Holier than Thou? Identity Buffers and Adoption of Controversial Practices in the Islamic Banking Category

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ABSTRACT

Existing scholarship on categories frequently highlights how some category members may violate codes that others diligently abide by. In this paper, we take into account the differences in identity across category members, and ask how these relative differences determine their response to a code-violating change. Taking a case where category members are identified as 'insiders' and 'outsiders', we argue that insiders' reaction to a code violation depends upon the extent to which they believe their identity to be distinct from the code violator's, who might be an insider or an outsider. Specifically, we suggest that it is the presence or absence of an 'identity buffer' – i.e., a relative identity advantage – which determines insiders' reaction. We hypothesize that when a fellow category insider introduces a code violation, the focal insider will be more likely to refrain from the practice. When it is an outsider who introduces the code violation, insiders will be more likely to adopt the code violation as long as they can retain an identity buffer. We further posit that when outsiders adopt a code-preserving behavior, thus narrowing the identity buffer between insiders and outsiders, it will mitigate insiders' likelihood of code violation adoption. We test and find support for our hypotheses using data on Islamic banking industry in 12 countries (2003-2014).

Key words: identity, categories, code, insider, outsider

With a double-digit annual growth rate over the last twenty years, Islamic banking has emerged as one of the fastest growing categories within the global financial industry. Between 1996 and 2017, the category went from assets worth US$509 billion to over US$1.5 trillion (Islamic Financial Services Board, 2017). Islamic banks' performance appears even more impressive when one considers the severe constraints under which they are forced to function including prohibitions on charging interest, or investing in socially undesirable businesses.

Unsurprisingly, such rapid growth drew interest from conventional banks, many of which started Islamic operations over the years. As a result, two distinct types of players now comprise the Islamic banking category. These include banks that were 'born' as Islamic banks, e.g., Al Rajhi Bank of Saudi Arabia, perceived as 'insiders' of the industry, as well as Islamic banking operations of conventional banks such as HSBC or Deutsche Bank. The latter ventured into Islamic banking given the impressive growth of the sector, but despite being in the same category, are commonly labeled as ‘outsiders’ because of their conventional, non-Islamic parentage. While both these groups claim to offer Islamic banking products, the differences in their origins or parentage set them apart within the category.

In the Islamic banking category, few practices are as controversial as the adoption of financial derivatives. Given the potential of derivatives to make risky but more profitable bets through speculation, they appeal to category members. However, because of their speculative nature, derivatives are considered to be inherently incompatible with Sharia law and understood to violate the principles of Islamic banking (El-Gamal, 2001). Therefore, a key dilemma for ‘insiders’ is whether to adopt derivatives or not as they struggle with questions about how adoption might affect their perceived identity as a ‘pure’ Islamic bank. In this paper, we generate insights that help us answer when ‘insider’ Islamic banks are likely to adopt derivatives, and whether this becomes more or less likely when the practice is first adopted by an ‘outsider’ bank versus a peer ‘insider’. We also examine whether insiders are more or less likely to adopt outsider-introduced derivatives when outsiders attempt to appear more like insiders through imitation of other practices.

Change within categories is a significant theoretical phenomenon. Since members are expected to follow the category’s central codes if they wish to be accepted as bona fide members (Hsu and Hannan, 2005), they are under social pressure to preserve their category identity (Polos, Hannan and Carroll, 2002). Identity, therefore becomes a central consideration in a firm’s decision to adopt or reject a particular practice that deviates from the category code (Durand, Rao, and Monin, 2007; Durand and Kremp, 2016). This is not to suggest, of course, that organizations cannot differentiate themselves (within limits) from their peers in pursuit of a competitive advantage (Boone and Özcan, 2016; King, Clemens, and Fry, 2011; King and

Whetten, 2008) but simply to state that navigating between conformity and violation of codes is a central challenge for all category members.

Given its centrality in decisions to conform or violate category codes, identity requires greater scrutiny by researchers. However, notwithstanding the important insights that have been produced by identity researchers focusing on intra and inter-category competitive dynamics (Dutton and Dukerich, 1991; Hsu and Hannan, 2005; Baron, 2004; Pólos et al., 2002; Smith, 2011), much of the extant work assumes an essentialist view of identity. In reality, as pointed out by King, Clemens, and Fry (2011), the process whereby organizations leverage their identities is relational. An organization's decision to adopt or defy a change introduced by other members of a category is shaped not merely by its own identity but more importantly by a consideration of the *relative* difference in identity between itself and the change agent (Bourdieu, 1984; Simmel, 1957; Van den Bulte and Joshi, 2007). This point is especially key since hardly any social category is entirely homogenous. Many categories, while uniform on the surface, are marked with tensions between longstanding members who consider themselves authentic, and relatively new entrants who may be conspicuous because of their violation of some category codes. These tensions are bound to influence how existing category members respond to code violations by those they consider as 'insiders' and those who are deemed to be 'outsiders'. In this paper, we ask: how does the relative difference in the code-violator's and the insider's identities affect a focal insiders' decision to adopt a new code-violating practice?

To answer this question, we directly explore the effects of differences in identity and compare how response diverge. We first hypothesize that a focal insider will be more likely to refrain from adopting the practice when the code violator is a fellow insider. We argue that as category members are expected to publicly disapprove any act of deviance and therefore reaffirm the category code (Durkheim, 1982), insiders will choose not to support a code violation in such a case. On the other hand, when an outsider introduces a profit-enhancing code violation, we posit that the likelihood of insider engagement with the code violation will rise. Insiders can afford to adopt controversial practices as long as they enjoy an ‘identity buffer’ or identity advantage over outsiders – i.e., they can take on controversial practices necessary to compete with outsiders while keeping their identity as an ‘insider’. In our last hypothesis, we explore what happens when this identity buffer is narrowed. We hypothesize that when outsiders publicly adopt a code-preserving behavior, this will mitigate insiders’ likelihood of code violation adoption as the buffer between outsider and insider identities narrows.

We test these theoretical arguments in the context of Islamic banking using a unique dataset of 108 Islamic banks in 12 countries over the period 2003 to 2014. In our study, we use two different and widely prominent social codes in the Islamic banking category. We use the offering of derivative products as a code-violating practice, and *zakat* payment – the voluntary Islamic practice of almsgiving universally associated with Islamic institutions – as an indicator of code-preserving behavior. We distinguish full-fledged Islamic banks (born as an Islamic bank) as insiders or incumbents, from the conventional bank–owned Islamic banks, which are denoted as outsiders or challengers. Additionally, we supplemented our quantitative data with qualitative insights into the industry. We conducted 21 open-ended interviews with Islamic bankers, lawyers, regulators, and scholars, and we also used books, newspaper articles, industry magazines, and bank filings.

We contribute to existing research in three ways. First and foremost, we take existing understandings of the role identity plays in the adoption of code violations further by generating new insights into how *differences* in the code violator’s and potential adopter’s identities shape the latter's response. Second, we contribute to understandings of intra category competition by showing how it is not identity per se that shapes competitors' actions but the existence (or absence) of an identity 'buffer' that separates those with an outsider identity from those with an insider one. Finally, we contribute to social identity theory by revealing how our findings add nuance to ideas of in-group favor and out-group discrimination.

THEORY DEVELOPMENT AND HYPOTHESES

Sociologists have long held that it is by classifying actors and organizations that economic order and stability are maintained (Durkheim and Mauss, 1963: 4; Simmel, 1910). Market categories provide audiences with cognitive infrastructure useful in signaling commonalities and differences among producers (Schneiberg and Berk, 2010) and in disciplining those who fail to meet with the requirements of category membership (Hannan, Pólos and Carroll, 2007; for a review, see Durand and Paolella, 2013).

Membership of a category comes with an unwritten obligation to abide by certain codes – i.e., a set of social rules that category members are expected to adhere to (Durand et al., 2007; Hsu and Hannan, 2005). Code preservation is important for attracting attention and garnering a favorable evaluation from relevant audiences (Zuckerman, 1999; Hsu, Hannan, and Koçak, 2009; Paolella and Durand, 2016). For example, an exclusive golf club will likely eschew principles of inclusiveness and egalitarianism to confine its access to members of a particular class (its audience). On the other hand, a human rights NGO will be careful to engage only in activities that are compatible with its category membership. As such, organizations generally engage in code preservation through the maintenance of existing practices or symbolic elements while resisting code-violating changes (Micelotta and Washington, 2013).

Preserving codes, however, does not mean that categories are devoid of internal competition and tensions. Intra-category competition in pursuit of competitive advantage pushes organizations to create and maintain some differences with their peers (King, Clemens, and Fry, 2011; King and Whetten, 2008; Durand and Kremp, 2016), albeit within limits of what is legitimately considered feasible (Deephouse, 1999). While distinguishing themselves from their peers, organizations are careful not to violate central category codes since doing so is fraught with risks, including penalties or disfavor of critical audiences (Negro, Hannan, and Rao, 2010). Nevertheless, the pursuit of competitive advantage does lead firms to push boundaries of what is legitimate or desirable (Rao, Durand, and Monin, 2005; Boone and Özcan, 2016).

This dynamic particularly strengthens when outsiders – not bound by category codes to the same extent – enter a category and engage in practices that are profitable though outside the ambit of what is legitimate within the focal category. In such a situation, insiders are faced with a dilemma: adopt the controversial practice or resist?

Making matters more complex is the fact that there might be instances where some codes are preserved while others are violated (Durand et al. 2007; Bascle, 2016). For example, a bank might preserve certain codes (in order to remain members of the category 'banks') but, at the same time, violate others. It is the question of how category members respond to players who are both violating as well as preserving codes that interests us.

IDENTITY AND CODE VIOLATION

In exploring how identity determines an organization's reaction to acts of code violation, it is important to recognize that identities are not static but in fact dynamic and relational (Mead, 1934; Goffman, 1979). In other words, organizations take other players' identities into account when formulating or changing their own identity (Hsu, Kocak, and Kovács, 2018; Karthikeyan, Jonsson, and Wezel, 2015; Pontikes, Negro, and Rao, 2010). It is thus not difficult to imagine that an organization's decision to adopt a code violation or not is shaped, among other things, by consideration of its own identity as well as that of the change agent (Bourdieu, 1984; Simmel, 1957; Van den Bulte and Joshi, 2007). This notion is also supported by scholars such as Porac et al. (1995) and Mathias et al. (2017) who describe how cognitive and social institutions influence economic actors in identifying their primary competitors and in determining their reactions to these competitors.

