goals and investor transparency, reporting on things like scope 1 emissions and electric vehicle program Fund criteria.

This comparison reveals contrasting approaches to stakeholder communication. UK banks employ universal ethics language, whereas MENA banks are more comfortable foregrounding religious identity and explicitly include it in their reporting about sustainability.

VI. Hypotheses

Hypothesis 1 : *Including religious language in ESG reports has a positive impact on the financial performance of Islamic banks.*

The hypothesis under consideration suggests that the incorporation of religion-related language, into ESG reports by Islamic banks may result in an enhancement of their ethical position, the establishment of stakeholder loyalty, and the demonstration of a moral stance. This is an instance of religious signalling that can be interpreted as a mechanism of legitimacy within the framework of legitimacy theory. Its significance is particularly pronounced when Islamic banks operate in institutional environments that support legitimate conduct, such as through the presence of Shariah Supervisory Boards and formal Shariah audits (Suchman, 1995; Emerald Group Publishing, 2024; Nawi et al., 2022). In this context, religious signalling may serve as a strategic tool to rebuild investor confidence, attract faith-oriented clients, and ultimately exert a favourable influence on financial performance

Hypothesis 2 : *In Muslim-majority countries, the use of religious language in ESG reports exerts a more substantial positive impact on the financial performance of Islamic banks than in non-Muslim-majority countries.*

This second hypothesis includes a contextual element. In Muslim-majority contexts, where cultural norms are closely intertwined with religion in all aspects of social life and economic activities, stakeholders are less likely to overlook religious references in corporate communications and will be most receptive to Shariah-aligned ESG references that also convey institutional legitimacy and cultural norms about financial markets. This may have an additive positive influence on financial performance. Conversely, in non-Muslim-majority contexts such as the UK, the relevance of religious language may be weaker, as firms may need to translate the religious references into more broadly recognised ethical terms, to not alienate their diverse stakeholders (Sciendo, 2024; Gezgin et al., 2024; Vinnicombe & Park, 2022). Overall, it is absolutely possible to use the religious framework to formulate messages that are financially advantageous. However, this effect remains limited or purely symbolic when Islam is not a point of reference for the target audience.

Hypothesis 3 *: Religious language in ESG reports has a positive effect on ESG ratings assigned by international rating agencies.*

While Islamic banks might employ religious language in their ESG reports to demonstrate ethical commitment by naming Shariah principles or Quranic values, this type of framing is not evaluated by any of the major international ESG ratings agencies (Kotsantonis & Serafeim, 2019). The majority of these agencies employ secular measurement that are standardized for comparative cross-market analyses. However, the faith-based ethics and governance employed within Islamic banks could be beneficial in terms of some of the dimensions of ESG, particularly in the areas of governance transparency, risk management and social responsibility. This is because these dimensions are closely aligned with the block of ESG dimensions that are universally recognised. This suggests a potential tension between Islamic banks' religious framing of their ESG commitments and the formal assessment frameworks utilised globally.

VII. Sample Selection & Data description

The study sample case consisted of a group of 42 Islamic banks in Asia, the Middle East, Africa, and Europe. The Islamic Banks identified for the study were preselected according to the availability of ESG Environmental, Social, and Governance reports and financial statements over the period 2019 to 2024. The ESG reports were collected manually from the Islamic banks official websites and provided a dataset of 122 ESG reports, which was matched to their financial data from their annual financial statements checked through Bloomberg. Due to differences in reporting practices and data transparency among banks and countries, we had little missing data which resulted in an unbalanced panel dataset, and some of the models that we built contained different numbers of observations.

This study intends to investigate whether the religious language used in ESG reporting affects the financial performance of Islamic banks. Firms use ESG disclosures as a channel of communicating their sustainability commitment to stakeholders but Islamic banks are different because they incorporate religious values and Shariah principles into their corporate communication. This research will help us investigate whether the religious framing of ESG practices serves to enhance legitimacy, stakeholder trust and financial performance of Islamic banks.

1. Banking performance variables

The financial performance of Islamic banks is evaluated in this study via three dependent variables, each of which captures a different dimension of the performance of the bank.

The first dependent variable, net revenue margin (NRM), is employed as an indicator of profitability. The Net Interest Margin (NIM) is a financial indicator used to measure the profitability of a bank's core banking activities after the deduction of operating costs. A high NRM is indicative of enhanced productivity in the revenue generation and expense management process, and thus provides an indication of the bank's earnings.

Secondly, customer deposits are regarded as an indicator of customer confidence and funding stability. In the context of Islamic banking, deposits function not only as a source of funding but also as a representation of stakeholder confidence in the bank's capacity to deliver financial performance in accordance with the ethical principles of Sharia law. A larger deposit base typically indicates stronger reputation and more long-term stability in the funding structure of the bank.

Finally, the Return on Equity (ROE) measures returns to shareholders, thereby providing an indication of the efficiency with which a banking institution employs its equity base to generate net profits. ROE is a frequently employed indicator within the banking sector, as it provides a means to evaluate the profitability of a bank from the perspective of its owner and/or investors.

Together, these three variables can provide a complete picture of the operational efficiency, profitability, and stakeholder trust of Islamic banks; this gives rise to the foundation for measuring the impact of ESG based religious language on financial performance.

2. Religieuse framing variables

On the other side, the key independent variables centered on examining the religious content incorporated in the ESG reporting. The first measure, ScoreRatio, measures religion related words in the ESG reports and is calculated by dividing the number of religion-related words (e.g. "Shariah", "Islamic values", "Maqasid al-Shariah") by the total number of words in the report. A higher score signifies a much higher intensity of religious framing, showing that the bank devoted considerable effort to align its sustainability discourse with religious principles.

In addition to this, the TotalUniqueScore measures the variance and richness of religious references. It only counts the number of unique religion-related keywords that appeared in at least one instance in the ESG report. This differs from ScoreRatio that measures frequency, as the TotalUniqueScore indicates the variety of religious concepts used indicating a more nuanced and sophisticated engagement with religious narratives in ESG communication.

3. Control variables

In order to enhance analytical robustness and minimise potential confounding, a wide variety of control variables was included to represent structural, financial, and macroeconomic variation in Islamic banks. The incorporation of these controls is expected to facilitate the alignment of the diverse attributes and operational contexts of financial institutions.

Several controls were implemented at the bank level. Age is used as a proxy for organizational maturity and experience, and it is defined as the number of years that the bank has been in existence. Total Assets is a measure of bank size, taking into account the potential benefits that larger banks may accrue from economies of scale and greater visibility. A further variable that has been taken into consideration is "is_public", which assumes a binary value of 1 if the bank in question is publicly listed. This variable is instrumental in the assessment of the potential impacts of capital market pressures and transparency requirements on ESG practices.

To account for relevant dimensions of bank performance and risk, a number of inclusion variables were incorporated. First, the ratio of Non-Performing Loans (NPL) represents the quality of the loan portfolio of a bank, and its exposure to credit risk; higher values indicate poorer quality of assets. Second, deposit Growth represents growth (or decline) year-on-year, in customer deposits and indicates funding stability and depositor confidence profitability. Third, the efficiency ratio takes the bank's non-interest expenses, divided by the net revenue, and tells us how effectively it manages the bank's ongoing costs. Moreover, the Tier One Risk Based Capital ratio, (Tier1 RBCR), measures capital adequacy, this is relevant, because it influences both a bank's propensity to take on risk and also how stakeholders perceive an overall level of stress. Finally, the Total Loans to Total Deposits ratio identifies liquidity transformation for the bank by reflecting the bank's ability to turn deposit receiving inflows into lending activity.

The models are also adjusted for macroeconomic conditions through the inclusion of the Inflation rate as one of the bank-specific factors which represents the annual inflation in the country of operation and may influence the performance of financials as well as stakeholder expectations.

Moreover, to account for broader structural and temporal variations, we include country and year fixed effects in the regressions which address potential bias from unobserved country-specific characteristics or time trends. Some model specifications also include regional dummy variables for being in Europe, Asia, Africa, and the Middle East. These dummies allow the exploration of regional heterogeneities in the relationship between ESG practices and financial performance since culture, regulation, and market context can influence the perception and value associated with ESG reporting.

