

# Evaluating the ‘Social Responsibility’ of Islamic Finance: Learning From the Experiences of Socially Responsible Investment Funds

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*In order to fulfil the Shari‘ah objective of promoting the welfare of society, Islamic financial institutions (IFIs) are expected to consciously align their decisions and actions so that these are ‘socially responsible’. An integral policy approach towards corporate social responsibility (CSR) would constitute assigning explicit social objectives to IFIs over and above their economic, legal, Shari‘ah, and ethical responsibilities. Alternatively, the task of undertaking socially oriented projects could be argued as being a discretionary responsibility of IFIs, with the objective of CSR being sought merely as a peripheral practise. Recent debates on the evolution of the practise of Islamic finance highlighted the profit and economic efficiency motives of IFIs rather than a concern for socio-economic equity and welfare. A divergence between the economics literature on Islamic finance and the course taken by the practisal field of Islamic banking and finance has been argued to be arising over the years. An assessment of this contention motivates this study. It seeks to evaluate the Corporate Social Performance (CSP) of IFIs, thus determining how socially responsible IFIs are in their objectives, actions and commitments as a socio-economic contributor to human welfare. It also seeks to learn from the experiences of secular ‘socially responsible’ investment (SRI) funds which promote ethical finance in the West.*

## **1. Introduction**

The ethical credentials of Islamic financial institutions (IFIs) make them attractive to not only Muslims but to also a wide spectrum of ethically-conscious consumers who desire a socially just financial system. Banking on the ethical qualifications of Islamic finance, mainstream financial institutions in the West – like HSBC (UK), Citibank (USA), Banque Nationale de Paris (France) and UBS (Switzerland) – have embraced Islamic financial principles and offer Islamic financial products to Muslims who seek alternatives to the *ribā*-ridden conventional financial system whilst they still highlight the relevance of these

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products to the larger society, especially the ethically-concerned. To this end, Islamic finance as a concept has been compared with parallel appealing themes like socially responsible investments (SRI). Based on similar core values – such as individual responsibility, commitment to the social interest, promotion of human welfare, care for the environment, concern for economic and social justice, and upholding the responsibility to shun harmful and unproductive activities – Islamic finance has been promoted as a socially responsible paradigm rooted on religious tenets.

Inspired by other philosophical notions of ‘human accountability before God’ and ‘man’s role as a vicegerent on earth’ (Ahmad, 1980: 178) which guide Islamic economic and financial practises, individual and institutional investors are led to be concerned with not just ‘what’ kinds of activities their money is financing but also with the ‘way’ projects and activities are funded. They seek the deployment of funds in a *ḥalāl* (Islamically permissible) way. Thus, the practise of Islamic finance would avoid investments in areas involving interest (*ribā*), uncertainty (*gharar*), alcohol, tobacco, drugs, pornography, prostitution, gambling, armaments, animal experimentation, genetic engineering, financial exploitation – areas which are considered to be “value destroyers” (Khan, 2001).

Founded on such socially laudable values, the practise of Islamic banking and finance has been institutionalised and has experienced impressive growth over the recent decades. As of 2004, Iqbal and Molyneux (2005: 1; 65-66) quote the prevalence of 70 Islamic banks (excluding those in Iran and Sudan), 40 conventional banks offering Islamic banking windows, 200 Islamic investment funds and 70 Islamic insurance companies, with a total market operation exceeding US\$ 150 billion.

Despite the progress made and the growing maturity of the industry several criticisms have been levelled against the practise of Islamic finance – some even questioning the ethical credentials of financial practitioners as they are said to be “bereft of any deep felt commitment to the sector” (Parker, 2004: 2). Parker (2005: 2) further argues that the pursuit of profit maximisation and shareholder value by IFIs often overrides the supposed faith-based ethical principles, which turn into “mere mechanisms for a means to an end”. In this respect, Parker (2005: 2) quotes one Islamic banker who states:

“As far as (my bank) is concerned, we are very committed to the development of the Islamic financial market. It is a means to enhance our shareholders’ value. From an institutional perspective we do not see Islamic banking either as a religious requirement or a social need. We see it more in terms of how we might enhance shareholders’ value.”

