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Developing Sustainability Practices Reporting Measurement Framework For Islamic Banks in Indonesia: A Literature Synthesis

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Abstract

This study aims to develop a theoretical model and measurement framework for reporting sustainability practices in Islamic banks in Indonesia. A survey of 58 selected works of literature was conducted to identify key concepts and insights related to sustainability, social, economic, and environmental dimensions. The theoretical model incorporates these sustainability values and aligns them with Maqasid Al-Sharia, the objectives and principles of Islamic law. By integrating these principles, the model ensures that Islamic banks' sustainability practices in Indonesia are socially, economically, and ethically responsible. The measurement framework facilitates assessing and reporting sustainability practices, enabling Islamic banks to evaluate their social, economic, and environmental impact. This study contributes to sustainable banking by providing a comprehensive model and framework tailored to Islamic banks, promoting transparency, accountability, and responsible finance in Indonesia.

Keywords: Sustainability Measurement; Maqasid Al-Sharia; Sustainability.

A. INTRODUCTION

The Laution of the Corporate Social Responsibility (CSR) concept has an extensive and complex past (Latapí Agudelo et al., 2019). The term that we currently know as CSR was initially coined as social responsibility in the famous literature called "social responsibilities of the Businessman" and is widely regarded as the turning point in the development of CSR literature in recent years (Carroll, 1999). As CSR practices become increasingly common, companies need CSR reporting; as a result, surveys conducted by KPMG show that the percentage of companies that report their sustainable practices is 71% out of 100 worldwide across 15 different business sectors (Vartiak, 2016). With that said, in light of the rising demand for and study into corporate sustainability, studies have revealed that sustainability practice and reporting from the Islamic banking industry worldwide remains low. The overall banking industry has realized the importance of modern sustainability practices. This is partly seen in the financial crisis of 2007-2008, which displayed the detrimental effects of the fall of large banks.(Abedifar et al., 2017).

However, on the academic aspect, research regarding the impact of CSR practices and reporting in the banking sector was initially conducted, focusing only on the economic dimension of sustainability. Research published by (Jan et al., 2017) described the banking industry's economic role in sustainability and provided a method for evaluating the economic sustainability of Islamic banks. As research on banks' economic sustainability aspects advanced, it emphasized the linked negative social and environmental implications. According to (Saleem et al., 2013), the banking industry ignored the negative repercussions of its activities on the environment and society in general in order to maintain its economic survival. Although the banking industries contribute to economic growth, their activities may harm the environment and societies (Saleem et al., 2013). As a result of banks'' inefficient sustainability plans, the world is failing to meet its social and environmental sustainability targets (Sobhani et al., 2011).

Regarding Islamic banking in particular, the literature reveals that studies on the sustainability of the Islamic banking industry are significantly inferior. Over the years, studies about Islamic banks primarily discussed the ongoing financial performance from different aspects. Risks for an undermined level of interest in developing sustainable practices, reports, and management could lead to an economic, social, and environmental crisis, particularly in Islamic banking nations with a large share of Islamic banking.

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In Indonesia, CSR practices are obligated by the state and government to any limited companies that practice their business in the field and/or related to natural resources, which is stated in Law No. 40 of 2007 concerning Limited Liability Companies and Government regulation no. 47 of 2017 concerning the Social and Environmental Responsibility of Limited Liability Companies. Banking corporations' business practices may be indirectly related to natural resources as banks have opted to invest in industries that perform any practices related to natural resources whatsoever, as explained in Law No. 25 of 2007 concerning investment. Thus, Indonesian banks classified as limited companies must obey the law and practice CSR, including Indonesia's Islamic banks. Islamic banks in Indonesia itself are on the rise; measured from the data published by (LPKSI, 2022), Islamic banks in Indonesia have a growth asset valued at 13,94% YoY and reaching a market share of 6,74% if compared to the conventional banks in Indonesia valued at 693,8 trillion rupiahs in total assets.

Considering the rapid growth of Islamic banks in Indonesia, the prediction is that if the Islamic banking industry fails to have a sustainability reporting model, it will create negative impacts due to its business practices on society and the environment. The sustainability reporting model should embody an economic, societal, and environmental measurement model. This study proposes a sustainability practice reporting measurement framework on Islamic banking in Indonesia. Consequently, other Islamic banking countries may utilize the framework as a reference.