However, it is necessary to emphasize that the dataset reflects the maximum coverage of data available to Islamic banks, and limited by reporting practices in emerging and frontier markets, where ESG disclosure is still developing. Because of this dynamic, the sample remains unbalanced, and the models include the highest set of financial, structural and contextual variables eventually, to ensure that the analyses are rigorous and robust despite the inherent limitations of data.

VIII. Methods and empirical analysis

1. Methodology

This study uses a quantitative research methodology to examine the associations between the use of religious language in ESG reporting and the financial performance of Islamic banks. The methodology involves text analysis of ESG disclosures, data collection for financial data, econometric modelling to examine the associations whilst controlling for bank-specific and macroeconomic factors.

A dictionary-based textual analysis strategy was employed to quantitatively capture religious language in Islamic bank ESG reports. In order to develop a specific dictionary, we identified 394 religion-based keywords with both concepts and terms from multiple sources of academic literature across Islamic finance, Shariah governance, Maqasid al-Shariah, Islamic ethics and religious legitimacy frameworks. These thematic contributions were refined and validated by experts in Islamic banking and Shariah auditing to ensure suitability and contextual relevance.

The ESG reports were collected in PDF format and then converted to text files using Python. After transformation of the reports to text files, automated text-mining techniques were used to prepare the text for analysis. The cleaning and standardization of the text included removal of punctuation, numbers, special characters, and converting all content to lowercase.

The clean ESG reports were then matched against the predetermined list of religion-related keywords described above. We used various automated text-mining functions in R to facilitate dictionary-based matching and standardize the identification of religious language in the entire set of bank-year observations.

Econometric Approach. To identify the impact of religious ESG communication on financial performance, we estimate the following model:

$$\text{Perf } i,j,t = \alpha + \beta \cdot \text{Religiosity } i,j,t + d \cdot \text{FE } t + \mu \cdot \text{Struct } i,j,t + l \cdot \text{FinHealth } i,j,t + \theta \cdot \text{Macro } j.t + \varepsilon i,j,t$$

The study employs Ordinary Least Squares (OLS) regression structure based on a linear panel model specification, to ascertain the effect of religious language in ESG reports of Islamic banks. The dependent variable *Perf i,j,t*, is a measure of bank *i* financial performance in region *j*, at time period *t*. Therefore, Net Revenue Margin (NRM), Return on Equity (ROE), and Customer Deposits will serve as outcome variables of interest.

The key independent variable of interest Religiosity represents the religious element contained within the ESG disclosures. The study captured religious language within ESG reports by using two varibles: ScoreRatio and TotalUniqueScore. A regional disaggregation of some specification is also reported, (e.g., ScoreEurope, ScoreAsia) which is contextually appropriate.

The model also incorporates several control variables. Year and/or region fixed effects *FEt* are included to account for time-specific or structural factors that may influence bank performance. Structural characteristics of each bank *Struct i,j,t* are controlled for through variables such as bank age, public listing status (is_public), and size (log of Total Assets). *FinHealth i,j,t* incorporates financial health indicators such as the Non-Performing Loans ratio (NPL), Efficiency Ratio, Loans-to-Deposits ratio, and Tier 1 Risk-Based Capital Ratio. *Macro j,t* captures the macroeconomic environment, for example, country-level inflation rate.

The error term $\varepsilon i,j,t$ captures unobserved factors influencing bank performance that are not explained by the included variables.

This methodological framework allows for the study to account for both the range and intensity of religious language in ESG disclosures as well the institutional, financial risk, and macroeconomic contexts through time and space.

Table 1: Description of Variables

Variable	Description	Unit / Type	Source
Dependent Variables (Financial Performance)			
ROE	Net income over average shareholders' equity	%	Bloomberg / Financial statement
NetRevenueMargin	Net income	USD	Bloomberg / Financial statement
CustomerDeposits	Total deposits received from customers	USD	Bloomberg / Financial statement
CustomerDeposits_M	CustomerDeposits in billion	USD	Bloomberg / Financial statement
ESGScore	External ESG performance rating	Index (0–10)	Bloomberg / Financial statement / Annual Report
Main Independent Variables (Islamic Language Use)			
ScoreRatio	Proportion of Islamic language in ESG reports	%	Author's calculation
Score_Europe	ScoreRatio × Europe dummy	Interaction term	Author's calculation
Score_Asia	ScoreRatio × Asia dummy	Interaction term	Author's calculation
Score_Africa	ScoreRatio × Africa dummy	Interaction term	Author's calculation
Score_MiddleEast	ScoreRatio × Middle East dummy	Interaction term	Author's calculation
Control Variables (Bank Characteristics)			
Total_Assets	Size of the bank (proxy for scale)	Log (USD)	Bloomberg / Financial statement
Efficiency_Ratio	Operating expenses over total revenue	%	Bloomberg / Financial statement
Deposit_Growth	Annual growth rate of deposits	USD	Bloomberg / Financial statement
NPL	Ratio of non-performing loans to total loans	USD	Bloomberg / Financial statement
TotalLoans_TotalDeposits	Ratio of loans to deposits	Ratio	Bloomberg / Financial statement
Tier1_RBCR	Risk-Based Capital Ratio (Tier 1 capital to risk-weighted assets)	USD	Bloomberg / Financial statement
Age	Years since founding	Years	Website banks
is_public	Whether the bank is publicly listed	Binary (0 = No, 1 = Yes)	Bloomberg / Financial statement
Macro-Level Control Variables			
Inflation	Annual inflation rate of the bank's country	%	World Development Indicators
Year (2020–2024)	Year dummies to control for time-specific effects	Categorical	Model dummies
Region	Geographic region (e.g., Middle East, Europe, Asia, Africa)	Categorical	Author classification

IX. Results

In this section, we interpret the different results obtained after the regressions. Before the analysis of the results, we show in Table below the main statistics of the variables used. One important observation is that 93% of the banks are publicly traded. This means that the majority of the sample banks are public institutions subject to high levels of transparency and disclosure regulation.

Table 2: Descriptive Statistics - Full Sample

Variable	N	Mean	SD	Min	Max
is_public	122	0.93	0.26	0.00	1.00
Inflation	122	5.00	9.46	-2.70	51.20
Age	122	35.05	24.96	0	119.00
ROE	122	12.96	9.07	-5.97	57.40
Total_Assets	122	49438.55	66338.67	385.67	383658.37
NetRevenueMargin	115	3.18	1.59	-0.17	9.19
Efficiency_Ratio	119	44.51	13.68	17.41	101.00
Tier1_RBCR	121	17.36	2.78	9.89	29.01
NPL	111	780.18	894.19	0.27	3752.74
Deposit_Growth	131	39.86	98.94	-9.04	517.59
CustomerDeposits	121	73598.26	170219.60	270.10	1352253.20
TotalLoans_TotalDeposits	111	86.70	18.02	11.52	124.61
ESGScore	84	2.42	1.17	0.39	6.10
TotalWords	122	30322.56	24143.08	753.00	117363.00
TotalScore	122	318.22	347.96	11.00	2632.00
TotalUniqueScore	122	34.91	16.05	6.00	74.00
ScoreRatio	122	1.16	0.82	0.28	4.22

In terms of financial performance, the average Return on Equity (ROE) is 12.96, indicating that the Islamic banks in the sample tend to provide a strong return to their shareholders. However, a fairly high standard deviation of 9.07 implies considerable divergence of profitability across institutions, likely because of variability in governance structures, efficiency, and market conditions. Likewise, the average Net Revenue Margin is 3.18, with minimum and maximum values of–0.17 to 9.19, indicating that operational profitability varies considerably across Islamic banks of our sample.

Customer Deposits also have a wide degree of variability. The mean customer deposits are approximately 73,598 million USD, but the deposit levels in the dataset range from 270 million to over 1,352,253 million USD. The same is true for Total Assets, which here average approximately 49,438 million USD, with some banks as low as 386 million USD and others as large as 383,658 million USD. All of this variability suggests that there is a diverse combination of small and large Islamic banks, which adds to the representativeness, and strength of the dataset.

