

# Comments of

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on

## **Corporate Social Responsibility of Islamic Banks**

This Discussion Report deals with three papers on corporate social responsibility (CSR) of Islamic banks. Islamic banks are essentially financial organizations whose objective is basically to make profits in a *ḥalāl* (permissible) way. However, in line with the normative principle of a “sharing and caring society” in the Islamic code of life, it becomes a social responsibility on the part of Islamic banks to shoulder social responsibility along with personal interests. Not only in Islamic banks, CSR has now been emphasized even in the conventional business enterprises as well. Although the emphasis on CSR is a recent phenomenon in the conventional wisdom, it has been emphasized right from the beginning of the concept of Islamic banking. The research and inquiry into the extent of CSR with respect to Islamic banking is, however, quite a new endeavour. The authors of the three papers under consideration deserve credit for delving into this new and important area of investigation. The three papers under consideration are as follows.

1. Sayd Farook and Roman Lanis, “Banking on Islam? Determinants of Corporate Social Responsibility Disclosure.”
2. Asyraf Wajdi Dusuki and Humayon Dar, “Stakeholders’ Perception of Corporate Social Responsibility of Islamic Banks: Evidence From Malaysian Economy.”
3. Salma Sairally, “Evaluating The ‘Social Responsibility’ of Islamic Finance: Learning From The Experiences of Socially Responsible Investment Funds.”

All three papers seem to agree on a single point that Islamic banks must shoulder social responsibility. But the specific areas of their enquiry are different. Following the thematic sequence of the papers, the third paper “seeks to evaluate the Corporate Social Responsibility (SRC)” of Islamic banks or Islamic financial institutions (IFIs), thus determining how socially responsible IFIs are in their objectives, actions and commitments as a socio-economic contributor to human welfare”. The second paper aims to explore the perceptions of the various

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stakeholders of Islamic banks regarding their social responsibility with special reference to Malaysia. The first paper examines the degree of CRS disclosure of Islamic banks in their annual reports and its possible determinants.

We would like to make some comments on these papers and then contribute to this discussion by clarifying the degree of Shari'ah imperative of CRS of Islamic banks vis-a-vis the authors' perceptions.

### **1. Comments on the Paper by Farook and Lanis**

1. The authors propose to investigate corporate social responsibility (CSR) of Islamic banks by studying CSR disclosure. To them, Islamic banks operate in accordance with Shari'ah principles and "Merged with this function is the social role of Islamic banks that entails social justice and accountability, requiring the banks to disclose corporate social responsibility (CSR) information" (p. 1). This view is indicative of a problem in the basic premise of the study. CSR role does not require CSR disclosure, which may even be negatively related. Higher levels of piety and Islamicity, which lead to higher levels of CSR, may lead to lower levels of CSR disclosure since, to many, CSR disclosure may seem to amount to "showing off" or "*riyā*" which is discouraged in Islam. Methodologically, this may defeat the whole purpose of the study since, if this has some bearing on the scale of CSR disclosure, lower CSR disclosure may be indicative of higher Islamicity of Islamic bankers with higher corporate social performance (CSP).

2. The question is this: Is CSR disclosure more important or CSP? If the objective is to study the CSP of Islamic banks, which is expected to be so, then it is more relevant to collect data on social welfare activities of Islamic banks and study their determinants, rather than CSR disclosure. This is because, due to the reason mentioned above, CSR disclosure is not expected to give a true picture of CSP of Islamic banks.

3. The authors collected data on CSR disclosure from Islamic banks. Even if one intends to base it on CSR disclosure, the annual reports alone may not be enough to provide information on CSR. Apparently, it seems to be a tradition of Islamic banks to report their CSR activities separately in brochures and "Activity Reports," rather than annual reports, which are mainly meant to report accounts instead of functions. Thus, depending on the annual reports alone will not give correct picture of even the CSR disclosure, thus under-reporting the scale of CSR disclosure. For example, Islami Bank Bangladesh Limited (IBBL) is very active in social welfare activities, which has a separate foundation by the name of Islamic Bank Foundation to perform functions related to CSR. The examination of its Annual Report 2004 shows that it does not present much information on its CSR activities. The report consists of a few lines on social welfare activities, giving merely the titles of major activities, and consisting of just one figure of Tk. 109.43

million<sup>1</sup> that was spent in 2004. It did not even mention the *zakāh* that it distributed. Besides provisions for payment of *zakāh* on deposits, and other income and assets through this bank, IBBL pays *zakāh* at the rate of 2.5% on share premium, statutory reserve, general reserve, investment loss offsetting reserve, exchange equalization, and dividend equalization accounts. These *zakāh* payments are definitely related to social welfare activities.