Understanding identity-driven dynamics within a category requires an appreciation of context. For example, depending on the context, a difference of size, status, or a difference in location may or may not lead to different identities in the eyes of audiences. When it does, however, it is likely to produce different identities (Paolella and Sharkey, 2017; Phillips, Turco, and Zuckerman, 2013). For example, while a school might be much older and established than another member of the category 'schools', the major difference in the eyes of stakeholders might be ownership: state or private.

When identity differences are based on origins or ownership, members may sometimes be categorically divided into 'outsiders' and 'insiders' (Frake, 2016; McKendrick and Hannan, 2014). In this case, when it comes to their competitors with an outsider position, insiders often believe that they possess what might be called an 'identity buffer'. In other words, insiders consider themselves to be advantaged by virtue of their identity and believe that they will be seen as more authentic than outsiders, *ceteris paribus*. For example, banks might think they possess an identity buffer over financial technology startups who are not necessarily seen to belong to the category of 'banks'. Similarly, universities might assert their identity as a bona fide member of the category 'universities' over a private, online, provider of higher education.

Scholars have shown that outsiders go to great lengths to close this identity buffer and persuade audiences that they should be treated like insiders (Carroll and Swaminathan, 2000; McKendrick and Hannan, 2014). Frake's (2016) study of brewers engaging in merger and acquisition (M&A) activity is illustrative in this regard where 'outsider' members of the category were negatively evaluated by audiences who considered them to be driven by money and profits, rather than a passion for beer.

There is much merit in this perception. While both insiders and outsiders can suffer from negative evaluations by audiences if they violate central category codes, insiders do enjoy higher levels of latitude with their audiences (Hannan et al., 2007). Their category-based collective identity accentuates their authenticity claim in the eyes of audiences (Hogg and Terry, 2000; Polletta and Jasper, 2001). This means when it comes to competing with outsiders, they can afford to experiment, within limits, without entirely losing the advantage that the insider status bestows on them. However, when it comes to competing against other insiders, who possess a similar identity, deviation from category codes becomes a different proposition. It is in this vein that we examine how focal insiders react to code violation by outsiders as well as insiders.

INSIDER CODE VIOLATION

We first examine an instance where the code violator possesses an 'insider' identity. While traditionally institutional theorists often implied that code-violating changes will be initiated from outside the category (Leblebici, Salancik, Copay, and King, 1991), recent work is much more open to endogenously generated change (Seo and Creed, 2002; Greenwood and Suddaby, 2006). Many studies of such internal changes, driven out of competitive and status considerations, though not necessarily defying category codes, do exist (Haunschild and Miner, 1997; Hsu and Grodal, 2015; Phillips, Turco, and Zuckerman, 2013). For example, Greenwood and Suddaby's (2006) study on big five accounting firms adding law consultation services shows how the change benefited the largest firms, while the smaller firms were less able to benefit from this change.

However, more often than not, co-membership of a category bestows a shared sense of collective identity that keeps members in check (Graffin, Bundy, Porac, Wade, and Quinn, 2013; Polletta and Jasper, 2001). Not only audiences but peers too are expected to impose sanctions on the deviant (Jensen, 2010). In many cases, the entire category might suffer because of one members' deviance (Paruchuri and Misangyi, 2015; Tieying, Sengul, and Lester, 2008), as an individual insider may be seen as representative of the group's identity and expectations as a whole (Hogg and Terry, 2000). As Durkheim (1982) pointed out, while deviance represents an act of rebellion, the public disapproval of deviances by peers, in fact, serves to affirm cultural values and norms prevailing within the category. Furthermore, the act of deviance leads to recognition and definition of moral boundaries. In other words, acts of deviance on the part of category insiders are unlikely to lead to category-wide change.

Seen from another perspective, in categories where insiders are aware of their privileged identity in contradistinction to outsiders, a strong 'logic of appropriateness' (March, 1994), which emphasizes the importance of 'doing the right thing' based on one's identity, will take hold. In a sense, an insider may feel that deviance must not come from another insider, a notion that will persuade the former to desist from imitating the code violation. In doing so, an insider protects not only their individual identity from contamination, but also the collective identity of the insider group as a whole. In sum, we hypothesize that an insider is likely to refrain from following the footsteps of a code-violating peer insider.

Hypothesis 1: *Insider-initiated code violation is negatively associated with the likelihood of a focal insider to violate the same code.*

OUTSIDER CODE VIOLATION

Scholars have frequently found code violation to be deployed by *de novo*, outsider members of a category as they are seen to have less to lose compared to insiders (David, Sine, and Haveman, 2013; Leblebici et al., 1991). Outsiders possess more freedom to advance their cause, as their 'foreigner' identity exempts them from similarly stringent expectations of conformity by audiences (McKendrick, Jaffee, Carroll, and Khessina, 2003). For example, in Rao and colleagues' study (2003, 2005), age-old culinary traditions were violated by young French chefs with little to lose.

While it is certainly possible to argue – and indeed there is some evidence to support this – that 'insider' members can choose to ignore code violations by 'outsider' members given the latter's lesser authenticity and the expectation of conformity on the part of the former (Negro et al., 2011), an identity perspective casts this situation in a different light. When outsiders deploy the code violation, insiders may be able to choose to adopt the controversial practice while retaining their insider identity. For example, in Hirsch's classic article (1986) on hostile takeovers, the mainstream banks eventually adopted the highly controversial practice after discursively justifying it. Outsiders continue to be seen as outsiders, but those on the inside adopt the practice. In this manner, insiders are able to leverage an 'identity buffer' that they enjoy over outsiders to adopt the same profitable – albeit code violating – practice. This identity buffer is a result of the readily apparent advantage in identity the insiders possess over the outsiders. It provides insiders with a cushion against immediate repercussions at the hands of audiences, or even latitude to push the boundaries when confronted with 'evil' outsider members (Hirsch, 1986).

As Mathias et al. (2017: 2) point out, the entrance of newcomers or outsiders moves the strategic emphasis of a category from value creation and cooperation towards value appropriation and competition. With the entrance of new members, oppositional collective identities may also take root, sometimes helping differentiate a group within a category (Sine, Haveman, and Tolbert, 2005; Verhaal, Khessina, and Dobrev, 2015; Weber, Heinze, and DeSoucey, 2008). Whether they differentiate themselves or aim to emulate the insiders, the very entry and presence of outsiders is likely to alter the dynamic of the category. Acutely aware of the identity buffer that they have at their disposal, and recognizing the threat of the new entrants, insiders are likely to implement a double standard when following outsiders vis-à-vis peer insiders; shifting their overall outlook to one that is based on what March (1994) calls a logic of 'consequence' rather than 'appropriateness'. Unlike the logic of appropriateness which emphasizes upholding identity expectations, the logic of consequence underlines the importance of anticipating future repercussions when deciding which action to (or not) pursue. In short, while emulating a controversial change introduced by an insider carries the risk of being seen as following in the footsteps of a betrayer, doing so with outsiders brings with it a lower possibility of prospective sanctions. All in all, an incentive to exploit the identity buffer insiders possess over outsiders makes it likely for the former to adopt code violations introduced by the latter. As such, we hypothesize:

Hypothesis 2*: Outsider-initiated code violation is positively associated with the likelihood of a focal insider to also violate the same code.*

SIMULTANEOUS CODE VIOLATION AND PRESERVATION

Existing literature suggests that when outsiders enter a particular category, they commonly progress in two ways. They either remain peripheral to the mainstream while engaging in code-violating practices (McKendrick et al., 2003) or try to assimilate as a full member of the category through the adoption of code-preserving practices (Jourdan, Durand, and Thornton, 2017). However, much of the literature continues to focus on instances where outsiders are only violating particular codes, with scant regard to any code preservation that the outsider might be undertaking simultaneously. We believe it is crucial to realize that code violation and preservation are not mutually exclusive but co-present – that is, challengers can deviate on some dimensions while conforming on others.

Identities are not composed of just one element (e.g., country of origin), nor do they comprise only a single dimension (e.g., high or low status) – although one dimension can assume more salience in some cases. Instead, identities comprise multiple dimensions which intersect (e.g., a high-status Chinese firm operating in the US, or a Qatari news channel staffed by high-status journalists from the West). In other words, identity is relational and changes not along a single dimension but any of several. Changes in a focal firm's identity come about relative to competitors' identities when it adopts or drops particular practices that symbolize various aspects of its complex identity.

For instance, the identity of a microfinance lender might depend upon any, or many, of the following: the loan sizes they give, who they lend to, their ownership, their status as a bank or NGO, and/or whether they are a for-profit enterprise or not (Roodman, 2012). Within the larger category of microfinance institutions, there are several sub-categories including a clearly delineated category of incumbents: non-profit microfinance banks (e.g., Grameen). A for-profit microfinance bank can enter the microfinance category but continue to be considered an outsider by the incumbents. However, the for-profit bank can always try to blend in, at least in the eyes of the audience, by adopting other practices associated with category insiders (e.g., by emphasizing poverty alleviation, financial inclusion or women's emancipation). In other words, it is possible for outsiders to violate one code while publicly adhering to another.

In essence, code preservation enables new entrants to appear more authentic and thus more easily assimilate into the category. Such a strategy can serve to blur to some extent the distinction between outsiders and insiders, increase outsiders' intrinsic appeal, and serve to meet expectations of what it means to be a category member (Jourdan, Durand, and Thornton, 2017). Outsiders who code preserve are thus less likely to be discounted and more likely to be accepted as an appropriate member. Insiders will perceive code-preserving outsiders as an increased threat, as compared to outsiders who do not code preserve. We therefore posit that insider response would be conditioned when the outsiders simultaneously code violate and code preserve.

We are not arguing that preserving another code will remove all difference between outsider and insider identities. Rather, we are proposing that preserving other codes while violating the focal one will serve to narrow the identity buffer that exists between insiders and outsiders. In such cases, insiders face a threat from actors who are different only in some ways in the eyes of their audiences. This will leave insiders with lesser space to adopt controversial practices while maintaining an identity buffer than they would have had there been no code preservation on the part of outsiders. In short, when outsiders exhibit code-preserving behavior along with code-violation, insiders will be more cautious in adopting the code violating practice out of fear that this might result in them completely squander their identity advantage. It is in light of these assertions that we hypothesize:

Hypothesis 3*: When an outsider violates one code while preserving another, the positive relationship between outsider-initiated code violation and the likelihood of focal insider code violation will be weakened.*

RESEARCH CONTEXT: ISLAMIC BANKS

Our empirical setting is the Islamic banking category, which includes all banks claiming to offer Islamic banking products. An Islamic paradigm constrains Islamic banks to only obtain profit if it adds real value to the development of the economy and society as a whole. Instead of ‘making money from money’ – for instance from keeping money in a bank account and accumulating interest – Islamic banking products have to be based on profit-sharing and genuine risk-sharing with clients. Table 1 compares the different facets of the conventional and Islamic banking.