At one point, doubts were also raised on the shari‘ah compliance of the *murābahah* (mark-up) mode of financing which resembles modes that are closer to interest. *Murābahah* is for instance reproved for violating the Prophetic rule of sale

prior to possession of the good (Badawi, 1997: 20). While the religious permissibility of *murābaḥah* is granted, its heavy bias in the portfolio of Islamic banks – which is often explained by the financial necessity and economic rationality of the instrument (Yousef, 2004: 64) – relative to the use of profit-and-loss sharing arrangements, has subjected the practise of Islamic finance to further criticisms.

More recently, debates among academicians and practitioners have been directed towards the very objectives of the discipline: the practise of Islamic banking and finance is argued to be evolving along the same self-interest, profit-g geared motive – the homo-economicus postulate of the neo-classical literature – that, in the first place, it was set to oppose. Islamic finance is observed to be developing in several countries as an “elitist phenomenon without much grassroots level appeal” (Dar, 2002: 48). Being in competition with mainstream financial institutions, IFIs are keeping pace with new financial developments. Islamic alternatives to hedge funds, securitisation and market indices are recent additions to the industry. Islamic investment managers are now targeting high-net-worth and even super-high-net-worth individuals and financial institutions – a growing practise observed in the Middle-East. According to El-Gamal (2000), financial experts and practitioners appear to devote more attention to the achievement of ‘economic efficiency’ than be concerned with the principle of ‘socio-economic equity’. A rift between the economics literature on Islamic finance and the course taken by the practisal field of Islamic banking and finance is therefore argued to be arising over the years.

The apparent divergence in the practise of Islamic finance from its initial objectives of targeting general human wellbeing is the problem that motivates this study. The aim is to appraise this contention and determine how ‘socially responsible’ IFIs are in their objectives, actions and commitments as a socio-economic contributor to human welfare. To this end, the literature on corporate social responsibility (CSR) which defines social responsibility issues and theories of corporate social performance (CSP) which shed light on the assessment of corporations’ social responsibility has been drawn upon. This study accordingly rises to the call of some academicians – like Ḥasan (2005) and Tag el-Din (2005: 45) – who voiced out the need to evaluate the performance of IFIs with reference to their contribution in meeting their social responsibilities.

Concurrently, this study seeks to investigate how the socially responsible role of IFIs could be enhanced. The experiences of western SRI funds have been examined in our quest to promote human wellbeing.

## **2. Islamic Financial Institutions and Social Responsibility**

Early contributors to the Islamic economics literature specifically assigned a key socio-economic role, above the principle of profit maximisation, to all the

operators of the financial system – from the central bank to the private commercial Islamic banks and non-bank financial institutions (NBFIs). These views are held by economists like Chapra (1985) and Siddiqi (1983). According to Chapra (1985), the Islamic financial set-up imposes upon IFIs an extra parameter – a socio-economic purpose – in addition to the responsibilities assigned to them by conventional financial laws. The Handbook of Islamic Banking (1982), cited by Warde (2001: 174-175), mentions a number of socio-economic objectives to be endorsed by IFIs. These are conventionally recognised 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.

- 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.

At an institutional level, central banks would have the added responsibility of overseeing that IFIs do not cause wealth and power to be concentrated in the hands of a few. Commercial banks on their part are expected to act as universal banks, being profit geared as well as catering for societal needs. Islamic commercial banks are exhorted to attribute public funds “to serve the common interest and no individual gain” (Lewis and Algaoud, 2001: 95).

In general, an Islamic firm – by extension an IFI – is believed to be distinctive in its behaviour, since according to Mannan (1992: 120), it can not be guided by the single objective of profit maximisation. It is argued that its behaviour “needs to be guided, among others, by the consideration of altruism – a concern for others to be shown as a principle of action” (Mannan, 1992: 120). While conforming to the principles of sharī‘ah is believed to be essential in the behaviour of a firm, it is argued that each and every firm must also ask ‘What contribution is the output of the firm going to make?’ or ‘Who are the beneficiaries of the value-added component of the product of the firm?’. In this respect, a concern for others – including all the stakeholders of the firm and not only the shareholders – is expected to be internalised within the operations of a firm, including IFIs.