4. The authors' findings show, "The mean disclosure for the 47 banks in the sample is approximately 16.8% of expected disclosure"<sup>2</sup> (p. 24). Does it mean that their CSR is under-disclosed? If yes, it is under-disclosed or under-reported by more than 83%. That is, Islamic banks disclose CSR significantly less than expected. Two options are possible:

- i) Islamic banks disclose CSR less than what they do, that is, an understatement of CSR performance. It is a good sign since the actual performance is better than disclosures in the annual reports.
- ii) Disclosure is the real picture of actual CSR performance, which is less than expected. If this were the case, it would not be desirable CSR performance on the part of Islamic banks.

However, the probability of the second option is slim. This is because if the disclosure is the real picture of the actual CSR performance of Islamic banks, there is no justification of investigating the determinants of disclosures, since the only determinant is the actual CSR performance. The study shows that the factors determining levels of CSR disclosure are: (i) levels of repressions and openness of societies under which the organizations operate; (ii) the degree of influence of the "relevant publics" on the organizations, and (iii) the existence of Shari'ah Board's monitoring resulting in greater Shari'ah compliance.

In other words, irrespective of the actual CSR performance, the levels of CSR disclosures will depend on the above factors. The author's findings show that Islamic banks actually disclose less than expected, or they fail to disclose the full extent of their CSR performance. In other words, they under-disclose their CSR performance.

## 2. Comments on the Paper by Dusuki and Dar

1. A reconsideration of the structure of the paper will probably improve the paper. After some discussion on the relevance of corporate social responsibility (CSR) in Section 3, the learned authors move directly to research methodology (Section 4) and research findings (Section 5). It would be useful to have a formal *a*

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<sup>1</sup> The exchange rate is around US\$ 1 = TK. 65.

<sup>2</sup> It is not made clear in the paper how is the size of the expectations determined.

*priori* analysis leading to objectives and hypotheses<sup>3</sup> for testing by empirical studies, followed by testing of the hypotheses as to their probable acceptance or rejection based on the findings.

2. CSR variables are voluntary as rightly mentioned by the authors, “In general, CSR is essentially a concept whereby companies decide voluntarily to contribute to a better society and a healthier environment” (p. 5). However, three out of four CSR dimensions mentioned by the authors are not voluntary in the Islamic or Islamic banking sense, but rather these are compulsory and binding from Sharī‘ah point of view, and hence these are Sharī‘ah imperatives instead of voluntary CSR imperatives. These are built in the Islamic system, without which the Islamic banking will not be Islamic. There cannot be a “balance between profit objective and these social objective” (p. 9), since these Sharī‘ah imperatives are binding. These three Sharī‘ah imperatives are human resource dimension, human rights dimension, and environmental dimension, and the voluntary CSR aspect is the philanthropic dimension (p. 6).

The authors’ findings suggest that the stakeholders value CSR factors positively for banking patronage along with other factors, which is a commendable finding. Although it seems that the stakeholders will not abandon Islamic banks even if their CSR performance is not as satisfactory,<sup>4</sup> Islamic banks should always keep in view their social responsibly in order to uphold the Islamic principle of establishing a “caring and sharing society”.

### 3. Comments on Salma Sairally’s Paper

1. Some structural modifications will probably improve the paper. After introducing the subject, the learned author provides literature review in Sections 2 and 3. Thereafter, she presents Wood’s<sup>5</sup> concept of CSP measurement consisting of three facets, followed by research methodology and an empirical analysis. It would be useful to provide, in addition to a modified version of the literature review, a formal theoretical exposition and an *a priori* analysis of the position taken by the author on the issue under consideration, a formal hypothesis to be tested by empirical investigation, research methodology, empirical investigation, followed by findings and conclusions.