Insert Table 1 about here

Interestingly, as very few countries have a legal and economic framework designed exclusively for Islamic banking, Islamic banks rely largely on category codes to ensure the 'Islamicity' of their products and operations. Given the absence of fully formulated regulation, there is interpretive flexibility, but also a fear of consequences if Islamic banks violate widely held codes governing the financial transactions. Wilson (1999) provides an illustrative example of how socially significant various organizational practices are in the Islamic banking context. Wilson describes the case of Kleinwort Benson, an investment bank which set up an Islamic investment fund in London in 1986. The fund, which initially operated without a sharia supervisory board (SSB) – i.e., a group of Islamic scholars who ensure the compliance of the bank to sharia law – found the going very tough, with investors highly reluctant to put their money in it. As soon as a sharia board was instituted, however, the fund took off immediately, thus confirming the value of visible adherence to industry norms. Hence, the strong normative context makes Islamic banking an ideal site to test our hypotheses.

Conventional-owned Islamic banks as outsiders

Islamic banks were first founded in the 1970s in Egypt to meet Muslim demands of banking according to Quranic wisdom. Their inception was dubbed as the future and only alternative to capitalistic, western finance. Since Islamic finance is developed as the antithesis of conventional banking, full-fledged Islamic banks are considered the gold standard regarding their compliance with sharia law and are more genuinely engaged in the core values of the category. On the other hand, Islamic banks owned by conventional banks tend to be perceived as clones of their parents, importing capitalistic values to a religious market. Therefore, the broadest and most deeply entrenched distinction between ‘fully fledged’ Islamic banks (insiders) from conventionally-owned ones (outsiders) exists in terms of ownership. As we will mention later, in their effort to look more Islamic to the relevant audiences, outsiders try to adopt certain visible practices that are often associated with being Islamic, but the primary division remains in the form of ownership. With this in mind, we distinguish actors’ central identity feature in the Islamic finance category based on ownership structure (as in McKendrick and Hannan, 2014; Frake, 2016; Carroll and Swaminathan, 2000).

In line with understandings widely held in the category, we define Islamic banks that are owned by conventional banks as outsiders (henceforth, CB-owned Islamic banks), whereas those which are not, as insiders (full-fledged Islamic banks). In essence, full-fledged banks are insiders because they were born in the Islamic finance category, whereas CB-owned banks are regarded as outsiders because they entered late and are majority owned by conventional banks. In the Islamic finance market, ownership by a conventional bank typically signifies more than 90% ownership holding by the conventional bank (Figure 1 shows the breakdown percentages of CB-ownership). In addition, most CB-owned banks carry their parent names (e.g., HSBC Amanah, Citibank Islamic). These two considerations make CB-ownership an immediately salient identity marker of an outsider firm.

Insert Figure 1 about here

As the initial members of an Islamic banking market in a country are always full-fledged Islamic banks, when a CB-owned bank enters the market, it is usually received with a certain amount of suspicion and displeasure. One of UK’s leading Islamic scholars explains:

> “Things changed when the "rocket scientists of Deutsche Bank", Goldman Sachs, HSBC and other big boys arrived on the scene. They saw Islamic finance as an opportunity for

> quick profit. Muftis and Mullahs [Islamic scholars] were hired at footballers' salaries to make some of their product "sharia-compliant", and bankers such as Irfan [Managing Director of a European Islamic bank] to sell them to an unsuspected Muslim public. Soon we had products such as Sukuk [the equivalent of interest on bonds], *hilah* contracts [which substituted bank charges for interest] and Islamic finance became embroiled in hedge funds, derivatives and other dubious instruments justified in the name of Islam." (Ziauddin Sardar, in *The Independent*, July 2014).

Likewise, an Islamic finance lawyer stated in the *Financial Times*: "With a few honorable exceptions, the big international banks do not intrinsically care about Islamic finance; they saw the space as another opportunity to make money" (Wigglesworth, 2009).

Hence, not only is their motive seen with suspicion, the practices of CB-owned Islamic banks in the Islamic finance market are also met with distrust. For example, another Islamic scholar remarked how in CB-owned Islamic banks "funds might get mixed up in common kitchens" and wondered "if the Islamic banks owned by conventional banks are as zealous or passionate about Islamic principles" (Dr Busari Akande, in Charles, 2015). This sentiment was echoed by many industry actors whom we interviewed (Table 2 provides representative quotes from interviews illustrating various aspects of the industry). Consequently, a 'pure versus impure' sentiment visibly developed between CB-owned and full-fledged Islamic banks.

Insert Table 2 about here

Derivatives as a code violation

Two of the strictest prohibitions of Islamic finance are speculation (*maisir*) and preventable uncertainty (*gharrar)*. The idea behind the law is that *maisir* and *gharrar* carries a risk of potential unavailability or injustice towards a party. One of the main financial products with both components is derivative products. Not surprisingly, these are frowned upon if not completely rejected by many Islamic banks. Even though the idea of derivatives has been around since the 1970s, there have been few adopters within the Islamic banking category, with most

Islamic scholars shunning them because they are “inherently incompatible with the principles of sharia” (El-Gamal, 2001). In the words of a prominent sharia scholar in Saudi Arabia:

> “Derivatives result in the creation of a pure speculative market totally separated from the real economy. This is a destabilizing factor to the world financial system and constitutes a threat to humanity. Gambling in the form of derivatives also leads to social disintegration and moral decay.” (Dr Sami Al-Suwailem, quoted in Paldi, 2014).

Such sentiments were widely echoed by many of our interviewees who underscored the social and religious undesirability of derivatives (Table 2). These sentiments were also challenged, however, by many CB-owned Islamic banks who openly endorsed derivative products, asking many prominent sharia scholars to take a pragmatic approach with them to push for more ‘sharia-compliant’ derivative products.

***Zakat* as a code preservation**

One of the five fundamental pillars of Islam is *zakat*, the voluntary annual practice of almsgiving. The expectation is that every Muslim, earning above a certain threshold (*nisab*), will give about 2.5% of his or her wealth in charity. For an Islamic bank, this will mean a 2.5% ‘tax’ on profits or retained earnings paid to a charity or social effort. Unlike other charity or corporate social responsibility measures that a Muslim or an Islamic bank can undertake (such as *waqf* or *sadaqah*), the giving of *zakat* is continuous every year and at a fixed predetermined rate. *Zakat* is thus a key differentiator across Islamic and conventional banking categories. When asked about the importance of *zakat* giving for Islamic banks, our interviewees immediately noted its significance as the most observable variable that showcases the ‘Islamicity’ of the bank (Table 2).

In lieu of paying *zakat* on their own earnings, Islamic banks can choose to be a *Zakat* Centre for its customers and employees, or to pass on the *zakat* responsibility to their shareholders instead. However, if a bank wishes to enhance its ‘Islamicity’ or Islamic identity, announcing that it will be paying *zakat* is a good way of doing it. As one senior industry figure told us:

> "Take the case of HSBC Ammanah, which is basically an Islamic division of HSBC. I'm a shareholder in HSBC myself. So, it's a bank I know very well, and I know the Ammanah people quite well. For HSBC to have its Ammanah division pay *zakat* is purely a marketing decision. It's a way of emphasizing its Islamic authenticity. It's a marketing cost, just like advertising would be."

The person went on to suggest that for other banks such as Citibank it would be no different. Indeed, conventional-owned banks tend to publicly declare when they adopt the practice of *zakat*. For example, one CB-owned bank states: "The positive achievement is commitment of [the Bank] to disburse the Company's *zakat* which will be commenced starting from the next year" – thus regarding *zakat* payment as an important milestone to the Bank. The simple act of paying *zakat* signals commitment to Islamic values of self-sacrifice in lieu of capitalist profit maximization. During our interview with an Islamic bank regulator in Jakarta, we were told that *zakat* constituted a "litmus test of Islamic *intentions*". He further explained:

> "It is not just about the *zakat* payable on the balance sheet, but banks that pay [*zakat*] will have to disburse – come to the needy organizations, get published in the news, etc., and this gains nice positive publicity."

Indeed, when searching for newspaper articles on *zakat* by Islamic banks, local headlines such as 'Bank A contributes X amount of *zakat* to B effort' or 'Bank X partners with Y *zakat* institution for Z cause' are ubiquitous. In all, paying *zakat* is one of the most observable ways to signal serious commitment to the norms of the Islamic banking category, even if not every Islamic bank pays *zakat*. Accordingly, we take the use of derivative products as code violation and the giving of *zakat* as code preservation.

MEASURES AND METHOD

Our full data set consists of 143 Islamic banks in 23 countries, covering almost all operating Islamic banks today (World Bank, 2016). Of the 143, 101 are full-fledged Islamic banks, whereas 42 are conventional-owned. Nonetheless, we ran our main analyses only on countries including at least one full-fledged Islamic bank (insider) and one conventional-owned Islamic bank (outsider). This sub-sample consisted of 66 full-fledged Islamic banks and 42 conventional-owned banks in 12 countries. Our main data sources were annual reports, websites, and the Bankscope database. We show examples of the distribution of insider and outsider banks in three countries in Figures 2, 3 and 4.

Insert Figures 2, 3 and 4 about here

Dependent variable. We test predictions about a full-fledged Islamic bank's likelihood of using derivatives with a dummy variable that equals to 1 if the bank adopts derivatives and 0 if the bank does not. As derivative usage was and remains a highly controversial practice in Islamic banking, only 12.8% of derivative usage amongst full-fledged Islamic banks were observed out of total observations.

Independent variables. The first independent variable is *Peer derivative use*. We first coded whether or not a full-fledged Islamic bank *i* used derivatives at time *t*. *Peer derivative use* is then calculated as the count of full-fledged Islamic banks using derivatives in country *c* at time *t*. Our second independent variable is *Outsider derivative use*. We coded whether or not a CB-owned bank *i* used derivatives at time *t* and then counted the number of CB-owned Islamic banks using derivatives in country *c* at time *t*. Prior work has commonly utilized counts of the number of some particular type of firm or product (see, e.g., Carroll and Hannan, 1989; Dobrev, Ozdemir, and Teo, 2006; Rossman, 2014), based on the argument that the prevalence of an entity increases exposure to it, which in turn affects a focal firm's strategic response.