B. RESULTS

Definition of CSR

A standard definition and actions of CSR vary as it was and are an ongoing study conceptualized numerous times by scholars to fit with relevancy, practicality, and increasing awareness of ethical business practices. The nature of CSR itself is complicated; a study (Sheehy, 2014) stated that CSR is both complex and challenging to define due to the cause of the nature and context of the problems. As scholars and high institutions in recent years argued about the actual definition of CSR (Riano & Yakovleva, 2020) defined CSR as the responsibility of for-profit and non-profit organizations to consider their impact on stakeholders, the natural environment, and broader society; it focuses on the accountability and transparency of corporate actions that include social, ethical, environmental, and economic efforts that are often voluntary and positioned both within and outside of market and commerce. (Richard & Watts, 2000) a report published by The World Business Council for Sustainable Development defined CSR as an ongoing commitment by businesses to behave ethically. It contributed to economic development while improving the quality of life of the workforce, their families, and the local community and society in general.

However, in 2015, The United Nations General Assembly formally adopted the transformational 2030 Agenda for Sustainable Development 2015, along with 17 SDGs and 169 related goals (United Nations, 2017), and a more profound definition of CSR was created. It is a management concept in which businesses incorporate social and environmental issues into their operations and stakeholder relationships. Even though the United Nations has its definition of CSR, scholars have not yet found an ultimate, precise definition and reached the singularity of what is defined as CSR. This was reasoned to understand the differences in priorities and the importance of sustainability dimensions/aspects that may differ for each organization. For example, it may not be imperative for the banking industry to consider, assess, and practice sustainability in the environmental aspect compared to mining industries or manufacturing industries that harm the environment as part of their business practice. Harmonious to prior statements, different business entities have their perception and way of conducting their sustainability, corresponding to their industry and priority. This study will use the concept of corporate sustainability (Brundtland, 1987) aligned with the approach of TBL (Elkington, 1997) that involves three dimensions of business sustainability, which are economic, social and environmental. This study is simultaneously aligned and inspired with GRI Framework as it incorporates the TBL approach in their framework, thus allowing it to propose a new sustainability measurement framework modified with Shariah principles to be compatible when measuring sustainability practices in the Islamic banking industry.

Sustainability Reporting Framework Global

The early practices of CSR reporting can be traced back to the mid-1970s; a study (Bowman & Haire, 1975) operationalized CSR by measuring the number of lines of prose allocated to social responsibility in the annual reports of the firms they analyzed. Furthermore, in 1979, (Abbott & Monsen 1979) aimed to discover more about the meaning of CSR by performing research incorporating a content analysis of Fortune 500 company annual reports. The study introduced a corporate "social involvement disclosure" (SID), a rating system that revealed an indicator of a company's CSR. A further notable and widely used voluntary standard for corporate social accountability is the Global Reporting Initiative (GRI), which was launched in 1998 and developed in collaboration with the Coalition for Environmentally Responsible Economies (CERES), the Tellus Institute, and the United Nations Environment Program (UNEP) which started in 1997 (GRI, 2022). A decade later, in 2008, the U.N. Worldwide Compact and GRI were regarded as de facto worldwide standards for economic, social, and governance reporting, with approximately 30,000 stakeholders and over 1,000 corporations adopting GRI reporting principles (Waddock, 2009). GRI standards are globally adopted guidelines for standardized reporting to stakeholders on topics like strategy, governance, economic, social, and environmental domains (Raghupathi et al., 2020). In fact, according to KPMG's worldwide study, more than 75% of significant companies employed GRI as the preferred method for sustainability reporting to present a greater degree of comparable and credible reporting to diverse stakeholder groups (KPMG, 2017). Adopting the GRI framework and principles as a standard in sustainability reporting has assisted many stakeholders in better understanding and analyzing firms' involvement in sustainability reporting (Qian et al., 2020).

The GRI standards are created as a simple modular set that provides a comprehensive view of an organization's material topics, their associated impacts, and how they are addressed. With three series of standards, each has its uses and purposes, namely the universal standards, the new sector standards, and the topic standards. The GRI Universal Standards apply to every organization; the GRI Sector Standards apply to specific sectors; and the GRI Topic Standards, each listing disclosures relevant to a particular topic. Using these Standards assists companies in achieving sustainable development (GRI, 2022).