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<sup>3</sup> The authors have, however, mentioned null hypothesis in the Section on Research Methodology. It is better to mention hypotheses formally and separately and then proceed to discuss how to test them (Research Methodology), rather than null hypotheses alone, which is to nullify. It is a rational sequence to start with what, followed by how; rather than how followed by what.

<sup>4</sup> This is because the Islamic banks seem to have succeeded in attracting patronage by professionalism rather than by emotional belief alone.

<sup>5</sup> D. J. Wood (1991), “Corporate Social Performance Revisited”, *Academy of Management Review*, 16 (4): 691-718.

2. Although a formal theoretical exposition and an *a priori* analysis of the position taken by the author on the issue under consideration are missing, the author's view can be understood from her passing remarks here and there. Let us look at some of the statements:

“The apparent divergence in the practise of Islamic finance from its initial objectives of targeting general human well-being is the problem that motivates this study” (p. 5).

“... How does the practise of Islamic finance compare with the theoretical promise of the discipline to create an innovative financial system for bringing about social and economic benefits to the Islamic world?” (p. 9)

Such statements of the author bears testimony to the fact that, according to her, the objectives of Islamic banks or Islamic financial institutions (IFIs) are mainly “general human well-being” or “to create an innovative financial system for bringing about social and economic benefits to the Islamic world”.

Now the question arises, “Are these objectives and targets Islamically binding?” If this is claimed, “How to substantiate such a claim”? And, “Who sets objectives for whom?” Has any IFI set such targets or objectives? The Islamic bankers are essentially businessmen who do business by raising financial capital by following the Shari'ah-approved methods of finance. Is it Islamically permissible for a person to set objectives and targets for somebody else?

Obviously, such targets and objectives of banks are similar to those of specialized financial institutions set up by governments without consideration of any direct economic gain, profit, or even economic efficiency and viability. In case of such specialized financial institutions set up by governments, any losses are borne by the government. This fact seems to have been perceived and understood even by the author herself when she mentions, “These are conventionally recognized objectives assigned to state banks and development agencies, hence attributed to IFIs as they are called upon to play a role in socio-economic development” (p. 5).

Now one may ask, “Would it be permissible to impose such welfare type objective of specialized public and charitable organizations to private business?” Would such impositions violate human rights or *ḥuqūqul 'ibād*, which the CSR functions are supposed to safeguard? Assigning such responsibilities to some private business organizations (just because they are IFIs) by excluding other Muslim businessmen would probably involve injustice (*zulm*),<sup>6</sup> which is not permissible in Islam.

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<sup>6</sup> This is because as a Muslim, each and every businessman has similar CSR. Imposing something extra on somebody excluding other similar category of people is against objectivity and justice.

3. In empirical analysis, the author found that the IFIs do appreciate social responsibility. She states, "According to the data, the theoretical understanding and ethical implications of Islamic finance by Islamic financial practitioners were observed to be consistent with the emphasis placed on social responsibility by the Islamic economics literature" (p. 25). However, according to the author, their behaviour was not consistent with declared perceptions. This is because, although almost all the IFIs spend some amount for shouldering social responsibilities, the amount spent as percentages of their earned income is not encouragingly large.

A closer look into the matter will not probably justify the author's view that the perceptions of IFIs and their behaviour are really conflicting. This is because a positive attitude towards social responsibility does not require a certain minimum of spending for the purpose. Spending for social welfare, no matter how much is the amount, proves compliance of social responsibilities. Besides, Islamic methods of finance in themselves have positive implications for social welfare (elimination of interest has equity and other welfare implications, financing only the permissible activities, and other practises of IFIs produce social benefits).

#### **4. Sharī'ah Imperative of CSR of Islamic Banks**

In this Section, I would like to supplement and complement in the discussion of the present topic with respect to corporate social responsibility (CSR) of Islamic banks.