In terms of financial risk and stability, Non-Performing Loans (NPL) variable has an overall average of 780 million USD and at their highest points up to 3,752 million. This demonstrates a certain level of credit risk. The Efficiency Ratio has an overall average of 44.51%, and there are large deviations as some banking institutions are above 100% regarding cost efficiency. The risk-based tier 1 capital ratio (Tier1_RBCR) has an average of 17.36. This indicates that banks maintain strong capital buffers, and several on one end can have a higher ratio, while others tend to have a lower ratio.

In terms of structure, the average age of the banks is 35 years, which indicates that the institutions are mature and well-established. Inflation rates across the covered countries vary from -2.70% to 51.20%, highlighting the diverse macroeconomic conditions and underscoring the importance of accounting for inflation in regression analysis.

The diverse range of financial scale, profitability, risk exposure, and institutional characteristics within the dataset makes it highly suitable for conducting an analysis of ESG reporting. Specifically, it allows for an examination of how religious discourse influences financial performance in Islamic banking.

Table 3 presents the correlation coefficients between the key variables used in the analysis. The majority of the coefficients are low, which suggests an absence of multicollinearity and enables these variables to be included in the same regression models. This indicates that the independent variables investigate separate dimensions with minimal overlap. Certain correlations, such as those between total assets and customer deposits, align with the expected relationships, which confirms the structural connections between the variables. Consequently, the correlation matrix supports the reliability of the regression framework and provides initial evidence of relationships that will be further explored through econometric models.

Hypothesis 1:

Including religious language in ESG reports has a positive impact on the financial performance of Islamic banks.

To test Hypothesis 1, which suggests that religious language in ESG reports affects positively the financial performance of Islamic banks, three separate regressions were run with different performance measures, Net Profit Margin, Log of Customer Deposits and Return on Equity (ROE). The variable of interest ScoreRatio shows statistically significant positive relationship with the three dependent variables. The results show that religious communication is much more than a symbolic practice or a form of affirmation. It appears to have real financial consequences.

In Model 1, we analyze how ScoreRatio affects banks operational profitability, as measured by Net Revenue Margin. We controlled for region and year fixed effects to capture macroeconomic and regulatory heterogeneity. In addition, Model 1 includes a number of bank-level controls (Table 4). The coefficient on ScoreRatio is 0.317 ($p < 0.01$) which indicates that a one unit increase in ScoreRatio is associated with a 0.317 point increase in Net Revenue Margin, which indicate that more religiously framed ESG communications are positively associated with better margins.

The findings confirm and are consistent with literature that supports the view that religious language can serve as a legitimacy enhancing signal (Haniffa & Hudaib, 2007), particularly for Islamic banks with clients. Customers sometimes recognise the superiority of a display of religious alignment as a form of brand authenticity and ethical commitment.. Furthermore, Nawi & al. (2022) provided evidence that religiosity in corporate disclosures can reduce perceived moral hazard or governance risk in the eyes of investors, and foster long-term relationships with depositors, thereby lowering the cost of capital.

The focus of Model 2 shifts focus from internal profitably to external stakeholder behavior by regressing log Customer Deposits on ScoreRatio. The estimator is specified with country fixed effects rather than year-region fixed effects, because behavior is likely to be highly shaped by national, or country-specific, legal, religious, and institutional factors, for example, Shariah-compliant banking regulations, or cultural norming around zakat and ethical savings. Thus, it allows the isolation of within country variance only in ScoreRatio.

Additionally, to promote parsimony and minimize overfitting in Model 2, we decided to conduct a stepwise AIC selection to keep the most informative controls while maintaining ScoreRatio as the major independent variable. Weighing the choice between explanatory power and parsimony becomes especially important when modeling customer deposits because of the potential for multicollinearity. The estimated coefficient for ScoreRatio is 0.369 ($p < 0.05$), demonstrating that religiously resonant ESG messaging contributes to increased deposits for customers. This is supportive of an idea that religious communication does possess a market signaling effect, ultimately drawing faith-based depositors to Islamic banks, which fits with the behavioral foundation that Kuran (2004) provides. Kuran (2004) states that Islamic financial structures gain legitimacy and public support when they reflect deeply held cultural and religious norms.

Interestingly, Is_Public has a strong negative coefficient ($\beta = –2.537$, $p < 0.01$), suggesting that privately held Islamic banks are able to draw in deposits, which we suspect is due to either community relationships or informal reputation mechanisms extending deposits sourced from the community.

The Model 3 tests the relationship between the intensity of religious language (as measured by the ScoreRatio) and its diversity (as measured by the TotalUniqueScore) in ESG reports, and Return on Equity (ROE). Again, ScoreRatio shows a strong, positive and highly significant relationship with ROE ($\beta = 2.150$, $p < 0.01$), while TotalUniqueScore showed a negative relationship with ROE ($\beta = -0.107$, $p < 0.01$). Given the inconsistent relationship between ROE and the two different indicators of religious language, it seems that a clearer and stronger religious message improves the return on equity for its shareholders, while greater diversity of religious language may have an effect on the clarity of the religious message or is received as inconsistence by the stakeholders.

The results suggest that religious ESG language provides trust and signals ethical stickiness and can improve financial performance. Nevertheless, while intensity enhances credibility, excess diversity may dilute the signal. Next, we investigate whether these effects vary to a regional context and consider how cultural, legal, and religious contexts influence the relationship between religious language and banks performance.

Table 4: Testing Hypothesis 1

	Net Revenue Margin	**Log Customer Deposits**	**ROE**
	(1)	(2)	(3)
Score Ratio	0.317***	0.369**	2.150***
	(0.108)	(0.183)	(0.777)
Total Unique Score			-0.107***
			(0.038)
Is Public	1.943***	-2.537***	8.577***
	(0.414)	(0.819)	(2.309)
Age	0.773	0.015*	-3.202
	(1.104)	(0.008)	(4.002)
Inflation	2.765***		5.994**
	(0.428)		(2.496)
Log Total Assets	-0.472		0.917***
	(0.372)		(0.281)
Deposit Growth	-0.754**		
	(0.364)		
NPL	-1.113***	0.002***	
	(0.357)	(0.0002)	
Total Loans / Deposits	-1.068***		-0.207***
	(0.358)		(0.044)
Tier 1 RBCR	-0.804	-0.365***	0.087
	(0.513)	(0.070)	(0.226)
Efficiency Ratio		-7.411***	0.494
		(1.178)	
Region Fixed Effects	Yes	No	Yes
Year Fixed Effects	Yes	No	Yes
Country Fixed Effects	No	Yes	No
Observations	98	98	98
R^2	0.792	0.833	0.541
Adjusted R^2	0.748	0.800	0.494

Note: This table presents the results for Hypothesis 1, assessing the impact of religious language in ESG reports on Islamic banks' financial performance, measured by Net Revenue Margin, log of Customer Deposits, and ROE. The main variables are *Score Ratio* (intensity of religious language) and *Total Unique Score* (diversity of terms). Control variables include bank size (log of Total Assets), age, listing status (is_public), inflation, deposit growth, non-performing loans (NPL), Tier 1 capital ratio, efficiency ratio, and loans-to-deposits ratio. Country, region, and year fixed effects are also included as indicated. Robust standard errors are reported in parentheses. Significance levels: * p<0.1; ** p<0.05; *** p<0.01.

Hypothesis 2:

In Muslim-majority countries, the use of religious language in ESG reports exerts a more substantial positive impact on the financial performance of Islamic banks than in non-Muslim-majority countries.

Hypothesis 2 is based on the results of Hypothesis 1, which showed a positive correlation between the use of religious language in ESG reports and financial performance. To delve deeper into this relationship, Hypothesis 2 examines regional distinctions by integrating ScoreRatio with regional dummy variables. By evaluating three financial performance models (Net Revenue Margin, Customer Deposits and ROE), we can ascertain how the influence of religious language varies across Europe, the Middle East, Asia and Africa (see Table 5). This comparative analysis will allow us to determine whether the trend observed in Hypothesis 1 is more pronounced in countries with predominantly Muslim populations and less significant, or possibly inverted, in countries with secular or mixed religious landscapes.