Moderator variable. In order to test the third hypothesis, we conducted the same steps to calculate *Outsider zakat payment* as code-preserving behavior. We first coded whether or not a

CB-owned bank *i* paid *zakat* at time *t* from our data sources. The moderator *Outsider zakat payment* was then calculated as the count of CB-owned Islamic banks paying *zakat* in the country *c* at time *t*.

Control variables. We used a number of control variables that might affect the likelihood of a full-fledged Islamic bank to use derivatives. As derivatives are profitable financial products, we first controlled for social aspiration between the focal bank and its competitors by accounting for performance differences. To do so, we categorized competitors between insiders and outsiders. We thus created the variables *Below outsider performance, Above outsider performance, Below insider performance,* and *Above insider performance*. We used *Returns on Assets* (ROA) as our main performance variable, given that it is the most commonly used measure of social aspiration in the literature (Cusumano, Kahl, and Suarez, 2008). As it is also widely available, it can be calculated by most managers and stakeholders and is thus a measure that is widely scrutinized. We calculated the difference of performance between the focal firm and its competitors, by subtracting the competitor's average performance from focal firm performance, lagged by one year. If the focal firm exhibits superior performance in that year compared to its its competitors, we set the difference as *Above performance.* If the focal firm performs below its competitors in that year, *Above performance* is set to 0 (Cusumano et al., 2008; Greve, 1998). As for *Below performance*, we did the opposite; we set the difference between the two firms' performance in absolute value if the focal firm is inferior to its competitors and 0 otherwise.

Further, we included whether or not a full-fledged Islamic bank is publicly listed (*Focal insider public listing)*, pays *zakat* (*Focal insider payment of zakat)*, the count of insiders that pay *zakat* (*Insider zakat payment*), *Profitability* as standardized net income, the *Size* of the bank as measured by natural log of assets, and *Product count change*, which proxies for how innovative the bank is in terms of new product development. We also controlled for various types of ownership variables that may affect the operating process of the bank, such as the ownership of full-fledged Islamic banks holds by conventional financial institutions (*Percentage of conventional financial institution ownership*) and the percentage of ownership owned by an Islamic entity (*Percentage of Islamic ownership*). We also controlled for the Global Ultimate Ownership (GUO) of the bank if it is a *government* or *private entity*.

As our independent and moderator variables are country-specific, we further controlled for *Total outsider banks* and *Total insider banks* in country c at time *t*. Moreover, we accounted for *Muslim percentage of population*, *GDP growth,* and *Bank density*. *Bank density* was obtained from The World Bank database, which is the total number of commercial bank branches in a country divided by 100,000 adults. We used this variable to account for general development and competition of the traditional banking sector in the country. Finally, we controlled for year and country fixed effects to account for general macroeconomic conditions and country-specific regulation. Tables 3 and 4 show descriptive statistics and correlation amongst variables.

Insert Tables 3 and 4 about here

Model specifications

We opted for a random-effects logit model widely used to model binary outcome, with ‘Islamic bank’ as the cross-sectional unit and ‘year’ as the temporal unit. The random effects logistic regression models the individual (bank-specific) probabilities of adopting derivatives. This method allowed us to estimate between-firm differences over the years as well as time-invariant parameters as explanatory variables (e.g., type of ownership, public listing, or country dummies). In our case, using a fixed-effects approach would have been inappropriate because our predictors had very low within-variance (Allison, 2009; Cameron and Trivedi, 2010: 244), which meant that derivative adoption for more than half of the full-fledged Islamic banks did not vary over time.

As observations in the longitudinal panel design are not independent, we used clustered-robust standard errors, which controlled for errors both not distributed identically across firms (i.e., heteroscedasticity) and correlated within firms across time periods (i.e., serial correlation) (Petersen, 2009: 465). We clustered standard errors by bank group (banks in different countries under single common ownership) – that is, one level above our unit of analysis (as recommended in Pepper, 2002) – to account for potential non-independence of decisions by the same bank group. In this way, we capture the unspecified correlation between observations within the same bank group. We ensured against potential issues of multicollinearity by using a regression collinearity diagnostic procedure described by Belsley, Kuh, and Welsch (2004). The test on our independent variables yielded a score of 23.10, below the acceptable threshold of 30. Further, we computed variance inflation factors (VIF) for all variables in the full model, with the average VIF being 7.93, below the standard cutoff of 10 in the literature (Hair et al., 2010). We also lagged all our independent and moderator variables by one year to enhance causal inference – i.e., we collected data from the year 2003 to construct lagged independent and control variables for the first year of observing our dependent variable (2004).

FINDINGS

Table 5 displays the results of our random effect logit models. Model 1 shows the effects of a base model with controls only. Model 2 includes our independent variable *Peer insider derivative use*, which we find to be negative and significant (β = -1.95, p = 0.03). Thus, we find support for Hypothesis 1 which predicts a negative relationship between peer insider-iniated code violation and the likelihood of the focal insider to code violate. Hypothesis 2 proposes that there exists a positive relationship between outsider-initiated code violation and the likelihood of a focal insider to also code violate. Model 3 includes the independent variable *Outsider derivative use* (β = 2.04, p = 0.07) and supports Hypothesis 2. It is worth noting that the marginal effects of insiders and outsiders on to the baseline probability are similar in magnitude.

Insert Table 5 about here

Hypothesis 3 predicts that the positive relationship between outsider code violation and the likelihood of a focal insider to also code-violate is weakened when the outsider engages in code preservation. Model 4 tests this prediction with the interaction of the independent variable *Outsider derivative use* with *Outsider zakat payment*. Our results indicate that the interaction between the two variables is negative and significant (β = -0.38, p < 0.01), lending support to our third hypothesis. Figure 5 depicts the interaction between *Outsider derivative use* and *Outsider zakat payment*. As can be seen, as more outsiders pay *zakat*, it would take more outsiders using derivatives for a focal insider to follow suit. We also ensure that the change in values of *Outsider derivative use* are statistically significant at various values of *Outsider zakat payment* to verify that the relationship between the independent and dependent variable does vary across different levels of the moderator. In all, our findings support our conjecture that insiders are more cautious to deviate when outsiders exhibit both code-violating and code-preserving behaviors.

Insert Figure 5 about here

Robustness checks and supplementary analyses

We carried out several robustness checks and supplementary analyses to confirm our results. First, the random-effects estimator makes the assumption that observed variables (regressors) are uncorrelated with the unobserved variables (error term). We thus corrected for any potential correlation by using Mundlak's procedure (1978), extended by Wooldridge (2002), that estimates random-effects regression models by adding entity-means of variables (Greene and Hensher, 2010: 71, 281-283). For each entity, we computed the time-averaged values and ran random-effects models with the time-invariant variables. We then ran Model 4 with these additional variables. As can be seen in Model 5 Table 6, we obtained the same results. Additionally, in models not shown, we also ran Models 1-3 with the Mundlak procedure and confirm our results remain the same for these models as well. We are thus confident that our findings are robust from potential correlation between the regressors and the error term.

Second, while the use of a count measure for *Outsider derivative use* and *Outsider zakat payment* is appropriate both theoretically and methodologically, we recognize that the correlation between the two variables is high (0.71). Even though this does not necessarily indicate problematic collinearity issues especially as our regression collinearity diagnostic procedure still measures under 30 (Belsley et al., 2014), we opted to verify our results by using an alternative variable with a lower correlation. Specifically, we ran Model 4, but instead of using a count measure for *Outsider zakat payment*, we use a proportion measure, which is calculated by dividing the count of outsiders which pay *zakat* in country *c* in year *t* with the total count of outsiders in country *c* in year *t*. The correlation between *Outsider derivative use* and the proportional measure of outsiders paying *zakat* is 0.26. We obtain the same results in models not shown but are available upon request.

Third, we tested Hypothesis 1 in countries without any conventional-owned Islamic banks to check if our theorizing holds in countries with only full-fledged Islamic banks or insiders. In this sample of insider-only countries, 35 Islamic banks were spread out in 11 countries between years 2003-2014. As derivative adoption is rarer in this sample compared to the full risk set (only 6.01% of observations, which is less than half the rate for countries with both insiders and outsiders), we adjusted our logit model. We acknowledge that standard logit estimates would be biased when the unconditional probability of a binary event is low (King and Zeng, 2001). Hence, as is conducted by Rider and Tan (2014), we corrected coefficient estimates and standard errors to account for the systematic bias related to the dependent variable's low unconditional mean using a rare-events logit specification (King and Zeng, 2001). We show results in Table 6, with Model 6 for insider-only countries. We confirm that *Peer insider derivative use* (β = -3.21; p = 0.03) remains negative and significant in insider-only countries. This buttresses the idea that the Islamic banking category with only insiders may be more likely to exhibit a community-like structure, where members are more committed to the values of the category and code violators are more likely to be penalized (Mathias et al., 2017).

Insert Table 6 about here

Fourth, we accounted for the possibility that it is the increasing legitimacy of derivatives rather than the identity of the code violator that drives our results. In other words, when derivatives are increasingly accepted, full-fledged Islamic banks could code violate because they do not expect penalties anymore. To measure *Derivatives legitimacy*, we utilized the media dataset Factiva (following Hsu and Grodal (2015) who also use media-based variables to measure the level of legitimacy). We first searched for the keywords 'derivative' or 'derivatives' selecting the Islamic banking industry and found 729 articles between 2007 and 2014 (we were not able to gather articles for all the countries and all the years). We then coded for counts of articles in each country *c* in year *t*. We counted how many articles were positive or neutral in tone when referring to derivatives in Islamic finance, vis-à-vis articles that were negative in tone. One author and a graduate research assistant familiar with Islamic finance performed the coding for the article tone. The reliability of the coding was tested on a random sample of 80 articles with 93.75% of the judgment matching between the two coders. *Derivatives legitimacy* was then calculated as the proportion of positive and neutral articles, which is the count of positive and neutral articles divided by the total articles in country *c* and year *t*. As can be seen in Model 7, our main results still hold even when controlling for derivatives legitimacy. It is worth noting that the variable *Derivatives legitimacy* while positive ($\beta = 0.04$, $p = 0.99$) – which is what one would expect – is insignificant. We also confirm that our results continue to hold when we control for the counts of positive and neutral articles together with the counts of all articles, instead of using a proportion measure (model not reported).