The term "impact" in GRI standards refers to the impact that a company's affairs or commercial partnerships have on the economy, environment, and people, especially the impact on their human rights, which can be actual or forecast repercussions, whether it be negative or positive, short-term or long-term, planned or unintentional, either irreversible or reversible and impacts on the environment, economy, and people are correlated to each other. The correlation between all three can be positive or negative; for example, a good impact on the environment can eventually lead to a negative impact on people, and a good impact on both the economy and the environment could also result in a positive impact on the people (GRI, 2022). The presets, and sets of objectives of the GRI framework are aligned with the notion of the triple bottom line by Elkington (Elkington, 1997) and show a similarity to the concept of sustainability by Brundlant (Brundtland, 1987). Thus, this study will also derive the Value and use the notion of sustainability and the economic, social, and environmental aspects to develop a sustainability report framework for Islamic Banks in Indonesia due to reasons for the comparability aspect of the framework developed to be able to be compared to other industry that also uses the GRI standards. Furthermore, A study by (Khan et al., 2023) promotes the use of globally acknowledged sustainability GRI standards to strengthen sustainability reporting; a point is added by the study, which is recommended for businesses in developing countries with similar histories and sustainability issues to adopt the GRI standards.

Islamic Banking

An Islamic bank is a financial institution that aligns with the spirit of Shariah, as defined by the Holy Qur'an and Sunnah, in terms of its goals, beliefs, practices, and operations (Khaki & Sangmi, 2011). Indonesia, the Financial Authority Services has established a definition of an Islamic bank, a financial institution that functions in line with Islamic principles (OJK, 2017). The application of Sharia rules has been the most significant distinction between traditional banks. Initially, the Shariah principle refers to Islam's Shariah, which gives primacy to the Quran and Hadith. Islam as a religion is a belief that aims to enhance people's lives in a broad and universal sense, whether via interactions with God or among themselves (OJK, 2017).

The most significant distinction is Islam's prohibition on interest, which prevents Islamic banks from offering fixed-interest payments on deposits or imposing interest on loans (Chong & Liu, 2009). Conversely, Islamic law supports the premise that financial activities should be based on profit and loss-sharing (Uppal & Mangla, 2014). Another critical point is to ensure that every financial transaction must be supported by a financial transaction comprising a tangible asset (Beck et al., 2013). Due to Islamic banks' business models being based on Islamic law, Shariah, which portrays religious principles, is occasionally seen to possess an ethical character. This stems primarily from the fact that Shariah principles were developed not just to foster religious devotion but also for the sake of social welfare and justice (Haniffa & Hudaib, 2007).

Furthermore, Islamic banks also emphasize the social goals that contribute to society, such as philanthropic donations and generous loans to socially disadvantaged communities (Haniffa & Hudaib, 2007). Thus, The theological foundation upon which the Islamic notion is founded differs significantly from a typical economic approach, which has been argued to entirely disregard social and ethical considerations in favor of profit maximization and the company's growth (Fang & Foucart, 2013). In a holistic view, Islamic banks strive for a complete integration of ethical, ecological, and social issues. This encompasses customers, the general public, and the industries involved. In reality, this implies that organizations that engage as business partners of Islamic financial institutions should be limited to covering any strictly prohibited activities, and their business models must be per Shariah's social, ethical, and environmental purposes. In the face of continuing environmental issues, the whole financial industry must accept responsibility and strive for sustainable development (Mohamad et al., 2014; Richardson, 2008)

In Indonesia, the rules and regulation related to Islamic banks are adhered to in Law Number 21 of 2008 concerning Islamic banking, which consists of 13 chapters that explain and describes numerous aspects concerning definitions, legality, code of conduct, structures, and activities in all regards of Islamic banks in Indonesia. The partnership and mutual benefits concept underlies Islamic banking activities and provides an alternative banking system with mutual advantages for both the public and the bank. This system would prominence variables linked to transaction fairness and ethical investing by emphasizing the principles of collaboration and partnership in production and eliminating any speculative behavior in financial transactions. Islamic banking will be a legitimate alternative that will benefit all Indonesians without exception by offering a wide range of goods and banking services backed by a diverse financial plan (OJK, 2017).

Maqasid Al-Sharia

The Sharia is described as a system of ethics and values that encompasses all elements of life (e.g., personal, social, political, economic, and intellectual), with its unalterable foundations as well as its foundational ways of adapting to change (Inayatullah & Boxwell, 2003). In a broader view, there is a theory that was established by Al-Ghazali for the first time, Maqasid Al-Sharia, arguing that maslaha (public interest) was God's general purpose in describing divine rule and that its specific goal was the preservation of five fundamentals of human well-being: religion, life, intellect, lineage, and property (Opwis, 2007)