This preceding argument is related to the discussion of corporate social responsibility (CSR) which has gained increased attention since the 1990s. CSR is generally associated with the concern of companies for the welfare of society (Gitman and McDaniel, 2002: 107). Holme and Watts (2000) define CSR as

follows: “Corporate Social Responsibility is the continuing commitment by business[es] to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large”. Carroll (1979) utilises a more sophisticated approach in defining CSR in terms of four expectations that society has of corporations – that they will respectively fulfil their economic, legal, ethical and discretionary responsibilities.

- The economic responsibility is for the business to be foremost profitable, efficient and viable.
- The legal responsibility is to obey the laws and regulations of the land.
- The ethical responsibility covers society’s expectations of businesses over and above the legal requirements – responsibilities that embody ethical norms which are not necessarily codified into law.
- The discretionary responsibility is the expectation that the firm will assume social roles over and above those already mentioned and be a good corporate citizen by caring for and investing in the society it operates in.

By attributing a social role to Islamic financial operators in the economy, where concern for the wider society is integral to the operations of the firm, early contributors to the discipline of Islamic economics and finance implicitly subscribed to the CSR model advocated by Carroll (1979). The model where businesses are focused on operating their core activities in a socially responsible way for solid business case reasons is usually referred to as the “European model” (Baker, 2004; Worthington et. Al., 2003). It is commonly alleged that fulfilment of ones ethical and philanthropic responsibilities – along with maintaining a profit seeking strategy – brings tangible benefits to the business. Some of the recognised benefits are reported to be: improved corporate reputation; better management of long term risks by protecting the business from being involved in irresponsible social and environmental scandals; increased employee satisfaction; stimulation of learning and innovation as companies identify new market opportunities; improved market positioning and long term profitability (Little, 2003).

Being philanthropic is nonetheless perceived as the highest level of responsibility of a business, considered after the economic, legal and ethical responsibilities have been respectively met (Gitman and McDaniel, 2002: 110). In the case of financial institutions, they are evidently not charities. Yet, the trend observed since the 1990s has been an elevation in the provision of financial services to a prominent social role such that banks and NBFIs have been reengineering their products, processes and services in order to have a greater social impact (Mayo and Guene, 2001: 1). This trend can be recognised under the

labels of “social banking”, “ethical investment”, “micro-financing” and “community reinvestment”.

On the other hand, an alternative model has been proposed by academicians like Ismail (1986) and Tag el-Din (2003) who prefer to allocate IFIs as part of the commercial sector of the economy and instead assign morally motivated economic and financial activities to the third sector which is non-profitable. The proponents of this argument classify the economy into a distinctively three-sector financial system comprising the government sector, the market sector (also known as the commercial sector), and the philanthropic sector (also called the welfare or third sector). Consequently, as argued by Ismail (1986), Islamic banks which belong to the commercial sector will have responsibilities to their shareholders and depositors and not to the larger society. The task of fulfilling socio-economic objectives, like voluntary spending, institutionalising *zakāh* or investing in community projects, would not fall under the responsibility of IFIs. As an alternative, socially-oriented projects would be undertaken by NGOs and social organisations which situate themselves in the third sector.

This alternative approach in the role of IFIs could be compared with Friedman’s (1970) view of operating a business. A socially responsible business, according to Friedman, is for it to “use its resources and engage in activities designed to increase profits so long as it stays within the rules of the game, and engages in open and free competition without deception or fraud” (Friedman, 1970: 126). The financial priorities, while undertaken within the limit of free competition and legal responsibility, should thus rank as the prime concern of a business. The social benefit of the business would be its contribution in the creation of wealth and employment. Being ‘charitable’ should not figure among a business’ objectives. Conversely, Friedman would argue that those put in charge of the business (managers, board of directors) have no right to dispense of shareholders’ money in the form of overt charitable activities as their role is to increase wealth for shareholders rather than giving it away (cited in Boddy, 2002: 129). Philanthropy, in this case, would only be a peripheral practise of the business. This model is commonly referred to as the “American” or “philanthropic” model in the literature (Baker, 2004; Worthington et. Al., 2003). Friedman’s view that the social responsibility of businesses is to increase profits is also referred to as the “efficiency” view (Rodriguez et. Al., n.d).