Fifth, a potential explanation for our work could be that it is bank status rather than identity that is driving our results. In other words, it may be the case that a focal insider would be more likely to code violate because it has lower or higher status (Rao et al., 2005; Phillips and Zuckerman, 2001). We thus undertook an analysis to disentangle the two constructs of identity and status and isolate the effects of each.

Based on our background research, it became evident to us that an Islamic bank's status is at least partially determined by its sharia supervisory board (SSB) composition. The SSB is a board consisting of sharia scholars who ensure that an Islamic bank's products and practices are in accordance with sharia law (Wardhany and Arshad, 2012). Although having a SSB is common, there is a shortage of expert scholars worldwide who are able to offer both sharia and finance expertise. As a consequence, the relatively small number of expert sharia scholars – usually from Middle Eastern countries – tend to sit on multiple boards of Islamic banks worldwide. Having a high-status sharia scholar on one's board indicates a bank's status, in the sense that such banks were able to attract the most in-demand scholars. It also further strengthens a bank's status, as these scholars represent a highly visible symbolic endorsement of the bank, similar to the way in which high-status venture capital firms serve to bolster the status of early-stage ventures with which they are affiliated (Stuart, Hoang and Hybels, 1999).

To measure bank status, we created a Bonacich centrality score for each scholar in a bank's SSB. This was done by creating a symmetrical matrix of all 380 scholars in our dataset per year to account for overlaps in bank directorship between any two scholars. We inserted the matrices into UCINET, which then calculated the centrality scores. We then summed the normalized score of SSB members for each bank-year.

In our full sample which included both full-fledged and CB-owned banks, the correlation between status and conventional banking ownership is low (-0.05). In order to examine the effect of status, we replicated Model 4 of Table 5 and additionally included the variable status of the focal insider. We find that our main results strongly hold and that there is a positive but insignificant effect of a bank's status ($\beta = 0.01$; $p = 0.84$) as shown in Model 8 of Table 6. It is worth noting that we were unable to gather complete information on all banks' SSB members for all the bank-years in our sample, especially for the earlier years (2003-2006). This is why we did not control for status in our main models and why the number of observations in Model 8 is lower. Nonetheless, we are fully confident that our models are robust to the alternative explanation that it might be status rather than identity which is driving our results.

Lastly, as our third hypothesis states, simultaneous code violation and preservation would narrow the identity buffer amongst insiders and outsiders. One might then wonder whether identity buffers also exist within insider peers? In other words, could it be that insiders who pay *zakat* will possess an identity buffer against insiders that do not. We suggest that this is unlikely and that the identity buffer only exists when the difference in the core differentiating feature (ownership) is readily apparent as in the case of full-fledged versus CB-owned banks. On the other hand, fellow insider banks will be perceived as possessing a shared identity and a sense of community (Polletta and Jasper, 2001). Below, we present suggestive evidence that we believe bolsters our case.

First, among insiders, it is assumed that even if the bank does not pay *zakat*, the individual shareholders must – an assumption that does not extend to CB-owned banks. Also, in line with recent research (Platonova et al., 2018: 464), we find that when insiders pay *zakat*, they are less likely than outsiders to showcase it "because it shows worship to God and showing it off will go against that" (interview with Malaysian full-fledged Islamic banker). We ran a test on the count of the word '*zakat'* in all Islamic bank's annual reports in the year 2013-2014, where the annual reports are generally more uniform in length and detail. The word count is illustrative in our setting because banks choose the extent to which they highlight their *zakat* efforts in their annual report. For example, while many banks only mention the amount of *zakat* paid with a standardized template-like accounting note, others go further by discussing where they distributed their *zakat*. We find the mean *zakat* word count of a full-fledged bank to be 7.15 (7.15 times the word '*zakat'* is mentioned per annual report), whereas the mean for CB-owned banks is 14.8 (14.8 times the word '*zakat'* is mentioned per annual report). This difference is also statistically significant ($p\ (|T| > |t|) = 0.000$), indicating that insiders are less likely to parade their code-preserving efforts than outsiders. This suggests that outsider banks are more likely to adopt code-preserving practices as impression management strategies (Goffman, 1959), which is in line with Peterson's (2005:1083) claim that authenticity tends to be proclaimed more strongly when it is called into question.

Second, we ran Model 2 but added the interaction *Focal insider zakat payment* (whether or not the focal insider pays *zakat*) with *Insider derivative use* (unreported model). We find no significance of the interaction, which supports our argument that payment of *zakat* does not redeem insiders when they code-violate. All in all, it seems that for insiders, *zakat* is not a strategic tool to prove authenticity as it is for outsiders.

DISCUSSION

Recent work in the organizational categories literature has shown how, given the changing nature of competitive threats that they face, organizations are continuously torn between conformity to category codes and an imperative to be distinct (Zhao, Fisher, Lounsbury, and Miller, 2016; Zuckerman, 2016). Within this scholarship, a strengthening stream of research has been exploring how such decisions are influenced by considerations of organizational identity, both of incumbents and new entrants (Carroll and Swaminathan, 2000; McKendrick and Hannan, 2014). Given the rapidly blurring industry boundaries (Kovács and Hannan, 2015; Kuilman and Li, 2009), an increasing number of firms are facing identity-based challenges. For example, as autonomous cars become a reality and individuals stop driving cars, established manufacturers such as BMW ("the ultimate *driving* machine"), might be left wondering about their identity in a world of driverless cars. Similarly, the entry of Amazon into healthcare might cause an existential crisis among healthcare providers. Understanding competitive behavior in the face of category members with different origin/ownership-based identities who may be violating some category codes while preserving others is perhaps more crucial now than ever before.

It is in this vein that we use our extensive data on insiders and outsiders in Islamic banking to explore how different identities shape the dynamics of change and competition within categories. In a case where category boundaries and codes are clearly laid out, and intra-category identities easily discernable, we first test what response a category code violation elicits. We find that a focal insider would be less likely to adopt a code violation when a peer insider initiates it.

We argue that this happens because expectations of loyalty to the category code are higher for insiders, leading them to desist from following a deviant. It also implies that radical innovation rates should drop when categories are homogeneous. We find the opposite effect when the code violator is an 'outsider' member of the category. In this case, insiders are more willing to adopt a code violation. We argue that the identity buffer insiders possess relative to outsiders allows them some leeway to adopt controversial practices while retaining their insider identity. This implies that the entry of outsiders is beneficial for radical innovation in any industry though for incumbents it means dealing with identity challenges. In our last hypothesis, we examine what happens when the outsider code violator adopts some code-preserving practices. This hypothesis was posed to test how the outcome changes as the identity buffer narrows. Consistent with our overall argument, we find that as soon as the identity buffer narrows, the insiders' propensity to adopt the code violation ushered in by outsiders also weakens. Our findings hold significant implications for existing understandings of market categories as well as organizational and social identities.

Identity, Categories, and Change

It is now established that category members tend to keep their and competitors' identities in mind when making strategic decisions (Battilana, Leca, and Boxenbaum, 2009; Pontikes et al., 2010). Likewise, competitive dynamics can lead to changes in the identities different category members lay claim to (King et al., 2011; Karthikeyan et al., 2016). It is not only individual identities, but shared ones too which are instrumental in shaping strategic decisions. For instance, Ingram and Inman (1996) described how national identities, and hence sense of allegiance, shaped the competitive behavior of Canadian and American hotels in the Niagara Falls area. Likewise, the entry of new players can lead incumbents to shift their own identities, as we saw in the cases of charter schools (King et al., 2011) and medical dispensaries (Hsu et al., 2018). King and colleagues (2011) suggest that outsiders are better able to drive changes in incumbent behavior thanks to the new templates they bring with them. McKendrick et al. (2003) find that high-status organizations are able to advance change more easily. Moreover, in one of the most recent studies on this phenomenon, Hsu et al. (2018) suggest that the adoption of code violations by insiders depends upon whether audiences accept the new practices.

While most studies, at least to our knowledge, look at a single instance of confrontation – generally between insiders and outsiders – in order to observe shifts in identity, we are able to empirically test two scenarios (when a code violation is deployed by insiders versus outsiders) in the same empirical context. While, on the face of it, one may interpret our findings as suggesting that those with an outsider identity are advantaged in terms of change creation, we are in fact going beyond this inference (which is based on identity itself) by focusing on the role identity differences plays in members' decisions to adopt a code violation or not. We argue that when a discernible identity difference between violator and potential adopters does not exist – as in the case when the code violator is a peer insider – insiders are reluctant to adopt code violations. When an identity difference does exist between the violator and potential adopters – as in the case of a code violation introduced by an outsider – insiders are more likely to leverage the identity buffer they possess to adopt code violations.

Realizing the centrality of intra-category identity differences to category dynamics casts existing understandings in a new light. While we already know that the entry of code-violating newcomers into a category leads to a shift in incumbents' focus, our notion of an identity buffer alerts us to the fact that any attempt on the newcomers' part to decrease or increase the difference between itself and potential adopters is likely to have a meaningful effect on the latter's likelihood of adopting the code-violating practice. By focusing on identity differences rather than identity itself, we move from considering binaries (American versus Canadian; Classical versus Nouvelle, etc.) to a spectrum where identities are malleable and relative. Our consideration of two different practices – derivatives and *zakat* – opens up new avenues to explore multi-dimensional identity differences as well as changes in the identity buffer that exists between firms, and their effect on competitive outcomes or firm behavior in general.

Another aspect of our research worth highlighting is how code-changing and code-preserving strategies can be of varying prominence (March, 1954; Bascle, 2016; Wry, Cobb, and Aldrich, 2013), depending on the actor deploying it. In our context, adopting *zakat* seemed to be an effective strategy for outsiders to blend into the category, but does not carry the same distinction for insiders. Further, it became clear to us based on background research that adoption of derivatives was one of the most contentious issues in the Islamic finance community, overshadowing many other potential code violating issues. It remains a theoretical puzzle as to why some code behaviors generate a great deal of attention, while others seem to be ignored. We are convinced that specifying the reasons would be an exciting avenue for future research.