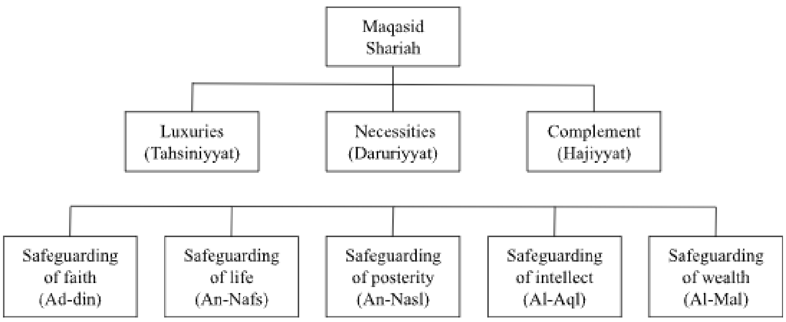

Figure 1: Al-Ghazali Theoretical Framework of Maqasid Al-Sharia (Abdul Rasool et al., 2020)

Ultimately, Maqasid al-Shari'ah can be defined essentially as the higher goals of Shari'ah principles, the adherence of which facilitates standard societal functioning through fostering the public good (maslaha). This involves avoiding activities that are likely to harm persons and society. The intention, objective, and purpose are to attain goals that exemplify social and economic justice while improving societal and environmental well-being. Thus, Maqasid were seen as necessities for people's existence and spiritual well-being, to the point where their neglect or omission would ruin and collapse society's regular functioning (IIBI, 2023). Maqasid Shariah's goal is to succeed in this world and the world to come. The scope of Maqasid Shariah encompasses the objectives and goals to be followed in all actions, including economic endeavors such as finance, banking, and Takaful, as well as social affairs, resulting in a train of thought that Maqasid Al-Sharia puts specific principles, measures, and standards to be followed in operations and highlights some harmful elements to be avoided since they would negate Shariah's purposes (Abdullah, 2015)

Sustainability Practicing and Reporting of Islamic Banks in Indonesia

In light with the current trend of growth of Islamic banks in Indonesia that is rising prominently by having a growth asset valued at 13,94% YoY and reaching a market share of 6,74% if compared to the conventional banks in Indonesia valued at 693,8 trillion rupiahs in total assets in 2021 (LPKSI, 2022), Islamic banks in Indonesia must be socially responsible in conducting its operational activities as banking is a financial institution that has a significant influence on the real economy (Adekola, 2016; Robinson, 2001). Moreover, Islamic banks that demand a moderate profit in their financing can stimulate economic growth as it relieves customer pressure and leads to more assets being directed to the real sector. Seeing how significant Islamic banks are, it is only common sense that they should prioritize sustainability; otherwise, it would create a failure or disaster in some economic, environmental, and society. The three sustainable dimensions will be discussed in more detail below.

The current economic sustainability of Islamic banks in Indonesia is critical owing to their potential to contribute to the country's overall economic growth. Islamic banking has multiplied in Indonesia, with assets and deposits steadily increasing over the last decade. Reflecting on the data displayed above, it is a reasonably substantial rise and a rising market share, demonstrating that Sharia banking services are becoming trusted by the general population. These essential data also compel Indonesian Islamic banks to maintain high economic sustainability. Islamic banks play a critical role in achieving economic sustainability in Indonesia by increasing financial inclusion and supporting responsible and ethical banking practices. As a rising market economy with a Muslim majority, Islamic banking allows people and companies to conduct financial transactions consistent with their religious views. Islamic banks provide a variety of instruments, including profit-sharing contracts (Mudarabah), joint ventures (Musharakah), and Islamic bonds (Sukuk), all of which adhere to Islamic standards, assuring justice and transparency (Sapuan, 2016; Ali and Hussain, 2021; van Wijnbergen & Zaheer, 2013). Islamic banks help to promote financial stability and inclusiveness, which are critical for long-term economic success, by meeting the different financial demands of the community.

Furthermore, the expansion and sustainability of Islamic banks in Indonesia are expected to benefit other sectors of the economy (Elmelki & Mounira, 2022). Islamic banks finance and assist various industries, including infrastructure, agriculture, and small and medium-sized companies (SMEs). This funding aids in generating jobs, entrepreneurial activity, and general economic growth. Furthermore, the emphasis on ethical investments and responsible financing procedures by Islamic banks, as studied by (Anas & Mounira, 2009), could help limit systemic risks and support financial stability. Incorporating Islamic banking concepts into the larger financial system can diversify funding sources, reduce reliance on traditional banks, and build a more robust financial sector.