There is a general trend in the discussions of Islamic banking to assign such responsibilities to Islamic banks that are normally assigned to public sector welfare organizations, specialized development institutions in the public sector, charitable organizations, or Islamic *da'wah* organizations. Such a notion can also be perceived from different statements of the three papers under consideration. Let us consider some statements of these papers and other authors.

Sairally mentions in her paper: "The apparent divergence in the practise of Islamic finance from its initial objectives of targeting general human well-being is the problem that motivates this study" (p. 5). "... How does the practise of Islamic finance compare with the theoretical promise of the discipline to create an innovative financial system for bringing about social and economic benefits to the Islamic world?" (p. 9). In addition, "the practise of Islamic banking and finance is argued to be evolving along the same self-interest, profit-gearred motive .... That, in the first place, it was set to oppose" (p. 4). These financial institutions are often blamed for mission statements with a view for "optimizing shareholders value", "improving efficiency", and "aiming at superior financial performance" (p. 22)

To Dusuki and Dar, "Thus, the concept of CSR ..... Is a natural commitment of Islamic institutions particularly Islamic banks whose objectives are directed towards making brotherhood, social equality and equitable distribution a reality in Muslim societies." (p. 7)

According to Farook and Lanis, “Merged with this function is the social role of Islamic Banks that entails social justice and accountability, requiring the banks to disclose corporate social responsibility (CSR) information” (p. 1).

Some other authors seem to subscribe to similar views about CSR of Islamic banks. For example, Usmani asserts that the philosophy behind Islamic banking was “aimed at establishing distributive justice free from all sorts of exploitation”<sup>7</sup>. Islamic banks “were supposed to adopt new financing policies and to explore new channels of investment which may encourage development and support of small scale traders to lift up their economic level”<sup>8</sup>.

“Islamic banks are expected to disclose relevant CSR information to discharge their responsibility and to earn legitimacy for their continued existence”<sup>9</sup>.

According to such views, the prime objectives and functions of Islamic banks boil down to the achievement of general human well-being; bringing about social and economic benefits to the Islamic world; making brotherhood, social equality and equitable distribution a reality in Muslim societies; establishment of distributive justice; development and support of small scale enterprises; discharging of corporate social responsibility (CSR), including its disclosure. To some, these seem to be such strict obligations that these are not merely moral responsibility, but rather these are necessary for the legitimacy of their existence. Furthermore, not only they must do it, but they must also prove it by disclosing the relevant information that they have done it. Otherwise, they lose right to exist (and hence they should probably be closed down).

On the hand, the Islamic banks have been blamed for self-interest, profit motive, profit maximization, economic efficiency, and for aiming at superior financial performance.

To me, these are serious issues which should be addressed carefully with Islamic objectivity rather than emotions, following the Sharī‘ah perspective without being loaded with one’s personal spirit of altruism, which is highly valued in Islam, without making it obligatory, and without imposing one’s high level of piety on others as long as they remain within the Sharī‘ah boundaries. We need to determine the boundaries, insist on all concerns to remain within the boundaries, and encourage them to approach the level of perfection without imposing it upon them. We need to understand that there is a large range and space of permissibility within the boundaries with different levels of piety and altruism, from a very high level in which one may spend for the society everything beyond his/her one-day’s

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<sup>7</sup> Usmani 2002, p. 113 quoted in Farook and Lanis, p. 1.

<sup>8</sup> Usmani (2002, p. 116, quoted in Farook and Lanis, p. 2.

<sup>9</sup> Sadeghzadeh 1995; Baydoun and Willett 2000; Haniffa 2001; Lewis 2001; Maali *et al.* 2003, quoted by Farook and Lanis, p. 9.

needs, to a level where one limits his/her societal obligation to the payment of *zakāh*.

With this introductory note, I would like to make some comments on some specific issues, without addressing them fully due to space constraint.