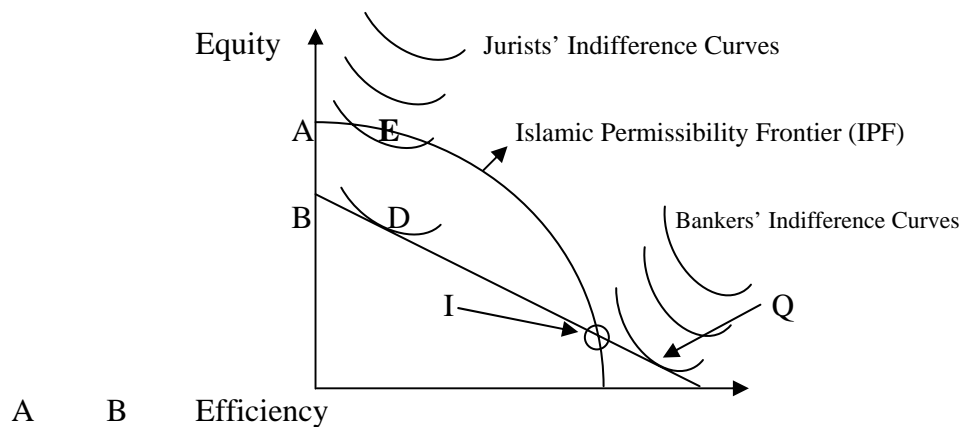
Following the above discussion, the question we pose is, firstly, how does the practise of Islamic finance compare with the theoretical promise of the discipline to create an innovative financial system for bringing about social and economic benefits to the Islamic world? Secondly, it is asked whether the practise of Islamic finance subscribe to the integral European model or the peripheral American model of CSR.

### 3. Debates on the Practise of Islamic Banking and Finance

#### Evaluating the Performance (Practise) of Islamic Banking and Finance as an Alternative Source of Ethical Investment

Discussions by El-Gamal (2000) and Halim (2001) have highlighted a divergence occurring between the literature of Islamic economics – which emphasises the attainment of socio-economic goals by IFIs based on recourse to the *maqāṣid* al shari‘ah – and the contemporaneous practises of these institutions. El-Gamal (2000) argued that the preferences of Islamic financial practitioners are more biased towards considerations of profits and efficiency, similar to those operating in the conventional financial sector, and in contrast to the considerations of equity favoured by Islamic jurists. The author illustrated his argument through Figure 1 (reproduced with modifications) which portrays the position of jurists and bankers in their choice between equity and efficiency. These two parameters are subject to the permissible set of allocations allowed by shari‘ah (curve AA) and the financial technological constraints (line BB). According to El-Gamal (2000), the “closest permissible point” that financial practitioners will choose is point I – which is situated along the Islamic Permissibility Frontier (IPF), is subject to the current financial technology, and is as closest as possible to the efficiency level of conventional financial products. This point, however, substantially lacks the equity criteria, of concern to jurists.

Figure 1: Divergence between Islamic Economics and Islamic Finance



Point E: Tangency of the jurists' indifference curves with the IPF, reflecting jurists' ideal choice of high level of equity. This point is currently not achievable because of the current financial technology which is still evolving and requires more decades of trial and error. Financial technologies have been defined by El-

Gamal (2000) as “institutional frameworks that render certain types of contracts and transactions feasible”.

Point Q: Represents choice of high level of efficiency of mainstream bankers and financial experts.

Point D: Represents choice of some Islamic financial practitioners, to maximise jurists’ preferences of equity while being subjected to the financial technological constraints. However, point D is socially inefficient as it is inside the IPF.