For Model 1 (Net Revenue Margin), the results clearly show that using religious language in Muslim-majority regions has a positive effect on operational profitability. In the Middle East, an increase of one unit in the ScoreRatio results in an increase of 0.49 points in the Net Revenue Margin ($\beta \approx 0.490$, $p < 0.01$), whereas in Asia, the increase is approximately 0.39 points ($\beta \approx 0.387$, $p < 0.05$). These significant effects highlight that including religious messaging in ESG reports meets stakeholder expectations and enhances perceptions of legitimacy and trust, both of which are important for profitability in Islamic finance. In cultures where Shariah principles are widely accepted, this type of communication may therefore resonate with depositors, investors and regulators, thereby reinforcing the bank's ethical stance and potentially reducing reputational or compliance risks.

However, in Europe, the coefficient is negative and shows some level of significance ($\beta \approx -3.624$, $p < 0.1$). This indicates that using overtly religious language in a secular environment may be seen as inappropriate or unappealing, potentially leading to concerns about transparency, universality, and relevance. The use of religious ESG framing could also cause confusion among stakeholders who are not familiar with Islamic terms or values. Even Muslim investors in non-Muslim countries may not show strong interest in such framing, as their investment decisions are usually based on financial performance and standardized ESG criteria rather than religious symbols. This highlights the difficulty of aligning faith-based communication with the expectations of a diverse, largely secular audience.

In the African region, the coefficient is negative but statistically insignificant ($\beta \approx -0.276$), which indicates no detectable financial benefit or cost associated with religious communication there. The diversity of African markets, some with substantial Muslim populations, others mixed or secular environments, would tend to dilute the overall effect. The model explains a lot of profitability variation (adjusted $R^2 = 0.699$), again confirming that regional environment is a significant factor.

Model 2 (customer deposits), in the Asian market, is a significant positive association between ScoreRatio and customer deposits ($\beta \approx 0.009$, $p < 0.05$). This suggests that faith-based ESG messages have a strong attraction for depositors. This result indicates a market signalling effect, where the use of religious language increases the attractiveness of the bank to faith-oriented customers. This result is consistent with research by Nawi et al (2022), which demonstrates that religious information can help to build trust, minimise perceived risk and build customer loyalty.

Conversely, a significant negative impact ($\beta \approx -0.020$, $p < 0.01$) is evident in Africa. This suggests that, in certain African contexts, using explicit religious terminology could reduce market appeal, potentially deterring mainstream customers or raising doubts about the bank's inclusivity. This highlights a potential hazard: when religious communication is incongruent with the intended recipients, it can result in stakeholder estrangement rather than engagement.

The coefficients for Europe and the Middle East are not significant (Europe: $\beta \approx -0.032$; Middle East: $\beta \approx -0.004$). This suggests that the use of religious language in ESG reports does not measurably impact financial performance in these regions. In Europe, any potential positive effect on Muslim clients could be counterbalanced by the discomfort or alienation experienced by non-Muslim stakeholders, resulting in a neutral overall effect. However, cultural norms in the Middle East render religious framing as familiar or anticipated, with little efficacy at separating banks or influencing depositors. In addition, there is a strong explained variance in the model, as indicated by a high adjusted R squared of 0.678.

In the context of Model 3 (Return on Equity), the influence of religious language on financial performance in Asia is particularly notable. According to ScoreRatio data, there is a strong positive correlation between ROE and religious ESG communication ($\beta \approx 3.085$, $p < 0.01$). This suggests that utilising religious messaging leads to increased profits and deposits and higher returns for shareholders. The consistent impact of these findings across various performance indicators suggests that, in Asian markets with a Muslim-majority population, incorporating religious language could enhance reputation, build stakeholder loyalty and drive positive financial outcomes in the long term.

In Europe, Middle East, and Africa, ScoreRatio does not show a significant impact on Return on Equity (ROE). The beta estimates for Europe ($\beta \approx -14.87$) and the Middle East ($\beta \approx -0.232$) are negative but not statistically significant. This underlines the conclusion that religious information can only produce financial benefits if it conforms to cultural and institutional norms. In secular environments, characterised by a mixture of beliefs. Such information may be perceived as symbolic, insignificant or likely to distract investors who prioritise conventional environmental, social and governance (ESG) metrics.

The results of Hypothesis 2 suggest that the financial impact of using religious language in ESG reports varies significantly depending on the context. In regions with a predominantly Muslim population, such as Asia and the Middle East, using religious terminology is associated with favourable outcomes in terms of profitability, deposit growth and shareholder returns. These findings suggest that stakeholders perceive the use of religious language positively, which enhances the organisation's credibility and legitimacy.

On the contrary, in regions that are not predominantly Muslim, like Europe and certain parts of Africa, the same religious language either has little to no impact or even a negative effect, indicating a lack of alignment with local expectations. These results highlight the importance of aligning religious ESG communication with cultural and institutional norms for financial effectiveness. Moving forward, Hypothesis 3 will shift the focus from internal financial performance to external perception, we will test whether the use of religious language also influences the ESG ratings provided by global rating agencies.

Table 5: Testing Hypothesis 2

	NetRevenueMargin	**CustomerDeposits_M**	**ROE**
Score Europe	-3.624*	-0.032	-14.872
	(1.862)	(0.047)	(10.615)
Score Asia	0.387**	0.009**	3.085**
	(0.151)	(0.004)	(0.861)
Score Africa	-0.276	-0.020**	0.003
	(0.253)	(0.007)	(1.005)
Score Middle East	0.490***	-0.004	-0.232
	(0.151)	(0.008)	(0.822)
Year (Fixed Effects)	-0.639	-0.008	-2.940
	(0.411)	(0.010)	(2.801)
log(Total Assets)	0.353**	0.005	0.364
	(0.160)	(0.003)	(0.241)
Deposit Growth	-1.289***	-0.001	2.239
	(0.344)	(0.010)	(1.679)
Age	-1.336**	-0.001	-2.066
	(0.386)	(0.003)	(1.412)
Inflation	-1.102*	0.006	-2.147
	(0.571)	(0.010)	(1.567)
NPL	-0.287**	0.010***	0.189
	(0.136)	(0.003)	(0.296)
Public Bank	0.007**	0.001*	0.007
	(0.003)	(0.0004)	(0.007)
Loans/Deposits	-0.005	0.0003**	-0.052*
	(0.006)	(0.0001)	(0.029)
Efficiency Ratio	0.142**	-0.002*	0.494**
	(0.068)	(0.001)	(0.218)
Tier1 RBC Ratio	0.0002*	0.000002***	0.0001
	(0.0001)	(0.0000004)	(0.0002)
is_public	-0.643*	0.032***	-0.492
	(0.376)	(0.009)	(0.892)
Efficiency_Ratio	-0.044**	-0.001*	-0.146
	(0.017)	(0.001)	(0.110)
TotalLoans_TotalDeposits	-0.008	0.0001	-0.177**
	(0.010)	(0.0002)	(0.073)
T1xr1.RBCR	0.069	0.005***	-0.308
	(0.050)	(0.001)	(0.287)
Constant	7.621***	-0.216***	51.541***
	(1.723)	(0.043)	(8.521)
Observations	98	98	98
R^2	0.699	0.678	0.563
Adjusted R^2	0.659	0.635	0.495
Residual Std. Error (df = 79)	0.820	0.026	8.858
F Statistic (df = 18; 79)	13.502***	12.346***	9.005***

1

Note: This table presents the results of testing Hypothesis 2, which examines whether the effect of religious language in ESG reports on financial performance varies by region. The main variable of interest, *ScoreRatio*, is interacted with regional dummies for Europe, Asia, Africa, and the Middle East. Significance levels: p<0.1; ** p<0.05; *** p<0.01.

Hypothesis 3:

Religious language in ESG reports has a positive effect on ESG ratings assigned by international rating agencies

Hypothesis 3 takes a different turn by switching the focus over to external Environmental, Social, and Governance (ESG) ratings rather than financial performance. That is, we want to test whether the use of religious language in ESG reports impacts how external agencies rate Islamic banks, in terms of ESG scores. We estimated two models. Model 1 uses the whole sample with region fixed effects (e.g., Europe, Asia, Middle East, and Africa) so that we can control for regional differences at a broad level. Model 2 uses the same model as Model 1 but includes interaction terms between the religious language indicator (ScoreRatio) and each region, to test whether the religious communication impact varies by geographic and cultural context (see Table 6). We followed a similar method in Hypothesis 2 so we adjusted the ability of ScoreRatio to vary over regions.