*Self-interest:* Safeguarding or pursuit of interest of the self or self-interest is one of the objectives of Sharī‘ah (*maqāṣid al-sharī‘ah*). After all, *īmān*, *a‘māl*, *‘ibādah*, and refraining from many attractive things of the world are for self-interest of achieving *falāḥ* in the *ākhirah*. Similarly, Islamic banking or any other business is for self-interest of earning profits, which has been made not only permissible, but also obligatory in Islam. However, it has to be achieved by following the permissible ways, without affecting the interests of others and the society. Besides, one is required to share the “personal interest (income and wealth)” with the society during its utilization through the institution of *zakāh* and through other channels. This Islamic concept of self-interest is different from the western one, which allows self-interest at the cost of social interest.

*Profit motive:* Earning profit and hence profit motive is not only allowed, but rather it is encouraged, in Islam. Man has been commanded to search for the bounty of Allah after prayers, and honest and trustworthy businessmen have been assigned very high status in Islam. Without any doubt and hesitation, all these activities are to earn *ḥalāl* living by making profits. In fact, sometimes we speak against profit maximization due to lack of understanding of the term. Profit maximization simply means, if we have several options (strategies), we accept the one that gives maximum possible benefits (profits), without violating the constraints.<sup>10</sup> I am not aware of anything in Islam that prohibits or even discourages this.

*Economic efficiency:* It is not permissible in Islam to adopt a strategy that is less efficient, if more efficient strategies are available, known, and accessible. The Prophet (saw) advised us to do a job in an efficient way, and even in slaughtering an animal by sharpening the knife. Therefore, each and everybody must strive to achieve efficiency, including economic efficiency in all economic activities along with Islamic banking, by aiming at superior financial performance. Obviously, this economic efficiency would of course be without affecting the others (without affecting *ḥuqūq al-‘ibād*). Such economic efficiency is an Islamic and Sharī‘ah imperative, rather than being discouraged in Islam.

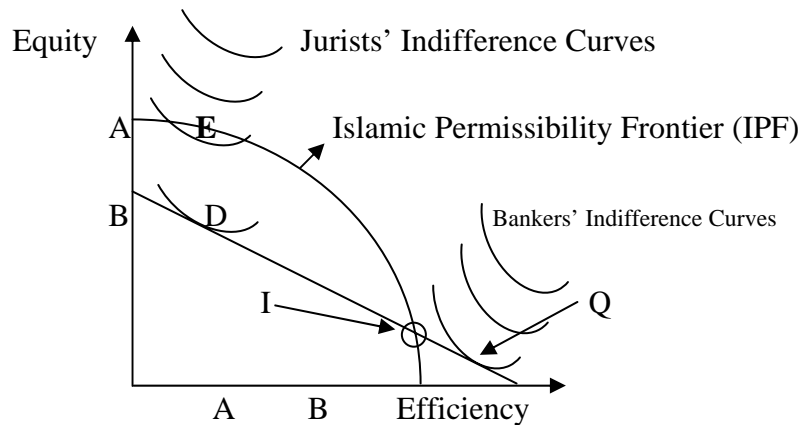
It is asserted that jurists are in favour of equity as against efficiency.<sup>11</sup> This has been explained by a diagram, to show that jurists’ preferred indifference curve would be inclined to “Equity-axis”; while the bankers’ preferred indifference

<sup>10</sup> In Islamic economics, both economic and moral constraints will be effective, while in conventional economics, only the economic constraints are considered.

<sup>11</sup> El-Gamal (2000), quoted by Sairally, p. 10.



curves would be inclined to “Efficiency-axis” in an indifference map, as in the following diagram.



This assertion may not be true. This is because the jurists emphasize justice and permissibility, which is given by the Islamic Permissibility Frontier (IPF), AA. Jurists' emphasis on the principle of *ʿadl* (justice) may go away from equity, while the Islamic principle of *ihsān* may take it closer to equity. Let us take an example of two friends, X and Y, going out together for fishing, but catching fish separately (it is not a sharing or joint activity, and hence everybody will get his own fish). Incidentally, Mr X catches 10 kilograms of fish, while Mr Y is unable to catch any fish. The justice-verdict of the jurists will be that Mr X will get all the fish, while Mr Y will get nothing. Clearly, this juristic verdict makes the fish distribution perfectly un-equal. Now, the role of *ihsān* comes in. The Islamic principle of *ihsān* may motivate Mr X to give some fish to Mr Y for his family members, who are waiting for fish. Thus, the jurists' verdict emphasizes justice leading to the Islamic Permissibility Frontier, which does not contradict with efficiency.