Point I: Represents “the closest permissible point subject to the current financial technology” which many financial experts end up choosing. Financial products offered are therefore within the bounds of sharī‘ah permissibility, of high efficiency but having lower equity characteristics.

Source: El-Gamal (2000)

Siddiqi (2004) also alluded to the divergence occurring between the goals of Islamic finance and Islamic economics as he states “modern finance tends to develop as an independent activity, complete with its objectives and methods, orchestrated by a distinct set of players. It is undoubtedly part of the economy but it does not necessarily share the goals of the economy. True to the conventional paradigm, its objective is to maximize profits”. Siddiqi (2004) partly ascribes this “alienation” of Islamic finance from Islamic economics on the overemphasis placed by jurists on *fiqh* (Islamic jurisprudence) in order to derive financial and economic rulings instead of complementing the *fiqh* approach with the *maqāṣid* al sharī‘ah – which envisions the economic and financial system as part of the Islamic way of life and not limits it to only the realm of Islamic law. He argues that the “primacy of rules and regulations over goals and objectives” is to be blamed for the unsolved social problems like poverty, inequality and corruption. Badawi (1997: 20) termed this practise as compliance to the “text of the law” while there is neglect of the “spirit of the law”.

Siddiqi (2004) further observed the emphasis placed on monetary gains by IFIs. He argues that modern financial institutions are much engaged in the “financial engineering” of products which is profit-driven whilst there is neglect of “social engineering” which is inspired by social goals. Some of the new developments in the industry, for instance, relate to the launching of Islamic bonds (*ṣukūk*), development of Islamic market indices, securitisation of assets, and the development of hedge funds. These latest financially engineered developments undeniably highlight the efforts made by Muslim jurisprudents and practitioners to evaluate whether new financial products could be absorbed in the Islamic financial system. At the same time, these developments indicate the move of Islamic finance towards sophisticated financial products and practises that target high-net-worth investors or institutional investors rather than small savers, and on the surface, point to the profit motive of IFIs.



Similarly, raising objections on the way the profits arising from Islamic funds are being channelled in the coffers of large institutions, Parker (1996:2) states: "There has yet to be an Islamic fund launched which is aimed at the ordinary investor. All the numerous Islamic investment funds currently on the market are aimed at high net worth individuals and institutional investors." The objective of empowering the larger society – in other words, the 'social responsibility' of financial institutions – is questioned in this respect.

Some empirical studies have been conducted to verify this statement. A study by Haron and Hisham (2003) on the fulfilment of socio-economic objectives by two Malaysian financial institutions, Bank Rakyat and Bank Islam Malaysia Berhad, found that the socio-economic development aspect of the institutions was lacking. The banks' socio-economic performance was measured in terms of (i) the proportion of *qard* hassanah (benevolent loan) dispensed, (ii) the distribution of their financing by economic sector, (iii) their *zakāh* contribution, and (iv) the overdrafts they provide and activities they support to preserve Islamic culture (Haron and Hisham, 2003). The authors attributed the observed down-play in the socio-economic objectives of the banks on the fact that they are operating in a mixed economic-conventional banking systems environment, where their survival rests on how successfully they compete with their mainstream counterparts. As Islamic banking is "still in the making", their activities had to be "commercial as opposed to predominantly socio-economic". It would therefore be expected that social welfare oriented activities of Islamic banks will increase as these institutions become more established.

Yet, retracing the developments of Islamic banking and finance since its early experimentation in the 1960s, Dar (2004) pointed out how the initial thinking had socio-economic development as its principal motive for establishing an alternative financial system based on the principles of justice and equity. The precursors to Islamic commercial banking involved the idea of social and community banking, institutionalised through the Mit Ghamr Savings Bank (1963-67) and the Nasr Social Bank (1971) in Egypt. The launch of the Islamic Development Bank (1973) in Jeddah also showed a concern for development banking at an international level.

