

# **Comments of**

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**on**

## **Corporate Social Responsibility Papers**

Corporate social responsibility (CSR) is a subject which was dealt with by economists and thinkers from other disciplines since long time. It attracted recently increasing attention. There is a proliferation of literature on this topic especially from accountants, politicians and economists. This recent concern about CSR might be due to the process of contemporary globalization which preaches organizing the economy on the basis of private ownership and allocating resources according to market forces, among other things. Various phenomena were associated with this globalization, which have some negative and positive effects on producers, consumers and on countries developed and developing. Two negative aspects are related to our topic, CSR, might explain the reasons behind this increased attention. These are income distribution and failure of many big corporations which were believed to be financially viable and sound.

First, inequality of income distribution, both within and between countries, worsened in the last fifteen years or so, i.e. since the beginning of present day globalization. The multiple of the share of rich to poor countries in world GDP increased from 30 to almost 100. Within countries gini coefficients substantially increased denoting greater inequality of income distribution between high and low income groups. While income distribution is the result of the interaction of many variables, it is believed that a higher share of profits to GDP means greater inequality of distribution. Corporate profits have been multiplying all over the world in recent years.<sup>1</sup> Hence, these corporations should have a responsibility towards the society in which they reside to correct this distortion.

Second, the last decade of the twentieth century witnessed the collapse of many big corporations such as Enron, and others. These companies were believed to be financially sound. Their distributed profits were quite high. Their sudden bankruptcy and collapse caused wide range of social problems. One of them is a deep financial crisis which resulted in a rise in unemployment. The slow rate of economic growth negatively affected the poor. The whole international economy was harmed in a chain reaction, especially in Korea, Japan and the United States of America. In brief, it could be said that these corporations did not meet their social

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<sup>1</sup> It is not strange to note that the richest person in the world is the owner of one of the biggest corporations of the global. The source of his wealth is corporate profit either current or capital gains.

responsibilities. To the contrary, they inflicted harm on the people and societies. Consequently, it is important to make sure, as much as possible, that corporations clear their social responsibilities and have good governance and avoid excessive risks. This could be mainly achieved through striking a balance between social interests and corporations interest. That is to say between profits on one side and growth and equity on the other side.

The previous remarks were said by way of introduction to our review of Sairally, Dusuki & Dar and Farook & Lanis<sup>2</sup> papers, since they mainly deal with the same topic. The rest of this review will be organized as follow, the next section will discuss the meaning of corporate social responsibility. It will distinguish the concept of "corporate governance" from the concept of CSR. It will be followed by a presentation of Islamic banks (IB) practises with respect to CSR in addition to Islamic financial institutions (IFI) in general. The next two sections will deal with the measurement of social responsibility and the methodology and sampling techniques adopted by the authors. Next, we shall discuss the findings and results of the papers. We shall end by a brief conclusion on the subject.

## **I. The Meaning of Corporate Social Responsibility and IFI Practises**

The three papers, especially that of Sairally, went into great details in the literature to review and define the concept of CSR. There seems to be a, general consensus on adopting Carroll's definition of CSR,<sup>3</sup> which relies on determining the components of this SR. This functional definition contains four categories. These are:

1. Economic (which I prefer for our present purpose to coin it as financial for obvious reasons to economists) responsibility which could be quantified by viability, profit maximization and growth of the corporation (firm) over time.
2. Legal responsibility, i.e. to abide to the rule of law.
3. Ethical responsibility, that it is to follow the ethical and cultural principles acceptable to the society.

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<sup>2</sup> These papers are: Salma Sairally, "Evaluating the Social Responsibility of Islamic Finance: Learning from the experiences of Socially Responsible Investment Funds"; Asyraf Wajdi Dusuki & Humayon Dar, "Stakeholders" Perception of Corporate Social Responsibility of Islamic Banks: Evidence from Malaysia Economy"; and Sayed Farook & Roman Lanis, "Banking on Islam: Determinants of Corporate Social Responsibility Disclosure".

<sup>3</sup> A.B. Carroll (1979), "A Three Dimensional Conceptual Model of Corporate Social Performance" *Academy of Management Review*, 4: 497-505.

4. "Discretionary" or "philanthropic" responsibility. That is to say, factors which are not, in the opinion of the authors, directly related to profit maximization.

As for the applicability of CSR concept to Islamic businesses, Dusuki and Dar go into length to cite the Qur'ānic verses which support these 4 dimensions (p.8).