Identity Buffer and the Quest for Competitive Advantage

In the previous section, we discussed how our study sheds new light on the role of identity differences in organizational decisions to conform or deviate from category codes. We now describe how we also enhance existing understandings of identity-based core competencies. The notion that distinctive identities serve as a basis for competitive advantage is not new in itself (Hsu and Hannan, 2005; Smith, 2011). For instance, as far back as 1991, Fiol (1991) wrote that identity needed to be considered a ‘core competency’ of organizations. Fiol argued that organizational identity was central to how managers viewed competition and themselves, and how they allocated resources. Ten years later, she questioned her earlier conclusion, however, suggesting that no one identity could continuously serve as a basis for competitive advantage

(Fiol, 2001). In a dynamic environment, she argued, competitive advantage needs to be renewed, and the continuously changing bases for competitive advantage in turn requires a fluid identity (Fiol, 2001). Given the increasing proclivity of organizations to breach category boundaries as ecosystems evolve, questions of how identity figures in competition between incumbents and new entrants have only assumed greater relevance. Navigation of how much to shift one's identity is never straightforward (Karthikeyan et al., 2016; King et al., 2011). This is also emphasized, for instance, by Navis and Glynn (2010) who state that within a collective identity, organizations go on to claim an identity of "optimal distinctiveness – distinctive enough from other members to individuate it, but not so distinctive as to make it unrecognizable as a rightful member of the category" (Navis and Glynn, 2010: 442).

Our results underline the importance of considering identity in the context of intra-category competition. However, our study suggests that contrary to what much earlier research emphasizes (Negro et al., 2011) it is not identity per se which serves as a core competence for the firm. Rather, it is the identity buffer, i.e., relative identity advantage, which they possess, that influences their strategies. Specifically, when competing against organizations with a markedly different identity, organizations compete on their identity advantage (buffer). However, when competing against organizations with a similar identity, they cannot compete on this basis. This would suggest that when, say, university publishers (e.g., Stanford University Press) compete against 'trade' publishers, they may leverage the identity buffer they possess over the latter. This could mean the adoption of certain practices that are not in line with their 'university publisher' identity. When competing against other university publishers, however, there is no identity buffer to leverage, likely resulting in continued conformity to the codes of their category. In this sense, our study underscores the importance of considering relative identity differences rather than binary identities.

Moreover, it is worth emphasizing that our focus on organizational identity, in particular, was motivated by the theoretical observation that competition between different identities can lead to an identity partition or the creation of a subcategory within a category (Carroll and Swaminathan, 2000; McKendrick and Hannan, 2014). As the partitioning allows for a change in the category's dynamics, it enables the existence of a 'double standard' to be enacted across different identities with insiders employing different strategies against insider peers than they do against outsiders. We also recognize that there is a limit beyond which the buffer will not protect the organization if it violates the code. This is also implied by Phillips, Turco, and Zuckerman (2013) who argued that while high-status actors are more able to engage in deviance, they will not go extents that might discredit them.

Social identity theory

Social identity theory argues that organizations can be a part of a "psychological group, defined as a collection of people who share the same social identification or define themselves in terms of the same social category membership" (Turner, 1984: 530). Theoretically, social identity theory distances itself from the traditional concept of categories by suggesting that social group membership can exist in the absence of shared goals or features, so long as the organization cognitively internalizes some common beliefs or perceives and shares a 'common fate' with other members (Cornelissen, Haslam, and Balmer, 2007; Rabbie, Schot, and Visser, 1989). Having said this, identification to the group will likely be stronger when the group possesses distinctive or unique features in relation to others and when they are aware of the salience of an out-group (Haslam and Ellemers, 2005).

A long sequence of research in this literature has established that producers tend to favor those within their group and discriminate against those outside. Moreover, this in-group favor intensifies when there exists competition between in and out- groups as “us against them” sentiments are accentuated (Ashforth and Mael, 1989). For example, Cannella, Jones, and Withers (2014) point out how family firms tend to favor board interlocks with other family firms and hire board members with family firm experience for longer periods. In another study, Haslam et al. (2001) noted that corporate leaders were viewed as more charismatic when leading the firm through a crisis if they affirmed and promoted their in-group identity, independent of actual organizational performance. Members of an in-group may even sacrifice resources to ensure that distinctiveness with out-groups is maintained, rather than risking potential fuzziness between the groups’ boundaries (Haslam and Ellemers, 2005; Turner, Brown, and Tajfel, 1979).

Our work sheds light on the caveats of in-group favoritism and its consequences. We argue that loyalty to in-group values does not necessarily translate into sustained favoritism towards other in-group members. On the contrary, it can lead in-group members to be stricter towards an in-group member seeking to introduce a controversial practice that goes against the group’s values. By doing so, in-group members reaffirm the boundaries of their group and may perhaps ensure its survival in the long run. This becomes especially pertinent in our case when we consider that full-fledged Islamic banks are unable to defect from their category. In this way, our work supports the argument that the foundations of social groups are not solely to uphold a positive shared identity but can also be reinterpreted as rational behavior aimed at maximizing both individual and group interests (Polletta and Jasper, 2001).

LIMITATIONS AND FUTURE RESEARCH

Like most studies, ours too carries its own set of limitations. First, while we recognize the multi-dimensional nature of identity, our measures of code violation and preservation are in themselves binary. We believe future work should measure more variation in the forms of code adoption. Future researchers are encouraged to explore adoption along with a spectrum. How do firm characteristics affect the legitimation of contentious social code violations? How does a focal firm's grade of membership (a pure player at the core versus a peripheral player) in the category predict the types of code violation and preservation a firm might engage in? These questions open up exciting and important avenues for future inquiry.

Another possible avenue of inquiry could be the exploration of the antecedents of code-violating or -conforming behavior, especially for outsiders. In our context, we were not able to fully mine data on the social position of outsiders in their original category. Ideally, we would have liked to understand how a CB-owned banks' identity in the conventional banking category might affect the several possible ways in which it could choose to enter Islamic banking. Given that we still lack a robust understanding of how outsiders' previous category 'life' affects their trajectory in the new category, it could be particularly fruitful to investigate which new entrants are more likely to be code violators or code preservers.

Finally, a boundary condition of our study is that derivatives are profitable financial products for banks. It would be exciting to study how firms' strategy changes when the code violation deployed is more neutral or uncertain in its potential economic gains. For example, when new technological standards first emerge, their success is unclear and adoption can be risky. How do members assess the code violation in such cases? How does the uncertainty impact their actions? What are the social codes that would be salient in such instances? We encourage future researchers to explore whether firms react differently with such offerings.

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TABLE 1. Islamic Banking versus Conventional Banking[1]

	Islamic Banking	**Conventional Banking**
Guiding Principles	Religious principles	Capitalistic, market-based principles
Prohibitions	Accumulating interest, speculation, unethical or socially undesirable projects, and other illegal practices as outlined by financial law	Illegal practices as outlined by financial law
Role of Bank	A partner who shares risk with borrower	A lender who is assured a rate of return
Purpose	Profit making that is ethical, appeases God, and creates real value for society	Maximization of profit to appease shareholders
Top Management Team	Board of Directors and Sharia Supervisory Board	Board of Directors
Products	Mudarabah (profit-sharing loan), Musharakah (joint enterprise), Murabahah (markup sale), Istisna (contract with deferred delivery), Ijara (lease), Wadiah (deposit), etc.	Loans, Mortgage, Deposits, Savings, Checking accounts, etc.
Penalties	Does not penalize its borrowers for late payments	Penalizes borrowers for late payments
Relations with Wider Community	Gives due importance to public interest. Its' ultimate aim is to ensure inclusive growth by providing needed capital to socially desirable projects	Bringing together those who need capital and those who possess it

1 Source: Anonymous, n.d., last accessed through http://www.landewednackhouse.com/

TABLE 2. Qualitative Insights from the Islamic Banking Industry

Proposition	Sub-proposition	Representative Quotes
CB-owned banks are viewed as outsiders	CB-owned banks are seen to imprint the capitalistic logic of their owners on Islamic products	"The ownership of the bank is the captain of the bank. Who do they [CB-owned banks] answer to? The [conventional bank] directors. That determines where that ship goes." (Interview with former full-fledged Islamic bank executive) "If you ask them (a CB-owned bank top management team) about a *fatwa*, they probably wouldn't know. They're all imports (from the conventional bank). 70% of their employees are." (Islamic finance scholar)
	CB-owned banks are seen as less loyal towards Islamic values	"I am just not sure whether they share the same devotion to Islam or they just want to make more money." (Interview with full-fledged Islamic bank, former Finance Director) "Islamic finance is about a balance between the sharia side and the finance side. The CB-owned banks need to go that extra mile on the sharia side." (Interview with SSB member of CB-owned bank)
Derivatives are considered to be controversial		"Derivatives have a bad name around here [in the Islamic finance sector], especially after the financial crisis that the Western world created. It's a system of buying into risk and using *riba* [interest] in every transaction." (Interview with Islamic banker, Head of Product Compliance Dept.) "The risk [of violating sharia] is there. But if the guidance sharia scholars give goes in the direction of 'I want the purest market', then I am convinced there will be no market." (Head of Deutsche Bank Islamic Finance, quoted in Al Arabiya News, August 2009)
Zakat as a visible proxy of 'Islamicity'		"Every year, Islamic bankers they like to publicize where their *zakat* was distributed. The *fakir* [poor], the *masakin* [needy], or the admins, it's up to the bank. It's good publicity, especially within the Islamic-based industry." (Interview with Islamic banker, Human Resources and Learning Dpt.) "*Zakat* is not charity and it's not supposed to be seen as a tax, like many do. It is a responsibility that Islamic banks have as an Islamic institution. They are the ones who need to pay it for God, although God doesn't need their charity." (Islamic finance scholar)

TABLE 3. Descriptive Statistics

Variables	Mean	Std. Dev.	Min	Max
1. Focal insider derivative use	0.13	0.33	0	1
2. Outsider derivative use	0.73	2.49	0	11
3. Peer insider derivative use	0.63	0.95	0	4
4. Outsider zakat payment	1.29	2.26	0	10
5. Above outsider performance	0.01	0.04	0	0.37
6. Below outsider performance	0.07	0.18	0	1.57
7. Above insider performance	0.02	0.05	0	0.96
8. Below insider performance	0.02	0.06	0	0.96
9. Publicly listed	0.48	0.5	0	1
10. Focal insider zakat payment	0.5	0.5	0	1
11. Insider zakat payment	2.78	2.35	0	9
12. Profitability (std)	0	1	-3.79	5.01
13. Size (ln assets)	6.89	1.55	-0.63	11.02
14. Product count change	0.23	0.6	0	5
15. Conventional F. I. ownership	0.05	0.11	0	0.47
16. Islamic ownership	0.41	0.37	0	1
17. GUO: Government	0.1	0.3	0	1
18. GUO: Private entity	0.14	0.34	0	1
19. Total outsiders in country	2.36	2.67	0	12
20. Total insiders in country	7.54	4.1	1	15
21. Muslim percentage	77.43	19.95	3.3	99.09
22. GDP growth	4.1	3.9	-15.09	17.32
23. Bank density	9.14	6.08	1.52	26.45