In Model 1, the ScoreRatio has a positive yet statistically insignificant effect on ESG ratings ($\beta \approx 0.084$) which indicates that globally religious language in ESG reports does not lead overall to enhanced ESG ratings. This is consistent with previous research (e.g. Kotsantonis & Serafeim, 2019) demonstrating rating agencies rely on a narrow set of standardized secular metrics (e.g. emissions, governance structures, labor policies). Consequently, the addition of Quranic references or Shariah principles will not impact how external rating agencies consider the bank's ESG performance.

Nevertheless, Model 1 provides evidence of variation across regions for average ESG rating. Banks in the Middle East have statistically higher cumulative bank ESG ratios than banks in Europe ($\beta \approx 5.296$, $p < 0.05$), while banks in Asia and Africa have statistically lower ESG ratios ($\beta \approx -2.346$ and -2.861 respectively, both $p < 0.01$). This variation likely reflects differences in disclosure or real ESG performance across regions, but since these regional variables do not interact with ScoreRatio in Model 1, they provide no information about the specific effect of religious language.

To investigate this more thoroughly, Model 2 adds interaction variables between ScoreRatio and region. In Europe, the interaction is positive and significant ($\beta \approx 2.934$, $p <$

0.01), suggesting that Islamic banks in secular contexts benefit in terms of their ESG ratings if they include religious content in their reports. A similar but smaller effect emerges in Africa ($\beta \approx 1.384$, $p < 0.05$). These findings suggest that in regions where Islamic banking is less dominant, religious framing may provide a differentiating signal of ethical commitments that is somehow accounted for either directly or indirectly by the rating agencies.

In contrast, the interaction effects for Asia and the Middle East are effectively zero and not statistically significant ($\beta \approx 0.018$; $\beta \approx 0.025$, n.s.). In these regions, where Islamic banks routinely include religious references, such content does not differentiate banks in the eyes of ESG rating agencies. In other words, when religious framing becomes the norm, it loses its signaling value.

One possible interpretation is that Islamic banks might use religious language, in secular or non-Muslim majority contexts (e.g., Europe or Africa), to purposely signal their ethical values. But in order to be credible, this symbolic language must be accompanied by real accountability or governance. When it means something, the religious references are working like a self-imposed ethical commitment. That requires a more ethical group behavior and makes the bank's message more coincident with its actions. This would also be in line with the notion that governance can convert symbolic language into measurable impact. This assertion is corroborated by more recent studies (Gezgin et al., 2024), in which governance quality serves as a mediator between ESG disclosures and ESG performance, which suggests that faith based language must be backed by action to matter.

In conclusion, despite the fact that the use of religious language in ESG reports does not significantly impact ESG ratings globally, indicating that rating agencies base their evaluations on consistent, non-religious criteria, regional differences provide a more detailed picture. In Europe and Africa, religious communication is often seen as a reliable indicator of ethical behaviour, especially when it is coupled with effective governance practices. This suggests that, in regions where Islam is not the predominant religion, the use of religious language can enhance perceptions of ESG if it genuinely reflects dedication. Adjusted R^2 values of 0.379 and 0.303 demonstrate that the models explain a substantial proportion of the variation in ESG scores.

Table 6: Testing Hypothesis 3

Dependent variable: ESG Score	**Model 1:Region Fixed Effects**	**Model 2: Regional Interactions**
	(1)	(2)
Score Ratio	0.084	–
	(0.151)	–
Region: Asia	-2.346***	–
	(0.755)	–
Region: Middle East	5.296**	–
	(2.013)	–
Region: Africa	-2.861***	–
	(0.790)	–
Score Europe	–	2.934***
	–	(0.840)
Score Asia	–	0.025
	–	(0.213)
Score Middle East	–	0.018
	–	(0.172)
Score Africa	–	1.384**
	–	(0.691)
Age	-0.001	0.002
	(0.005)	(0.005)
Inflation	-0.056	-0.045
	(0.035)	(0.039)
log(Total Assets)	-0.074	-0.122**
	(0.055)	(0.055)
Public Bank	1.409***	1.548***
	(0.393)	(0.412)
Deposit Growth	-0.002	-0.002
	(0.001)	(0.002)
Tier1 RBC Ratio	0.028	0.001
	(0.047)	(0.053)
Loans/Deposits	0.009	0.004
	(0.009)	(0.009)
Constant	3.281**	1.836
	(1.613)	(1.483)
Observations	82	82
R^2	0.464	0.398
Adjusted R^2	0.379	0.303
Residual Std. Error (df = 70)	0.922	0.978
F Statistic (df = 11; 70)	5.502***	4.200***

Note: This table presents the results for Hypothesis 3, which examines the effect of religious language on ESG ratings. Model 1 includes region fixed effects to control for geographic variation, while Model 2 introduces interaction terms between *ScoreRatio* and each region. The dependent variable is the external ESG score. Control variables include bank size, age, inflation, deposit growth, public ownership, capital adequacy, and liquidity ratios. Robust standard errors are in parentheses. Significance levels: $p<0.1$; ** $p<0.05$; *** $p<0.01$.

X. Discussion and Conclusion

1. Summary of the Main Results

The results from each of the three models show that referencing Islamic religious language in ESG reports provides a strategic communication device whose relevance is context sensitive. The first model (Hypothesis1) supports the idea that religious discourse will positively influence financial performance, profit margins, return on equity, and deposits by customers when Islamic values match with stakeholder expectations. This aligns with legitimacy theory that states organizational legitimacy increases with cultural similarity and with signaling theory, which supports the idea that religious language signaling can communicate carefully deep ethical commitments to stakeholders, can lessen information asymmetries, and can shift control of the narrative about the organization. In contexts where Islamic prescriptions do influence norms in society, Islamic religious language promotes trust and credibility in the organization, enhancing legitimacy.

The second and third models continue the analysis as they advance the understanding of how cultural context and evaluation frameworks can shape how religiously enacted ESG discourse reinforces or weakens the effects of Islamic ESG language. The Islamic ESG language effect becomes more pronounced in Muslim-majority areas like the Middle East and Asia because the Islamic ESG discourse is socially further aligned with norms and societal constructs that exist in those locations. In secular areas or areas with religious pluralism, such as Europe, Islamic ESG language can be less impactful or considered irrelevant or symbolic. While religious language itself does not appear to provide an aggregate improvement in ESG scores, it appears to provide a positive indication in areas where banks affiliated with Islam are only one of many minority options. As such, it can be considered a signal of differentiation, dependent on the supporting strong ESG performance. Ultimately, the study demonstrates that religious discourse on ESG-related reports is not inherently effective or universally advantageous; rather, effective religious discourse in ESG matters depends on the compatibility of the cultural context within which the messages originate as well as the evaluative frame to measure them.

Table 7: Summary of Hypotheses, Findings, and Validation

Hypothesis	Focus	Main Finding	Conclusion
H1: The use of religious language in ESG reports contributes positively to the financial performance of Islamic banks.	Overall financial performance (Net Revenue Margin, Deposits, ROE)	Religious language (ScoreRatio) shows **positive and significant effects** across financial indicators.	**Confirmed**
H2: In Muslim-majority countries, the use of religious language in ESG reports has a stronger positive impact on financial performance than in non-Muslim-majority countries.	Regional variation (Asia, Middle East vs. Europe, Africa)	Significant **positive effects in Asia and the Middle East**; weak or **negative in Europe and Africa**.	**Confirmed**
H3: The use of religious language in ESG reports improves external ESG ratings for Islamic banks.	External ESG ratings (global vs. region-specific)	**No global effect**; but **positive in Europe and Africa**, **neutral in Muslim-majority regions**.	**Partially confirmed**

2. Practical implications & limitations

This thesis provides practical implications for Islamic financial institutions, ESG practitioners and policymakers who wish to communicate ethically while creating measurable impact.

