

Corporate Reporting and Social Responsibility
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CSR & Islamic Finance



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1 Executive summary

Corporate Social responsibility(CSR) has become a significant and substantial issue for practitioners in the past decades. It should contribute to sustainable development by delivering economic, social, environmental, ethical and philanthropic benefits for all stakeholders. (William B; 2006;Carrol 2003)

The concept of CSR is in line with the principles of Islamic Finance which is growing rapidly in the worldwide as the main principles of Islamic Finance are the prohibition of interest and the sharing of profit and loss. With the focus on ethical value and social responsibilities, CSR can be perceived as a religious obligation for IBFIs. Compared with western banks, the concept of CSR in Islam has a broader meaning since the religious responsibility is unique and compulsory for Islamic Finance, they are required to keep socially responsible and maintain the justice.

While implementing the practice of CSR, there is a positive relationship between profitability and CSR spending, and it is also a good approach for Islamic banks to raise their reputation and realise ethical values. However, despite benefits brought by CSR, Islamic Financial institutions have to face the challenges from the lack of supportive environment, huge consumer base, standardisation and a unified CSR system, which makes it difficult for IBFIs to execute the practice of CSR and have greater impact on the society. A unified system and an interdisciplinary platform are recommended to help Islamic finance with social projects.

2 Introduction

The main purpose of this report is to demonstrate the nature and principles of Islamic Finance and also critically discuss the benefits and challenges that IBFIs may encounter when implementing CSR practices. Recommendations related to this issue and differences between the application of CSR in western and Islamic banks are also given in this report.

3 Main Findings

3.1 Discussion of the meaning of the term CSR.

Emerged in the 1950s in the US, corporate social responsibility (CSR) is a much debated subject in contemporary business community. Carroll(1979) defined the term as ‘the social responsibility of business encompasses the economic, ethical, legal and discretionary expectations that society has of organisations at a given point in time’. Another key word ‘stakeholders’ appeared in various versions of the definitions of CSR, for instance, European

Commission (2005) defined CSR as ‘a concept whereby companies integrate environmental and social concerns in their business operations and interactions with their stakeholders on a voluntary basis’. With the diversity of theoretical perspectives and conceptual approaches, to certain extent, there is no strong consensus on the definition of the term CSR. (Mc Williams et al., 2006)

3.2 Key Drivers of CSR

CSR has risen to unprecedented prominence throughout the global business market over the past decades. There are five key drivers of the popularity of CSR: 1) Increasing affluence: since there are more options available with the growth of economy, customers are more likely to pay a premium for a brand that deserves trust. (William B 2006) 2) Changing social expectations: in developed societies, consumers expect the firms to behave in a more appropriate manner and relative to society since citizens are more aware of social and environmental issues. (Miller 1999) 3) Ecological Sustainability: concerns over environmental issues have fueled the CSR discussion and protecting the sustainable future is providing long-term availability of the resources that firms depend. (William B 2006) 4) Globalisation and free flow of information: the growing influence of global media makes consumers exposed to different views and more aware of high-standard company policies, so only authentic and transparent companies who apply CSR are more likely to profit in the long term. 5) Brand reputation: some companies attempt to build core image which is associated with socially responsible behaviours and CSR is an ideal way to promote reputation (Fripp 2017).

3.3 The nature and principles of Islamic Finance

Since the 1960s, Islamic finance has experienced half a century of dramatic growth and development. More than 300 financial institutions in more than 75 countries around the world are involved in Islamic finance (Hassan 2018). Compliant with Sharia's law, Islamic banks operate an interest-free system (Qadri 2008) and are based on the concept of sharing risk and reward between the depositors and investors. There are four principles in Islamic finance: Risk-sharing, Materiality, No Exploitation and No Financing of Sinful activities (Khan 2019), and the main principles of Islamic principle are the prohibition of interest and the sharing of profit and loss (Castro 2012).

As Islamic financial institutions lay their ideological foundation in ethics, they put the welfare of the whole society in the first place and attempt to engage in Shariah-based banking, which worships God in the finance sphere. (Khan 2013)

3.4 Islamic Finance and CSR

With initial and idealistic social objectives to reduce economic inequalities, alleviate poverty, establish justice, forbid all forms of exploitation and promote the welfare of society, Islamic Banking and Financial Institutions (IBFI) are expected to act consciously as 'socially responsible' (Cebeci 2012) and relate to the practice of CSR. At the same time, a positive relationship can be found between CSR expenditure and the banks' profitability, and IBFIs are not irresponsive to this strategy due to their identifications as business entities. (Migdad 2017)

3.5 Benefits of implementing CSR in Islamic Finance

Firstly, according to the research conducted by Migdad (2017) among Palestinian Islamic banks, implementing CSR practices and making these practices visible and connected with the community and customers have positive effect in maximising market share. Besides, Sabri (2016) concluded that there is a positive relationship between bank's profitability and the level of CSR disclosure in the case of Gulf Cooperation Council (GCC) Islamic banking.