TABLE 4. Pairwise Correlations

Variables	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22
1. Derivative																						
2. Peer insider derivative use	0.33																					
3. Outsider derivative use	0.44	0.56																				
4. Outsider zakat payment	0.44	0.57	0.71																			
5. Above outsider performance	-0.08	-0.11	-0.09	-0.14																		
6. Below outsider performance	0.03	0.02	-0.09	-0.11	-0.14																	
7. Above insider performance	-0.02	-0.05	-0.06	-0.03	0.26	0.02																
8. Below insider performance	-0.08	-0.03	-0.04	-0.01	-0.07	0.39	-0.10															
9. Publicly listed	-0.11	-0.10	-0.26	-0.29	0.13	-0.15	0.01	-0.10														
10. Focal insider zakat payment	0.10	0.05	0.19	0.24	0.02	-0.24	-0.04	-0.13	0.20													
11. Insider zakat payment	-0.03	0.03	0.04	0.04	-0.11	-0.17	-0.07	-0.01	0.05	0.32												
12. Profitability, std.	0.27	0.01	-0.04	-0.05	0.10	-0.18	0.04	-0.16	0.22	-0.05	-0.06											
13. Size (ln assets)	0.36	0.22	0.10	0.08	0.00	-0.25	-0.04	-0.27	0.38	0.10	-0.01	0.49										
14. Product count change	0.16	0.07	0.11	0.09	0.02	0.00	0.00	-0.06	-0.04	0.10	0.11	0.08	0.11									
15. Financial inst. own.	0.09	-0.01	-0.07	-0.10	0.06	0.10	0.02	0.09	-0.12	-0.23	0.09	0.03	-0.07	0.08								
16. Islamic own.	-0.02	-0.01	0.03	0.14	-0.18	0.04	-0.06	-0.01	-0.11	0.02	0.05	0.04	0.03	-0.01	-0.21							
17. GUO: Govt.	0.19	0.08	0.11	0.06	-0.08	0.04	-0.06	-0.05	-0.12	0.06	0.10	-0.05	0.18	0.05	0.14	0.12						
18. GUO: Private entity	0.14	0.30	0.50	0.54	-0.10	-0.06	-0.07	0.06	-0.24	-0.02	0.03	-0.11	-0.04	0.02	-0.14	0.29	-0.13					
19. Total outsiders in country	0.40	0.53	0.70	0.74	-0.12	-0.09	-0.06	-0.02	-0.29	0.23	0.10	-0.07	0.09	0.13	-0.08	0.14	0.09	0.50				
20. Total insiders in country	-0.10	0.01	-0.16	-0.17	-0.08	0.01	0.10	0.11	0.01	-0.04	0.51	-0.04	0.01	0.03	0.21	-0.13	-0.05	-0.10	-0.11			
21. Muslim percentage	-0.25	-0.29	-0.22	-0.09	0.10	-0.70	-0.07	-0.03	0.13	0.24	0.29	0.02	-0.05	-0.06	-0.12	0.08	-0.16	-0.04	-0.10	0.02		
22. GDP growth	-0.03	-0.09	0.05	0.04	0.14	-0.23	-0.01	0.01	0.07	0.00	-0.12	0.10	0.02	-0.02	-0.01	-0.01	-0.02	0.07	0.03	-0.04	0.10	
23. Bank density	0.23	0.27	0.09	0.07	0.01	0.42	0.03	-0.02	0.11	-0.19	-0.48	0.14	0.23	0.02	-0.05	-0.09	0.00	0.05	0.02	-0.49	-0.62	-0.10

TABLE 5. Random Effects Logit Estimations: Likelihood of Insiders' Derivative Use

VARIABLES	Model 1 Controls	Model 2 H1	Model 3 H2	Model 4 H3
Peer insider derivative use		-1.95*	-1.92*	-2.05*
		(0.895)	(0.919)	(1.006)
Outsider derivative use			2.04+	4.47*
			(1.142)	(1.743)
Outsider derivative use x outsider zakat payment				-0.38**
				(0.145)
Outsider zakat payment		2.14	0.94	5.21**
		(1.389)	(1.622)	(1.965)
Above outsider performance	8.31	2.18	4.29	11.98
	(11.639)	(10.733)	(11.685)	(16.167)
Below outsider performance	-0.11	-0.93	-1.14	-0.18
	(2.862)	(2.760)	(2.773)	(3.104)
Above insider performance	8.73*	7.67*	7.10	4.46
	(3.799)	(3.618)	(8.264)	(13.489)
Below insider performance	-36.11**	-31.68*	-34.96**	-26.80+
	(12.099)	(13.892)	(11.225)	(14.965)
Focal insider public listing	-7.24*	-6.19**	-7.10**	-6.88**
	(2.850)	(2.192)	(2.369)	(2.342)
Focal insider payment of zakat	1.86	1.51	1.60	0.63
	(1.211)	(1.040)	(1.082)	(0.969)
Insider zakat payment	-0.03	-0.51	-0.36	-1.66**
	(0.429)	(0.365)	(0.344)	(0.638)
Profitability	0.09	-0.27	-0.27	-0.05
	(0.530)	(0.518)	(0.518)	(0.560)
Size	3.83***	3.11***	3.60***	3.56***
	(1.022)	(0.768)	(0.946)	(0.953)
Product count change	-0.22	-0.18	-0.35	-0.39
	(0.649)	(0.768)	(0.762)	(0.714)
Percentage of conventional F.I. ownership	15.18*	11.74*	12.97*	13.24*
	(6.250)	(5.269)	(5.601)	(5.536)
Percentage of Islamic ownership	-0.56	-0.68	-0.96	-0.92
	(2.006)	(1.637)	(1.732)	(1.452)
(Dummy) Global Ultimate Ownership: Government	-2.15	-1.11	-1.19	-0.44
	(2.595)	(2.024)	(2.369)	(2.297)
(Dummy) Global Ultimate Ownership: Private entity	-1.43	-0.90	-1.24	-1.27
	(2.395)	(1.805)	(1.955)	(2.004)
Total outsider banks in country	0.30	-0.79	-1.51	-2.91*
	(0.349)	(0.943)	(1.087)	(1.318)
Total insider banks in country	1.97*	2.90**	2.95**	4.21**
	(0.981)	(0.913)	(1.041)	(1.303)
Percentage of Muslims in country	-0.52+	-0.35*	-0.26	0.09
	(0.284)	(0.174)	(0.204)	(0.183)
GDP growth	-0.06	-0.13	-0.06	-0.12
	(0.089)	(0.140)	(0.119)	(0.126)
Bank density	0.57+	0.96***	1.10**	0.98*
	(0.337)	(0.264)	(0.342)	(0.383)
Constant	-12.63	-25.02*	-36.70*	-68.88**
	(18.733)	(10.034)	(14.828)	(21.554)
Log likelihood	-56.06	-52.89	-51.36	-49.23
Country and year dummies	Y	Y	Y	Y
Observations (bank-year)	536	536	536	536
Number of banks	66	66	66	66