First, to Islamic banks, the results demonstrate that religious language in ESG disclosures is not simply meaningful, it can shape stakeholder perceptions and sometimes, even financial performance. However, the impact of religious language is sensitive to the context. In Muslims-majority contexts, religious framing might reinforce credibility and stakeholder alignment. In secular and religiously pluralist contexts, religious framing might be either ineffectual or not understood.

Second, for corporate reporting professionals and sustainability officers, this research raises awareness to think about ESG reporting more broadly as a form of storytelling and social engagement than something offered for compliance alone. The meaning communicated by language, especially when associated with religious/moral ideas and values, it will serve as a signal of authenticity and commitment only in conjunction with the governance structure and overt evidence of performance. Consequently, firms need to refrain from using religious educational expressions as rhetorical embellishments, and instead integrate them into credible, performance-supported marketing and communication frameworks.

Finally, this research extends an invitation to both investors and rating agencies to more critically engage with the narrative dimensions of ESG disclosure, particularly in relation to institutions operating within ethically and/or religiously based financial systems. This approach may allow considering the extent to which ethical and moralized language is consistent with their actual governance and risk management practices, as indicators of institutional integrity.

XI. Appendix

Table 3: Correlation Matrix

	ScoreRatio	TotalUniqueScore	TotalAssets	EffRatio	DepositGrowth	NPL	Loans/Deposits	Tier1RBCR	Age	isPublic	Inflation	NetRevMargin	ROE	CustDeposits	CustDepositsM	ESGScore
ScoreRatio	1.00***															
TotalUniqueScore	0.30***	1.00***														
TotalAssets	0.13	-0.08	1.00***													
EffRatio	-0.02	0.09	-0.30**	1.00***												
DepositGrowth	0.07	-0.01	-0.04	0.13	1.00***											
NPL	-0.13	-0.02	0.66***	-0.34***	-0.13	1.00***										
Loans/Deposits	-0.32***	-0.13	0.16	-0.22*	-0.16	0.32	1.00***									
Tier1RBCR	0.03	0.02	-0.12	-0.15	-0.07	-0.16	-0.25**	1.00***								
Age	-0.05	0.07	0.30***	-0.28**	-0.20*	0.18	0.10	-0.06	1.00***							
isPublic	-0.00	0.18*	-0.12	0.07	0.01	-0.22*	-0.03	-0.09	0.10	1.00***						
Inflation	0.28**	0.03	0.26**	0.11	0.09	-0.20*	-0.34***	-0.04	-0.19*	-0.07	1.00***					
NetRevMargin	0.14	0.23*	-0.07	0.17	-0.01	-0.22*	-0.02	-0.11	-0.01	0.03	0.01	1.00***				
ROE	0.33***	-0.02	0.12	-0.37***	0.14	-0.05	-0.46***	0.04	-0.04	0.04	0.54***	-0.00	1.00***			
CustDeposits	0.12	-0.11	0.99***	-0.28**	-0.03	0.65***	0.14	-0.13	0.26**	-0.13	0.39***	-0.07	0.18	1.00***		
CustDepositsM	0.12	-0.11	0.99***	-0.28**	-0.03	0.65***	0.14	-0.13	0.26**	-0.13	0.39***	-0.07	0.18	1.00***	1.00***	
ESGScore	0.04	0.21	0.15	0.12	0.02	-0.27*	-0.13	0.11	-0.05	0.25*	0.18	-0.05	0.02	0.16	0.16	1.00***

Table 8 - List of words related to the Muslim religion

Istihsan	Qiyas	Ijma’
Ra’y	Interest-Free Banking Compliance Policy	Shariah audit report
Hamish al-Jiddiyyah	Values-based finance	Halal Karobar
Risk Margin	Sunnah	Akar
Wakālah	Iltizam bi al-Shariah	Foundation Culture
Ethical and Transparent Banking	Underwriting Surplus or Deficit (Takāful)	Istisnaa
Maslahah mursalah	Gharar yasir	Minimum Target Capital (Takāful)
Sharia	Operational Risk	QURAN
Musawamah	Faith-based banking	Mubāraah
Gharemeen	Fiqh al-muamalah	Amwal
Tabarru Commitment (Takāful)	Salam	Fiqh
Bai Mu’ajjal	Wadīah	Islamic Development Bank Group
Urf sahih	Diminishing Mushārakah	Sharīah
Ethical yield	Amana	Bai-Muajjal
Profit Commission (Takāful)	İslami Finans	Khiyanah
Time Horizon (Takāful)	Usul al-fiqh	Urf
Absentes	Shareholders’ Fund	Credit Risk
Wa‘d	Zero Tolerance to Discrimination	Amin
Technical Provisions (Takāful)	Shariah audit checklist	Bay al-Inah
Participants’ Investment Fund (Takāful)	Sharia Board	Displaced Commercial Risk
Qard Hasan	Takāful Undertaking	Musharakah mutanaqisah
Zakah	Majallah al-ahkam al-adliyyah	Participation bank
Kâr Payı	Vakıf	Eirad
Maysir	Sharīah non-Compliance Risk	Shariah auditor
Legal and Non-compliance Risk	Rahn	Awkaf
Solvency Control Levels	Fiduciary Risk	Mudharabah
Islamic Corporation for the Development of the Private Sector (ICD)	Facultative (Takāful)	Mutajar
Gharar	Participation finance	AAOIFI standards
Aqd	Social Responsibility	Retakaful Participant
Prudent Person Rule (PPR)	Ijarah	Brokerage (Takaful)
Market Consistent Valuation	Bay al-murabaha	Ijara Thumma Bai
Bai Inah	Musharaka	Treaty (Takāful)
Unrestricted Investment Accounts	Wakala	External Shariah audit
ukūk	Bay al-dayn	Mujtahid
Islami Bankari	Alim	Halal Investment
Provisions (Takāful)	Riba	Sahm
We grow with our values	Muhammad	Commodity murabaha
Qiyas al-tard	Shariah supervisory board	Ajr
Charity	Islamic Banking	Al Hisba
Heritage preservation activities	Host Undertaking	National and moral values
Parallel Istisna	Hanbali	Bayt al-mal
Solvency Requirements	Al-kharaj bi al-daman	Murabaha-tawarruq

Liabilities (Takāful)	Mudarib	Members of the Shariah Board
Zakat	Hiba	Ta-awun
Holy Quran	Prohibition of speculation	Total Balance Sheet Approach (Takāful)
Retakaful Undertaking	Sharia-compliant portfolios	Tawliyah
Riba al-nasiah	Muraja'at Shar'iyya	Wajeb
ESRA (Environmental and Social Risk Assessment)	Hawala	Ameen
Prescribed Target Capital (Takāful)	Umrah	Captive (Takaful)
Dayn	Musyarakah	Takāful Operator
Taskeek	Participation finance principles	Islamic Finance
Interest-free lending	Investment Risk Reserve (IRR)	Current Central Best Estimate (Takaful)
Shariah audit	Reserves	Bay al-Istijrar
Governance Committee	Underwriting (Takāful)	Maqasid al-shariah
Hiwalah	Tijarah	Internal Shariah audit
Hajj	Sukuk	Mudarabah (capital provider, Entrepreneur 'Mudarib)
Ummah	Participants' Risk Fund (Takāful)	Prohibition of speculative market transactions
Cedant (Takaful)	Amanah	Sustainability Sukuk Framework
Sanadat al-dayn	Market Risk	Underwriting Risk (Takāful)
Murabaha	Taqrir	Ahliyah
Urf fasid	Ijtihad	Tanazul
Takaful	Bai Al Ajel	Islamic Collective Investment Scheme (ICIS)
Mobah	Riba al-fadl	Shariah governance framework
Qur'an	Corporate Governance	Halal
In the Name of Allah the Compassionate the Merciful	Syariah	Faizsiz Finans
Sadd al-dharai'	Shafi'i	Ibra
Ujrah	Maslaha	Internal Model (Takāful)
Katılım Bankası	Akad	Kar-Zarar Ortaklığı
Mu'amalat	Bulugh	Restricted Investment Accounts
Istishab	Madhhab	Green Sukuk
Ijarah tashghiliyah	Shariah audit manual	Ayn
Risk Weighting	Sharia-compliant	Hibah
Tabarru	Responsible income generation	Liquidity Risk
Profit Equalisation Reserve (PER)	Bai Salam	Minimum Capital Requirement (Takāful)
Kharaj	Gharar fahish	Waqf
Hasana	Ju'alah	Takāful Participant
Deficit (Takaful)	Risk-sharing	Ijarah mausufah fi al-dhimmah
Fatwā	Ceding Commission (Discount) (Takaful)	Own Risk and Solvency Assessment (ORSA) (Takāful)
Run-off	Shirkah	Islamic Window
Institutions Offering Islamic Financial Services (IIFS)	Amanat	Shariah compliance audit
Mudaraba	Ijara	Hanafi
Urbūn	Sharīah Advisor	Illah
Bai'	Munafa	Sood-Free
Bai al Arboon	Tafaqquh fi al-Deen	Risk Appetite