From the legal and Sharī'ah points of view, IFI should follow the generally agreed upon tenets of Islam. If they do not they will lose their credibility as the application of Islamic way of life is the *raison d'etre* of their existence. Hence, theoretically we would expect IB and IFI in general to abide by the principles of Islam. If some of these institutions do not strictly follow the Islamic rule, it is only normal and happens under any social system. This does not justify the indication of some researchers (such as Metwally 1992 and Maali, et.al (2003)<sup>4</sup> that "Islamic banks did not completely fulfil their social role in accordance with the prescriptions of Islam". This diversion, if it exists, might be due to several factors and circumstances:

- a. It might be due to differences in opinions and perceptions to what conform and that does not conform to Islamic principles. That is to say that it is a matter of value judgement, which differs among researchers, institutions and scholars.
- b. This diversion in my opinion might be due to the various difficulties facing IB in carrying out their business according to the optimal Islamic modes of transactions (*mushārahah*). The preferences of the two parties to the banking intermediation might be different. Savers (depositors or sources of funds) might prefer to invest on the basis of *mushārahah* (profit sharing) while investors (borrowers or users of funds) do not prefer this method. They usually prefer to borrow money especially at a fixed interest rate. This dilemma might force IB to use a second best solution which is much better than turning these banking to just safe boxes for money.
- c. The third possible explanation for the allegation of non-compliance of IB to their SR in accordance with Islamic principles might be due to the lack of disclosure on their side. Non disclosure does not necessarily mean that the observance of SR according to Islamic principles is violated. It needs more effort from both sides the researchers and IB. The lack of disclosure on the part of IFI might be stemming from some cultural practises. Namely, concealing charitable and good social deeds. The Qurān says "If you

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<sup>4</sup> Metwally, S, 1992, "The Aggregate Balance Sheet and the Results of Transactions and Financial Indicators for Islamic Banks and Financial Institutions, "Journal of Islamic Banking and Finance; Maali, B, Casson, P. And Napier, C. (2003) "Social Reporting by Islamic Banks", Discussion Papers in Accounting and Finance, University of Southampton.

disclose the act of giving charities they are accepted, and if you conceal them and give them to the poor it would be better for you."<sup>5</sup>

Hence, researchers might not be fully justified to state that IB did not fulfil their SR according to Islamic principles. From the Sharī'ah point of view, some SR actions are a must (*wājib*). Others are preferred (*mustahab*), which corporations are encouraged to observe. Their violation does not justify condemning IFI of breaching the principles of Islam.

Describing the discretionary dimension as philanthropic, seems to me as incorrect. Charity is a one side transaction, doing business should be distinct from charity. CSR requires, however, that Islamic corporations do some acts on a non quid-pro-quo basis. It is recommended to classify these acts as "non-price competition."<sup>6</sup> A better social image for a corporation will certainly be reflected on the demand curve which it faces. It will enable them to increase their market share. This would benefit the corporations as a result of economies of scale and greater profits.

On the other side, the concept of corporate social responsibility should not be mixed with the other concept of "corporate governance" (CG). One of the components of good CG is disclosure of financial position. As was said before corporations might not disclose information about their SR, while they carry these responsibilities very well. Although CG and CSR might intersect and overlap, it is much better to distinguish one from the other. CG, as well known, requires transparency and accountability in addition to disclosure. Maali et. al.,<sup>7</sup> as reported in Farook & Lanis (P.5), found that Islamic banks disclose less information far below the expected level. This again pertains to CG and not CSR, and it does not necessarily mean that they are less committed to SR.

Generally the three papers consider CG as a subset of CSR. From the analytical point of view, they should be kept separate. This would be reflected on the variables to be considered in measuring the determinants of CSR.

## 2. Research Methodology

Research methodology applied in the three papers is generally sound and advanced. There are, however, some remarks and suggestions regarding sampling and the coverage of Islamic financial institutions. The three papers base their analysis mainly on a sample of IFI to assess their commitment to SR. Nonetheless, the process of sampling is not presented in details. This should have been done in order to gauge the validity and exactness of the sampling techniques and results. Sairally identified a sample of 250 IFI, and received 20% responses, of which 70% were banks. Dusuki and Dar, on other hand, distributed 1780 questionnaires and

<sup>5</sup> The Holly Qur'an, *Sūrah Al-baqarah*, verse 27.

<sup>6</sup> See any book on intermediate microeconomics.