Robust standard errors in parentheses
*** p<0.001, ** p<0.01, * p<0.05, + p<0.1

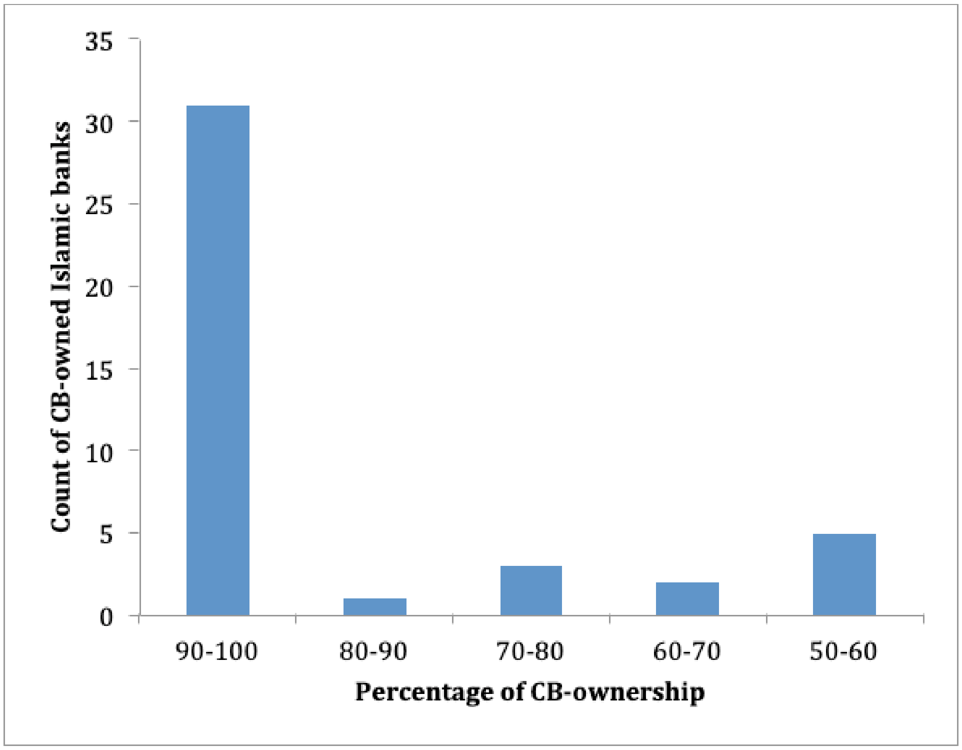
TABLE 6. Robustness checks

VARIABLES	Model 5 Mundlak procedure	Model 6 Insider-only countries	Model 7 Derivatives legitimacy	Model 8 Bank status
Peer insider derivative use	-1.02+	-3.21*	-2.22*	-2.22*
	(0.575)	(1.491)	(1.007)	(1.073)
Outsider derivative use	1.19*		3.35**	4.37*
	(0.462)		(1.236)	(1.872)
Outsider derivative use x outsider zakat payment	-0.17**		-0.43*	-0.37*
	(0.063)		(0.168)	(0.154)
Outsider zakat payment	5.73***		6.26**	5.58**
	(0.989)		(2.134)	(2.081)
Derivatives legitimacy			0.04	
			(2.986)	
Bank status				0.01
				(0.004)
Above outsider performance	14.42		44.94*	21.57
	(7.775)		(18.316)	(23.511)
Below outsider performance	-2.23		3.68	0.63
	(1.334)		(4.910)	(3.256)
Above insider performance	-0.92	-74.13	21.00	7.61
	(7.737)	(112.636)	(13.222)	(6.574)
Below insider performance	-14.99+	41.79***	-25.65	-25.58
	(7.990)	(7.213)	(16.708)	(16.170)
Focal insider public listing	-4.43***	18.34***	-6.38**	-6.75**
	(1.109)	(2.897)	(2.244)	(2.540)
Focal insider payment of zakat	-0.36	31.91+	-0.05	0.67
	(0.344)	(19.375)	(0.996)	(1.018)
Insider zakat payment	-1.45***	-10.00	-2.00**	-1.77*
	(0.337)	(8.812)	(0.731)	(0.701)
Profitability	0.32	-3.39	-0.42	-0.15
	(0.285)	(3.214)	(0.536)	(0.584)
Size	3.56***	-7.48***	3.03***	3.32***
	(0.860)	(1.566)	(0.790)	(0.940)
Product count change	-0.21	-1.83**	-0.41	-0.43
	(0.423)	(0.639)	(0.604)	(0.695)
Percentage of conventional F.I. ownership	0.23	27.16***	13.82**	13.24*
	(1.991)	(6.356)	(4.419)	(5.553)
Percentage of Islamic ownership	-0.46	-6.10	-0.77	-0.54
	(0.515)	(4.225)	(1.116)	(1.392)
(Dummy) Global Ultimate Ownership: Government	2.10**	2.12	1.06	-0.58
	(0.744)	(3.785)	(1.674)	(2.153)
(Dummy) Global Ultimate Ownership: Private entity	-2.04**	-18.16**	-2.37	-1.25
	(0.628)	(5.806)	(2.106)	(2.255)
Total outsider banks in country	-4.19*		-2.19*	-3.26*
	(0.780)		(1.017)	(1.296)
Total insider banks in country	2.92**	2.97**	4.92***	4.66**
	(0.770)	(1.047)	(1.423)	(1.562)
Percentage of Muslims in country	0.10+	-0.48***	-0.09	0.05
	(0.051)	(0.036)	(0.194)	(0.222)
GDP growth	-0.23***	-0.59	-0.20	-0.14
	(0.068)	(0.422)	(0.140)	(0.137)
Bank density	0.99**	0.75	0.60**	0.98**

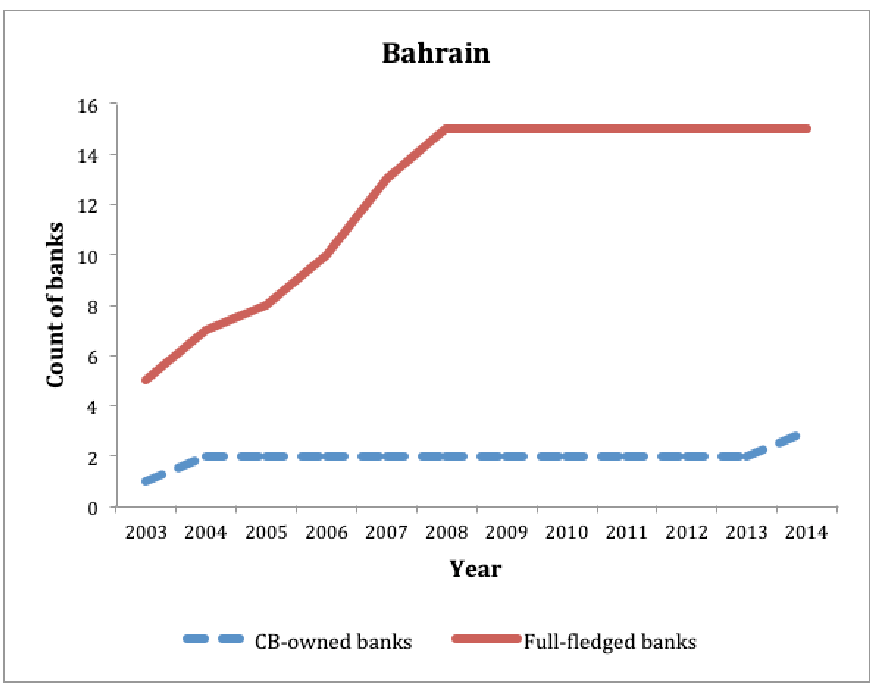
	(0.355)	(0.567)	(0.219)	(0.367)
Constant	-34.50**	82.79***	-50.20**	-65.45**
	(11.599)	(7.359)	(17.173)	(23.494)
Log likelihood	-34.39	-16.45	-43.01	-48.27
Country and year dummies	Y	Y	Y	Y
Observations (bank-year)	536	367	309	405
Number of banks	66	35	58	59

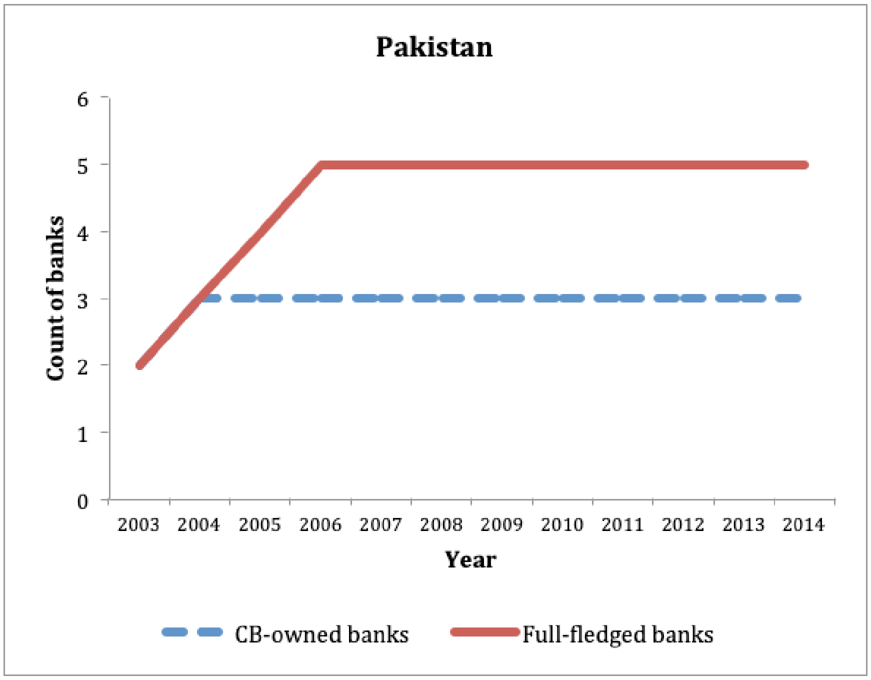
Robust standard errors in parentheses
*** p<0.001, ** p<0.01, * p<0.05, + p<0.1

FIGURE 1
Distribution of CB-ownership Percentage in CB-owned Islamic banks (outsiders)



FIGURES 2, 3, and 4
Counts of CB-owned and Full-Fledged Islamic Banks in Countries




Pakistan
Count of banks
0
1
2
3
4
5
6
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
Year
CB-owned banks
Full-fledged banks

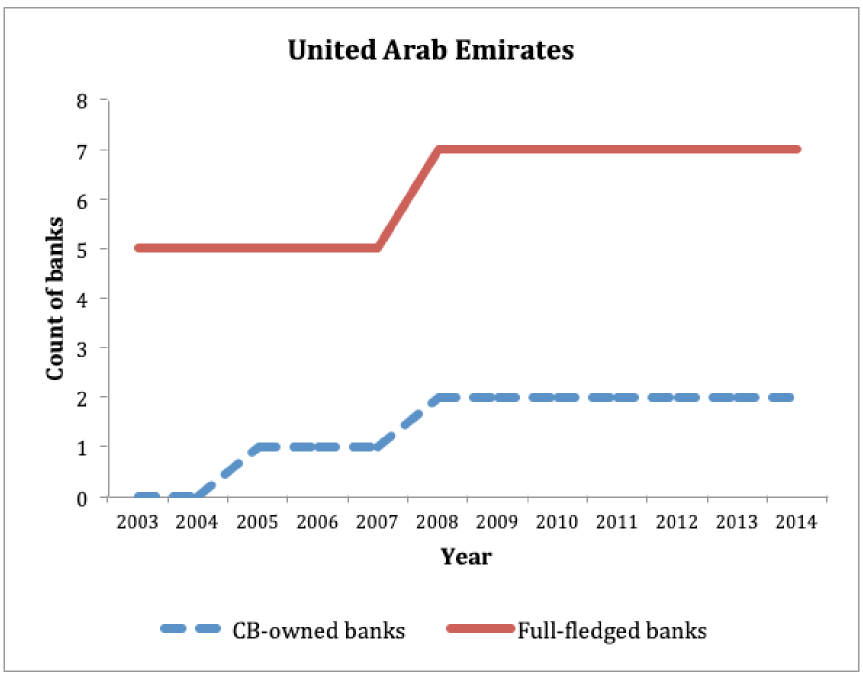
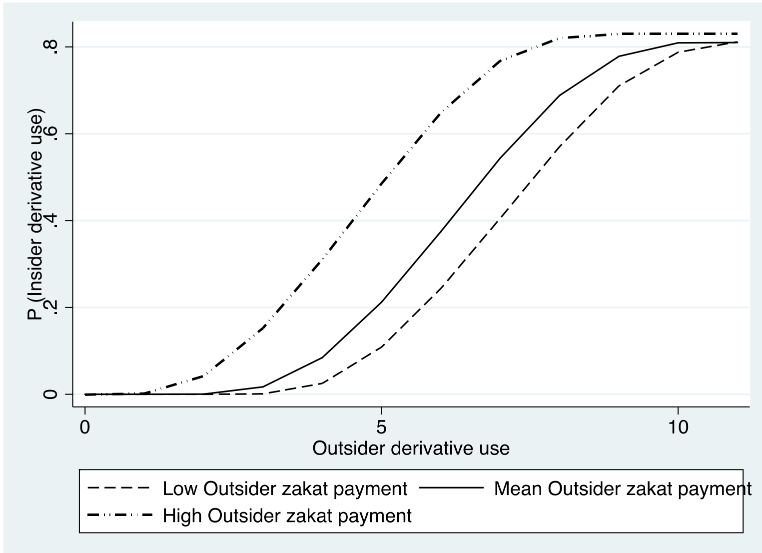

United Arab Emirates
Count of banks
0
1
2
3
4
5
6
7
8
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
Year
CB-owned banks
Full-fledged banks

FIGURE 5

Hypothesis 3: Effect of Simultaneous Outsider Code Violation and Preservation on Focal Insider Code Violation



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