Solvency Resources	Awqaf	Allah
Baitul Mal	Ayah	Hukm
Khilabah	Islamic audit charter	Shariah Board reporting
Makrooh	Quantitative Restrictions	Deficiency (Takaful)
Haram	Bay al-wadiah	Bai' Bithaman Ajil
Risk Management	Parallel Salam	Ijarah al-a'yan
Shariah compliance review	Qard	Exit Value
Tawarruq	Bay al-tawliyah	Murabaha li al-amir bi al-shira
Sharia-compliant principles	Arbun	Ijarah Muntahiyah bi al Tamlik
Maqasid	Kafalah	Ajal

Theoretical foundations of Islamic finance: contracts, principles and contemporary implications

Islamic finance in its current form emerged from a combination of historical, religious and socio-economic variables in the twentieth century, but the roots of its conceptual underpinnings go much deeper. Early Muslim reformers and economists, such as Sayyid Abul Ala Maududi and Muhammad Baqir al-Sadr, envisaged the possibility of reforming modern banking practices to bring them into line with the Islamic prohibition of interest (riba) (Siddiqi 1983). After the post-colonial period, the newly independent Muslim-majority countries were able to re-establish their economies in accordance with Islamic cultures and traditions. This position stimulated the debate on how to implement Islamic financial mechanisms instead of interest-based mechanisms, which were based on risk sharing and real economic transactions (Ayub, 2007).

One of the early modern experiments in Islamic banking occurred in 1963 in Mit Ghamr, Egypt when Ahmad El-Najjar created an interest-free savings institution to gather deposits and invest in small asset-based enterprises. The success of this local initiative led to the eventual adjustment of Islamic banking practice, which resulted in the formation of the Islamic Development Bank (IDB) in 1975 and several commercial Islamic banks thereafter (Chapra, 1992). In the years ensuing widespread Islamic finance began proliferating in the Middle East, Asia, and beyond, driven by religious reasons and a desire for alternative, ethical forms of financial intermediation (Mirakhor & Iqbal, 2011).

The Islamic finance industry may be relatively new. However, the fundamentals principles and rules are rooted in classical Islamic jurisprudence that regulates economic life but also social, moral and religious conduct surrounding economic life. Shariah serves as both the ethical and legal precept for Islamic economics, not only prescribing practices of worship, but also a host of social and commercial obligations (Ayub, 2007). Shariah goes far beyond the prohibition of interest (riba) and advocates fairness, mutual consent, and social justice. Seeks to have all transactions share legitimate risk and reflect real economic activity (Chapra, 2000). In practice, Islamic banks recruit Shariah Supervisory Boards comprised of scholars trained in Islamic jurisprudence and finance, to vet proposed products and contracts for compliance (IFSB, 2021). These boards ensure that modes of financing appropriately limit excessive uncertainty (gharar) and speculation (maisir), while preserving the transparency and ethical principles of Islamic finance (Mirakhor & Iqbal, 2011). Through this governance process, Islamic finance strives to align profit and ethical goals through financial products that have investments and entrepreneurship that are guided by the higher purpose of socio-economic welfare and responsible behavior (Alam, Gupta, & Shanmugam, 2017).

The basic premise is that wealth is produced through legitimate trade or investment in real economic activity, rather than simply receiving interest on loans (Ayub, 2007). Riba is defined in almost all sources of Islamic law to mean any guaranteed increase on a principal amount that is received by a lending party regardless of any other outcomes. Such a contractual arrangement is seen as exploitative because the lender is guaranteed a profit regardless of the success or failure of the underlying venture or activity, which on a wider basis may increase disparities in socio-economic contexts (Siddiqi, 1983). Riba is prohibited so that Islamic finance can facilitate a fairer and more equitable distribution of risk and reward for both providers of capital and entrepreneurs (Chapra, 1992).

In addition to the prohibition of riba, Islamic law also forbids transactions which include gharar (considerable uncertainty) and maisir (gambling or speculation), as both generate conditions that breach transparency and fair treatment. In terms of gharar, contracting parties are expected to be aware of the terms of the contract, meaning price, quality, and quantity of goods and service must be clearly understood (Iqbal & Molyneux, 2005). This prevents one party from taking advantage of another due to hidden conditions or ambiguity in the contract

(Mirakhor & Krichene, 2009). Maisir is not allowed to encourage deals that are based on the speculative nature of a transaction where returns are based primarily on chance rather than real economic productivity (Dusuki & Abdullah, 2007). Thus, Islamic finance is based on principles of disclosures, partnerships, and ethical investments.

Since the 1970s, with the formal establishment of Islamic banks, several classical commercial contracts have been modified to suit contemporary financial requirements (Ayub, 2007). One of the most common contracts is murabaha, often described as a "cost-plus" sale. Through murabaha, a financial institution buys a tangible asset, such as machinery or raw materials, at the request of a client, takes on temporary ownership and risk for the asset, and then sells the asset to the client at a profit. The cost and profit in murabaha are agreed upon and disclosed at the beginning of the transaction and are typically payable in installments. Murabaha has been popular for trade finance, short-term credit, and working capital needs (Warde, 2000). From a Shariah perspective, the murabaha trade is different from an interest-based loan because it is an actual sale of goods, which transfers part of the ownership risk to the financial institution for some period. Critics of murabaha contend that its economic consequences may copy a loan, while supporters state it is compliant with Shariah requirements that ties return to an observable trade and that the fund provider accepts ownership risk after acquisition (Ayub, 2007).

Another similar contract, musawamah, is closely related to murabaha, which involves trade, but in this case, the seller need not disclose the original purchase price to the consumer. The selling price will be determined through negotiations of the musawamah contract based on what is typically a normal bargaining process (Iqbal and Molyneux 2005). Although their use is not as widespread as that of a formal bank financing tool, musawamah, such as murabaha, can be justified within this same ethical framework, insofar as they use the characteristics of a sale price based on a real exchange of goods and do not have any hidden or exploitation features.

Another finance instrument is salam, a forward-sale contract initially utilized by farmers for pre-seed financing (Chapra, 1992). Salam contracts entail buyers pre-paying the entire purchase price and sellers delivering a specific commodity as to quantity and quality on a specified future date. When Islamic banks act as salam buyers, they are providing the working capital to clients in need of liquidity to assist in producing or propping up goods. When the contract matures, the Islamic bank receives the commodities that were agreed upon. To hedge against the price changing or storage issues, the bank would likely enter a parallel salam, and resell the commodity to a third party, again for future delivery (Mirakhor & Iqbal, 2011). Salam illustrates the Shariah compliance principle through transactions being tied to tangible assets instead of simply exchanging money for more money.

Istisna‘a, another type of forward-financing structure, is specific to production or construction (Ayub, 2007). In this contract, the buyer orders a seller or builder to produce a specific item, such as a building, a boat, or factory equipment, at a price and time agreed upon by both parties. Payments can be made in several lump sums that are consistent with the work progress, rather than a single up-front payment, which allows for more flexibility than a salam (Iqbal & Molyneux, 2005). Istisna‘a is often used in infrastructure financial transactions, real estate development, or manufacturing. Islamic banks may use the parallel istisna‘a structure (the original istisna’a contract) to subcontract actual manufacturing to another party, to ensure the original istisna‘a contract with the client remains Shariah compliant.