<sup>7</sup> Maali, B., Casson, P. Napier, C., op. cit.

obtained 84% responses. The questionnaires were distributed to IFI stakeholders, i.e., customers, depositors, local communities, employees, branch managers, regulators and Shari'ah advisors. They consider the sample to be very large. The soundness of the sampling process could not be assessed as no enough information on the population of which the sample was drawn were given.

Farook and Lanis use a sample of 47 observations. They consider this as a limitation on obtained results. Again, the questions regarding how representative the sample is and its randomness could not be answered. This paper depended on published annual reports by IB (P.12). This might seriously affect the results. It is common that these reports do not contain enough detailed information on SR matters as well as other variables. It should be noted, that the number of banks included in the sample differ from one country to the other. How representative these banks for each country is hard to determine. The sample included 5 Saudi banks. It is known that there is no bank in Saudi Arabia which bears the word "Islamic" on its title. It is assumed that all banks functioning in the kingdom are Islamic. It will be illuminating to know the basis of choosing these banks. This remark would also apply to the other countries included in the sample.

In sum, the three papers should give more details about data selection and sampling techniques in order to correctly assess the results and conclusions reached.

On the other hand, it is known that IFI, like the other institutions include banks and non-banking entities. Sairally's sample included 30% of non-bank intermediaries. Theoretically, it is expected that they will differ from IB with respect to SR practises. Several reasons could be mentioned. Regulators for banking institutions usually ask for more information than in the case of the NBI (nonbanking institutions). NBI are in general smaller in size compared to BI. They also rely more on personal and direct contacts. These circumstance would lead NBI to reveal less information about their SR practises. Therefore, it would have been illuminating had these two groups of institutions been analyzed separately, and the significance of the differences, if any, were reported in the paper. Both Farook & Lanis and Dusuki & Dar analyze banking institutions only. The former paper covers 14 countries while the latter relates only to Malaysia. It is recognized now more than ever, that culture matters from one society to the other although all would be Islamic. The universality of Islam can absorb different cultures applying the agreed upon general Shari'ah principles. Therefore, I believe that a more relevant variable would have been an index representing cultural difference rather than the proportion of Muslims to total population (MSPOP p.37). It would have been very useful to assess in details the variability among banks in these 14 countries. The questionnaires were directed to stakeholders including managers. It is not clear whether this was done in their personal capacity or as representing the institutions. If the case is the former, then it might be better to include these institutions as a legal entity in the questionnaires. It is also known in the theory of

"Principal – Agency" that agents do not necessarily follow the instructions of the principals and consistently act in their interest. Farook & Lanis point briefly to the agency problem in their paper (p.13). Directing the questionnaire to the principals might contribute to more disclosure on the side of IFI and how they evaluate their social responsibility role.

Furthermore, these studies could have included a control sample of non-IFI in the same communities with almost the same financial circumstances and characteristics. This would make better comparisons rather than relying on the results of other papers.

### 3. CSR Measurement

The results of quantitative analysis could be seriously affected by the quality of data and the degree of clarity of the concepts used. Hence, the question of the way social responsibility is measured is crucial. Sairally's cites the variables used by Haron & Hisham<sup>8(8)</sup> which measure SR (p.9). These are: proportion of *qardḥasan*, distribution of financing by sector, *zakāh* contribution and overdraft they provide to preserve Islamic culture. I disagree with most of these variables as a measure for SR. *qardḥasan* should not be the basis of doing financial activities. An IB might have small proportion of *qardḥasan* and carry a high degree of SR. Similarly, the distribution of financing by sector depends on the institution's policies rather than their SR. *zakāh* is determined by Shari'ah, and IFI has nothing to do with that.

Dusuki and Dar cites 12 elements for the measurement of CSR (P.17). These are: product price, customer service quality, convenience, vicinity to work, friendly personnel, knowledge and competence of personnel, Islamic working environment, reputation, respect of human rights, Islamic image, involvement in the community, and environment impact. These variables were grouped in four categories relating to environment, human resources philanthropic and human rights. Sairally's (p.15) cites similar variables. Those who responded to Sairally's questionnaire seem to expect a gigantic role to be played by IFI. This could be seen in responses such as community development, ethical, sustainable development etc.

The dependent variable in Farook and Lanis paper is "an index of expected CSR disclosure of Islamic banks operating in Muslim countries. Again, as was said earlier we are trying to explain CSR and not just its disclosure. The independent variables in his model are quantifiable, however, they do not fully represent the determinants of CSR. This will be seen, as discussed in the next section, by the small coefficient of determination,  $R^2$ , although there are 6 explanatory factors.