Secondly, CSR can also be perceived as a religious obligation since the practice of CSR is highly related to ethic and social responsible, which satisfies the objectives and purposes of Shariah's board requirements. At the same time, the prohibition of Riba (interest) and the principles of financial assistance provide a solid foundation for the framework of CSR in IBFIs.

Thirdly, the positive impact of CSR lies in bank reputation and further impact on financial performances. For instance, Meezan Bank offer Shariah-compliant product and services to different level of business, community groups and individuals to establish itself as a well-trusted bank and show genuine adherence to Shariah's law. The bank holds the certificated credentials, corporate awards and great appreciation for its CSR performances and initiatives such as supporting small business, farmers, relatively weak economic groups and other neglected social individuals and it makes contribution to the economy of Pakistan in the past years. (Khan 2016)

3.6 Challenges in implementing CSR in Islamic Finance

On the one hand, in several regions such as Palestine, there is no specific approach or strategy for CSR or unified plans of CSR's implementation. Although each Islamic bank engaging in CSR may have its own specific procedures, it is dynamic and unsettled and can only make plans in a limited way. (Migdad 2017)

On the other hand, Islamic finance lacks social impact of CSR's practice at the public level. Compared to conventional banks in western societies, institutionalisation is a main problem for IBFIs, which is posed by complicated structures of the modernity. For example, NGO and governments are able to contribute directly to the economy with the practice of CSR, including providing guidance for entrepreneurs and allocating resources for the future capitalist economy. However, it is insufficient for Islamic banks to follow the procedures. For instance, Kuveytturk Bank recruit interns from among college graduates and sponsor sport activities while conventional banks such as TSB can directly provide scholarships to students, distribute free books and target environmental problems. The lack of institutional structure leads to the decline of productivity and less use of resources. (Cecebi 2012) Moreover, current IBFIs have to operate in western economy and may be shaped by the capitalist mindset, which means they lack sufficient political and economic power to influence the public opinion and develop social projects and are also not supported enough by social and legal infrastructure. (Mohammed 2007)

Additionally, Islamic banks do not have as sound a customer base as conventional banks do, which means certain practices may not be accomplished in western capitalist systems and IBFIs may fail to achieve goals in the short run (Cecebi 2012)

3.7 Recommendations

It is recommended that a unified CSR system should be set up to broaden CSR and make it acceptable to more audience and have greater impact on financial community. Moreover, a transparent and committed system would help eliminate randomness and help standardisation. (Migdad 2017) However, it is also argued that CSR should be left free from systemic applications and rules to keep the voluntary nature of CSR. A un-unified CSR could operate with different priorities to meet various needs of different communities. Therefore, the implementation of a unified CSR needs further discussion in future studies.

An international social platform such as 'CSR forum for Islamic Banking' is suggested to be created and fulfill institutionalisation. The main tasks of such platform are to produce a variety of projects for IBFIs and bring academic or professional specialists in diverse fields such as psychology, sociology, law and economics to help Islamic banks.

3.8 Differences between Islamic banks and Western banks engaging in CSR

In terms of CSR, both Islamic finance banks and conventional western banks share certain similar core values, such as commitment to the social responsibility, ethical transactions,

promotion of community welfare, concern for the global environment and attention to social and economic justice.(Beebee 2013) However, the religious factor is an additional element that guides the principles of Islamic finance. IBFIs are acquired to abide by two levels of regulatory laws: an external check for banking and financial laws; and an internal check by religious and under the review of Shari'ah supervisory board.(Beebee 2013). The rule of morality, law, justice and the taqwa(God-consciousness) dimension are the foundation of the concept of CSR in Islam.

Therefore, the obligations and rights of individuals and organisations are clearly defined and regulated by religion, which build a solid base for IBFIs to apply CSR and realise ethical values. By contrast, in western communities, there is a lack of consensus about ethical codes which may be affected by realistic factors.(Lewis and Unerman, 1999; Maali et al., 2006). For certain groups, an action may be acceptable, while it may be unacceptable to other groups.

Technical matters such as the calculation of zakat and the prohibition of usury are also CSR differences between Islamic and conventional banks(Kamla 2006), which leads to a gap between the ideal concept and the practice of CSR in Islamic Finance.

4 Conclusions

The concept and implementation of CSR is a trending issue during the past decades, and at the same time, Islamic Finance is gaining attention in financial community, who is also closely connected with CSR. Despite the benefits of implementing CSR, such as better reputation, market share and a way to show adherence to Shariah's law, challenges and problems also occur. There is a lack of supportive environment and institutionalisation for Islamic banks to apply CSR in west, which results in weaker impact at the public level and smaller consumer base. It is recommended to found a unified CSR system to improve its acceptance and attract more audience. An interdisciplinary platform focused on CSR is also expected to be created to help Islamic Finance with social projects.

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