We need also to understand that Islamic banks should stand on its professionalism and efficiency in order to succeed, instead of being based on Islamic emotions of the clients for their patronage and survival. Islamic banks should be able to pass the efficiency test to justify that the Islamic system is superior to other systems.

*Social Responsibility:* Islam recognizes private ownership, encourages *ḥalāl* earning, and it does not put any limit to earnings and wealth provided these are earned by *ḥalāl* means, without affecting *ḥuqūq al-ʿibād*.<sup>12</sup> However, in the

<sup>12</sup> *Huqūq al-ʿibād* consist of rights of all concerned involved in the production process, including just pricing of the factors of production, rights of all those who are not directly

disposition of the earned income and wealth, Islam does assign a societal share and right. A minimum level of this share and right is given by the institution of *zakāh*, while no upper limit to social responsibility has been fixed. The upper limit will depend on the level of one's *taqwā*, piety, and Islamicity. The minimum level will be imposed and enforced by the state agency, while the other levels will be left to the persons concerned, although the state may impose something officially beyond the minimum under certain circumstances.

This social responsibility is applicable to individuals as well as business enterprises including Islamic banks. There is no reason why one business will be different from others. Thus, corporate social responsibility (CSR) of Islamic Banks is not supposed to be different from other businesses run by Muslims. If it is claimed to be different, or if Islamic banks are required to behave like a social welfare or charitable organization, this position must be substantiated. Otherwise, it may turn out to be violating *ḥuqūq al-ʿibād* (denying the due rights of Islamic banks), which is not permissible in Islam. It is not also allowed to insist *nafl* (spending beyond *zakāh*) over *farḍ* (Shariʿah imperative of safeguarding the rights of Islamic banks).

It is observed that many of us tend to assign such functions to Islamic banks, which are really the functions of specialized organizations, social welfare organizations, or charitable organizations. For example, some assign to Islamic banks such functions as fulfilment of broad socio-economic benefits, focus on promising economic sectors, job creation and stimulation of entrepreneurship, maintenance and dispensation of social justice, establishment of equity and fairness, alleviation of poverty, promotion of regional distribution of investments (Sairally, pp. 5-6).

Obviously, these are not functions of a commercial bank or any private business organization, but rather of specially established social welfare or charitable organizations, which cannot be imposed on any private business enterprise, including Islamic banks.

One need to go deeper into these issues. In this context, the basic questions that we need to ask are: Is business allowed? If yes, is it allowed to make profits? If yes, is it allowed to adopt a strategy of economic efficiency in business? Is it allowed for the business partners to benefit from the business, or is it necessary to commit everything for the society? What is the "MINIMUM" that a Muslim "MUST" commit for the society?

Once such questions are addressed, we need to further ask the following questions: In what sense a banking business is different from any other business? In what sense the social responsibility of Islamic banking business is different from

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involved in the production process but are indirectly affected through environment, externalities, and so on.

any other business run by Muslims? Or, under what justification, Islamic banking must be a social welfare or charitable organization (if this is not required for any other business)?

It seems that the degree of emphasis on CRS of Islamic banks in the existing literature are based, at least, to some extent on personal religious emotions motivated by the spirit of altruism, rather than objective Sharī'ah imperatives, which needs clarification, justification and substantiation. In this context, we need to refer to the fact that the level of *'azīmah* is not binding, but rather optional, and there is a need to consider the boundaries consisting of the level of *rukḥṣah* (the level of permissibility).

To conclude, it is important to address these issues for a clear perception regarding the degree of CSR on the part of Islamic banks that are binding, including the extent of their CSP and its disclosure. Once the parameters, which are binding from Sharī'ah point of view, are substantiated from the basic Islamic sources, rather than just quoting from different authors, one may proceed to investigate compliance between Sharī'ah imperatives and Islamic banking practise in the real world situation.

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