While murabaha, salam and istisna'a involve trade, ijarah presents an Islamic leasing option (Warde, 2000). In an ijarah transaction, a bank buys and retains ownership of an asset, which it rents to a customer over a stipulated period. The customer pays a rental fee and the bank assumes the typical ownership responsibilities, including major maintenance or insurance (Ayub, 2007). In particular, the principle of "risk follows ownership" is at the heart of the ijarah. There is also a variant called ijarah muntahia bi-tamleek (lease to ownership), which allows the customer to receive full title of the asset at the conclusion of the term, either for a nominal price or gradually. Ijarah can be a Shariah-compliant alternative to a conventional hire-purchase transaction, whereby risk is appropriately assigned until the customer assumes title (Mirakhor and Krichene, 2009).

Despite the existence of these debt financial mechanisms, many Islamic economists argue that equity-based financing is a more accurate representation of Islamic finance. (Chapra, 1992). Musharakah or equity partnership, is one of these participatory modes. In a musharakah contract, multiple partners invest both financial and other resources into a joint commercial venture and share profits according to a ratio agreed in advance and share losses in relation to their capital contributions (Siddiqi, 1983). This feature creates a sense of co-ownership that offers an incentive for all partners to act judiciously. As a limitation, however, it requires a high degree of trust and governance that may not be evident in every market circumstance (Iqbal & Molyneux, 2005). Nonetheless, scholars consistently discuss musharakah's usefulness toward entrepreneurship and socio-economic development by arguing that a profit and loss sharing model can promote more equitable patterns of wealth creation.

Diminishing musharakah is a form often found in Islamic housing finance products (Mirakhor & Iqbal, 2011). In this case, the bank and the customer buy the same property together and the customer then buys back the bank's share over a given period. The client will also pay rent to the bank for its share. As the client's equity increases, the rental payment will decrease accordingly, which will lead to the client full ownership at the end (Ayub, 2007). Diminishing musharakah is a structure that attempts to replace the dependence on pure interest-based structures that are commonly found in conventional mortgages while maintaining real ownership of assets and the notion of gradual ownership.

Mudarabah is a different form of partnership commonly referred to as a "trustee partnership". In mudarabah, one partner (rab-ul-mal) provides capital, while the other (the mudarib) provides management expertise or labor (Chapra, 1992). Any profits are shared based on a previously agreed equity ratio, while losses are borne primarily by the capital provider, unless it can be proven that the manager acted with negligence or misconduct. Mudarabah is commonly used in Islamic banking to create investment accounts where depositors put funds together and the bank invests them in Shariah-compliant commercial enterprises (Mirakhor & Krichene, 2009). Consequently, the return on the depositor's funds is based on the bank's total investment performance. The partner structure also highlights the accountability and transparency required in mudarabah, as capital providers must be satisfied that depositors' funds are invested wisely.

In addition to the key contracts noted above, the contemporary industry of Islamic finance has also developed sukuk (certificates of Islamic investment) to enable capital markets transactions (Iqbal & Molyneux, 2005). Sometimes referred to as Islamic bonds, sukuk certificates differ from traditional bonds in that they provide an ownership right to the investor in the underlying assets or projects (Ayub, 2007). Rather than receiving interest on the bond, the holder of the sukuk receives either dividend income, or lease payments, returned to them based on the performance of the asset or project. This is meant to represent real engagement in both the success and value of real economic activity and addresses the two central principles of Shariah to ensure transactions are asset backed and there is a risk sharing agreement (Mirakhor & Iqbal, 2011). Over the past two decades, the volume and variety of sukuk issuance have increased significantly, allowing both governments and corporations a different opportunity to address funding for tangible assets, infrastructure and power generation or social development projects. However, in addition to differences in local regulatory platforms, local interpretation of the Shariah has also led to different structures of sukuk from one jurisdiction to another (Warde, 2000).

Alongside these financing methods, takaful developed to accommodate insurance needs covered in a Shariah-compliant manner (Dusuki & Abdullah, 2007). In conventional insurance schemes, participants pay premiums to the company who then invests funds in various ways, routinely interests, and when a claim is made based on an identified loss, provides payment if the claimant is entitled to indemnification. Conventional insurance contains issues under Islamic law if it is merely risk transferred using interest or is vague, creating uncertainty. Takaful organizes participants into a risk-sharing pool. The contribution is treated as a donation (tabarru), and any claims made associated with the donation are paid from funds of the takaful pool. If there are excess funds left after all legitimate claims have been paid and administrative fees taken care of, participants may receive a distribution of excess funds, (Ayub, 2007). In this context, the operator is responsible for overseeing the fund, typically placing the pooled funds in suitable Shariah compliant vehicles, and there is no riba involved. Like the Islamic banking sector, the global growth of takaful is simply a response to meet the demand of individuals who want insurance systems that are consistent with their religious values, in this case Shariah.

While Islamic finance has shown considerable development and growth, it still faces some practical and theoretical questions. One significant issue is the excessive reliance on contracts such as murabaha, ijarah, or any debt-based contracts, which has resulted in musharakah and mudarabah being less frequently utilized (Iqbal & Molyneux, 2005). It has been noted that equity-based contracts can often be a much more effective form of financing that adheres to Islamic principles, however they require a more extensive level of oversight, strong corporate governance, and commitment from providers of funds toward picking up additional risk. Liquidity management also has been a long-standing issue. Conventional banks have access to interest-based money markets or government bonds as a buffer to manage short-term liquidity constraints, while Islamic banks lack the ability to utilize these channels directly as this is prohibited. Alternatively, some Islamic banks apply commodity murabaha, repos based on Sukuk, or central bank windows that have been re-purposed with Sharia compliance (Mirakhor & Krichene, 2009). Though this is an interesting approach, there still lacks depth and uniformity in the formation of Islamic capital markets. Consequently, Islamic institutions can suffer from liquidity issues more often and more severely compared to conventional institutions.

Shariah governance can create challenges, especially with multiple interpretations of the rulings of the Shariah boards (Warde, 2000). Each Islamic financial institution usually has a Shariah Supervisory Board of qualified jurists that approves the product structures. In recent years, they have been attempts made by international standard-setting organizations, such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB), to harmonize or standardize some rulings, create global standards, and achieve more uniformity in product documents (Ayub, 2007). There are still differences in rulings because of opinions, customs and norms, and possibly the nature of the products. For example, one board may find a sukuk structure acceptable whereas another board may find the same structure acceptable if they rely on a different school of thought's ruling.

Another relevant dimension refers to the ethical or social justice objectives of Islamic finance. In principle, the system aims to address inequality and support broad-based development and moral and fair conduct (Chapra, 1992). This aim is seen through the focus on risk-sharing, asset-backing, and the wider Islamic principle of maslahah (public interest). Yet some critics argue that Islamic finance institutions have mainly served middle-class or rich individuals for consumer finance or large corporations for project finance, by being inattentive to the underprivileged or focus on micro-enterprise. There are some limited microfinance programs which often uses murabaha or qard al-hasan (benevolent loans), but they are small in scale. As a result, whether Islamic finance reduces poverty or yields more equitable income distribution, remains up for debate (Mirakhor & Iqbal, 2011). Supporters argue that as the industry develops over time that too can be expanded into rural finance, small and medium enterprise development, and investment in social infrastructure, all important industry functions in areas where conventional finance has not met the objectives.

In summary, Islamic finance originated in the latter part of the twentieth century as part of a broader movement to revive faith-based economic principles and to rethink how financial intermediation could occur without charging interest. The industry has developed over time to include a range of products from murabaha and ijara to sukuk and takaful all based on Shariah principles around fairness, transparency and risk-sharing (Ayub, 2007). While challenges could still be addressed operationally, the products offered point to how Islamic finance is trying to connect financial exchanges with the real economy, limit the propensity to invest speculatively and address ethics into all aspects of financial conducting. While society continues to move towards providing social impact and inclusive finance globally, Islamic finance has positioned itself to provide an alternative model that provides a religious foundation and broader aspirations around justice, sustainability and growth based on real assets. Success ultimately lies in the willingness of regulators, scholars, practitioners and people to be positioned around developing financial innovation that strives for the greater ethical reasoning that underwrites key Islamic laws and traditions.

XII. References

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