The prevailing environmental sustainability of Islamic banks in Indonesia is vital due to their weight in encouraging ecologically responsible financial practices. By incorporating environmental aspects into their financing decisions, Islamic banks in Indonesia play a critical role in supporting environmental sustainability. They should place the most outstanding Value on investments in renewable energy, energy efficiency, and long-term infrastructure (Fad, 2021). Implementing a concept of green banking also contributes to sustainable development by overcoming institutional barriers and market constraints on allocating finance to green initiatives such as renewable energy, energy efficiency, water saving, green travel, and waste management (Uddin & Ahmmed, 2018). Overall, the environmental sustainability of Islamic banks in Indonesia is critical for the banking industry, the larger economy, and society. Islamic banks contribute to the transition to a greener economy by encouraging sustainable finance and implementing ecologically responsible activities. This assists Indonesia in meeting its environmental goals, such as lowering carbon emissions and encouraging sustainable development. Furthermore, ecologically friendly initiatives can boost Islamic banks' brand and trustworthiness, attracting socially concerned investors and clients.

The social sustainability of Islamic banks in Indonesia is critical because it indicates their commitment to addressing society's needs and supporting inclusive growth. Islamic banks promote social welfare and equality by functioning according to Shariah principles to cover the financial requirements of people and communities. They play an essential role in fostering financial inclusion by providing disadvantaged community members access to financial services, such as low-income persons and small business owners. Focusing on financial inclusion helps reduce inequality and empower underrepresented communities (Ben Naceur et al., 2015). Furthermore, Islamic banks' social sustainability in Indonesia is critical for producing a beneficial social effect beyond their financial services. These financial institutions are dedicated to ethical and responsible practices guided by fairness, openness, and accountability (Tok & Yesuf, 2022). Their operations foster ethical funding while discouraging negative behaviors such as excessive speculation or financing activities deemed damaging to society. By adhering to these principles, Islamic banks help to build a socially aware financial sector that reflects the values and ambitions of the individuals and groups they serve. Following that, the social sustainability of Islamic banks in Indonesia is critical to supporting inclusive growth and social well-being. Islamic banks help to eliminate inequality, strengthen underprivileged groups, and have an excellent social effect through promoting financial inclusion, participating in social activities, and abiding by ethical values. Islamic banks' commitment to social sustainability is consistent with their fundamental ideals and principles, making them critical change agents in pursuing a more fair and socially just society.

Proposed Theoretical Framework

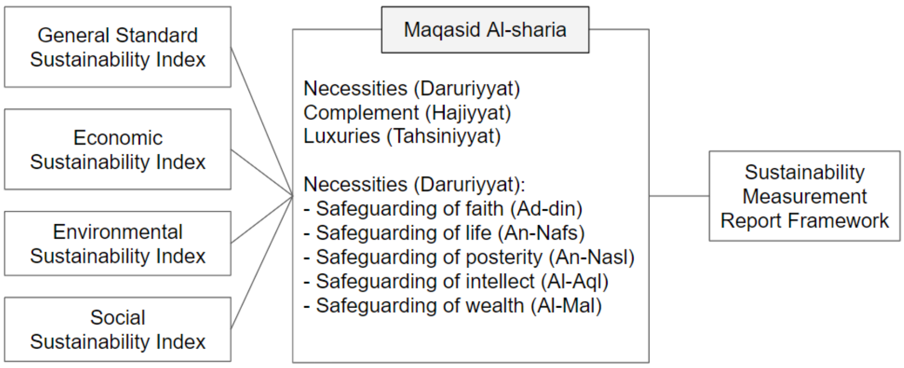

Figure 2. Theoretical Framework Proposed By This Study

The various concepts that will be summarized in this paper and integrated are the historical and theoretical perspectives of previous studies in the corporate sustainability industry, mainly the most common reporting framework for sustainable practice, which is the GRI index, will be put as a reference then discussed to identify several key components/indexes due to the embodiment of three dimensions, which are economic, social, and environmental aspect in the GRI that would be appropriate to integrate with the fundamental concepts that Islamic banks are upholding, which is the sharia value.

C. FUTURE RESEARCH

After reviewing all the selected literature, the study proposes a theoretical framework that would enable the development of sustainable practices reporting framework for an Islamic bank. Sustainability dimensions are derived from the most common sustainable reporting framework dimension, the GRI and shall be incorporated with Sharia value from Maqasid-Al Sharia standpoint to fit the needs and nature of a Shariah-based bank. The study recommended that higher institutions and governmental entities take upon a role to investigate and promote this study to strengthen further the generalization for Islamic banks in Indonesia. Future research shall be conducted to create a detailed, thorough index for each dimension and conduct a verifying stage to Islamic bank stakeholders before testing it using an empirical approach, either quantitative or qualitative method.

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