On the whole, the papers did big effort to measure the dependent and independent variables in the study of CSR. They conform to the general stream of

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<sup>8</sup> Haron, S. and Hisham, B. (2003), "Wealth Mobilization by Islamic Banks: The Malaysian Case", paper presented at the International Seminar on Islamic Wealth Creation, University of Durham.

papers on the subject. It seems to me that there is a need for more efforts to be directed to clearly measure the meaning of SR. The limitations mentioned above obviously might seriously affect the findings and results.

#### 4. Findings and Results.

The three papers under review confirm the generally agreed upon phenomenon of the growth of Islamic banks and financial institutions during the last three decades. Theoretically they also expect that these institutions would fulfil their social role inherent in the Islamic social system. They, however, try to test somewhat different aspects of the subject. Farook and Lanis on one hand, was trying to "measure the CSR disclosure levels... and subsequently ascertain their likely determinants". They tried to test four null hypothesis which are listed in table 1 with the results:

*Table 1: Null-Hypothesis Testing Results*

Null-Hypothesis	Results	
	Direction the relationship	Significance
<b>No.1.</b> There is a negative association between the level of political and civil repression and the level of CSR disclosures.	as expected	non-significant
<b>No.2.</b> There is a positive association between the proportion of adherent Muslims and the level of CSR disclosure	as expected	significant at 5% level
<b>No.3.</b> There is a positive association between Islamic governance scores and the level of CSR disclosure.	as expected	significant at 1% level
<b>No.4.</b> There is a positive association between the proportion of investment account holders (IAH) to shareholder funds and the level of CSR disclosure	as expected	significant at 10% level

It should be noted that the regression equation used by Farook and Lanis has 6 independent variables. The determination coefficient,  $R^2$  in both the main and optimal models (0.459 and 0.528) are relatively small. About 50% of the variability in CSR disclosure is not explained by these variables. The authors should have looked for other factors substituting IAH which is marginally significant. The paper should have also tested for multicollinearity between Islamic governance score and the proportion of adherent Muslim. It is a bit strange that the association between the level of political civil repression and the level of CSR disclosure was not significant. Did the author make a run for the regression omitting this variable? The general conclusion that "the majority" of Islamic banks disclose less than expected would be due either to measurement deficiencies or to cultural and social

factors. The recommendation to Islamic banks to disclose more should be acceptable.

As for the findings of Dusuki and Dar they found that:

1. Stakeholders in Malaysia apply more importance to IB reputation and the quality of service as factors of CSR compared to the other factors in banking selection criteria.
2. There is a significant disagreement among stakeholder groups on reputation & service delivery quality and CSR. There were, however, no significant disagreement among them regarding convenience and product price.

These results are expected.

The finding of Sairally reveal that 80.9% of respondents allocate SR to IFI, of which 63.8% equate the importance of financial gains with social objectives, 27.7% see the former more important to the latter. As for financial practitioners response to the responsibility of morally- motivated economic and financial activities 48% agreed or strongly agreed that this should be the responsibility of "social organization", while 32% disagreed and 20% were neutral. About 96% of the responding financial practitioners agreed that SR creates value for IFI. The statement, "The practise of Islamic finance was not thought to be as socially responsible as the views voiced out by financial practitioners" p.23 needs more substantiations. In general, we would agree that IFI should disclose more information on their social activities and be more transparent.

## **5. Conclusion**

The papers under review dealt with the subject of CSR from various angles. One of the questions which were raised relates to the possible contradiction between profit motives and social responsibilities. Other questions were about disclosure, the elements of CSR, stakeholders view about their priorities in patronizing IB, and how Islamic financial practitioners evaluate the conformity of these institutions practises to Islamic principle. The general consensus seems to be that IFI are not philanthropic entities. They are commercial institutions which seek to realize profit, either on the basis of profit maximization or any other goal. This practise does not mean that they do not observe SR, which does not contradict with profit maximization. All firms and corporations under various social systems, including Islam, are required to abide by these social responsibilities. This SR might be looked upon as "a constraint" in the process of profit maximization. From another angle it seems that the right classification of SR should be an element of "non-price competition" rather than "philanthropic action".

As for the differences in the evaluation among stakeholders it is only natural that human perceptions and preferences would differ from one individual to the other. The lack of disclosure does not negate that IFI meet their SR. It is



recommended to separate the concept of CSR from corporate governance although disclosure might be a common element to both.

The three papers pointed to the limitations of their conclusions. Further research is required to arrive at definite answers which would greatly benefit Islamic financial institutions, economists, accountants and the public in general.

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