In line with Siddiqi's (2004) arguments, Dar (2004) also believed that the initial thinking on the discipline considered the practise of banking and finance as an integral part of the Islamic economic system, designed to achieve policy objectives like sustainable development. The modelling of Islamic banking and finance, Dar (2004) states, has however shifted the emphasis from social banking to profit-and-loss sharing and profit motive. To this end, the focus has been on such activities like product development, financial engineering, efficiency building, viability and profitability and, if a social role is to be endorsed, it is only made peripheral to the activities of the institutions.

#### **4. Theoretical Concepts for Measuring the Social Responsibility of Islamic Financial Institutions**

The practise of measuring the social responsibility of a corporation has been termed as Corporate Social Performance (CSP) in the literature. This has developed as thinking on CSR has matured, shifting from definition onto measurement aspects. Principally CSP measurement embraces three aspects, commonly denoted as CSR1, CSR2 and CSP (Frederick, 1978).

CSR1 defines the CSR principles as classified by Carroll (1979) in terms of the economic, legal, ethical and discretionary responsibilities expected of a firm by society.

CSR2 relates to “corporate social responsiveness”, examining the response of firms towards the CSR principles.

CSP discusses the “outcomes” of the implementation of CSR policies and their measurement.

These three facets of CSP measurement have been advanced by Wood (1991) who has fine-tuned other models like those of Carroll (1979) and Wartick and Cochran (1985). Wood (1991: 693) has defined these three stages as an evaluation of “a business organization’s configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and observable outcomes as they relate to the firm’s societal relationships” (emphasis added).

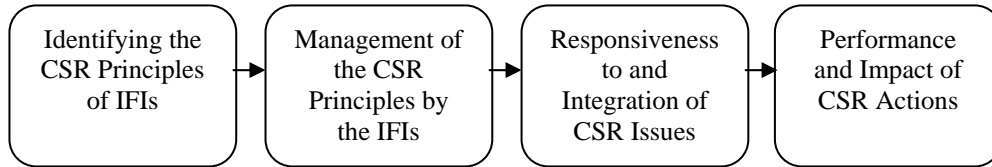
A stakeholder approach has also been advocated by Clarkson (1995) and Donaldson and Preston (1995) who determined the CSR impact on the stakeholders of a firm.<sup>1</sup> The main theoretical models of CSP are depicted in Table 1 in the Appendix.

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<sup>1</sup> The stakeholders of a firm are classified mainly into two categories – internal and external. The National Association of Accountants (NAA) committee on accounting for corporate social performance defined the following actions of a firm which will have an impact on these stakeholder groups (Epstein et. al., 1977).

- *Human resource development*: This includes activities directed towards the welfare of internal stakeholders like employees and managers.
- *Community development*: This includes socially oriented activities that are of benefit to one major category of external stakeholders – the general public. Examples are financing housing construction, providing grant for educational purposes, scholarship to students, financing of health services, etc.
- *Product or service contribution*: This includes activities meant to improve service provision to another key category of external stakeholders – customers. Examples are improved product quality, good customer relations, customer security, protecting financial privacy, removing financial exclusion, etc.

Adopting Wood's (1991)<sup>2</sup> model of CSP measurement as a basis of assessing the social responsibility of IFIs, the following schema could be used to describe the assessment procedure.



The ensuing questions are posed as a way of finding proxies for the four stages of the assessment procedure.

#### 4.1 Identifying The CRS Principles Endorsed by IFIs

In stage one, the understanding of and attitudes towards CSR issues by financial practitioners<sup>3</sup> are assessed. The CSR issues endorsed by the IFIs are also identified.

- What do financial practitioners understand by the terms 'corporate social responsibility' or 'to be socially responsible'?
- How do financial practitioners define Islamic finance? Is their view of Islamic finance comprehensive enough to cover CSR issues which impact on the community and the environment?
- Do financial practitioners assign a social responsibility function to financial institutions?
- Do they believe that IFIs should emulate the objectives of western SRI funds?
- What CSR issues are stipulated to be the concern of the IFI?

#### 4.2 Assessing the Management of CRS Issues By IFIs

After identification of the CSR issues, their management and analysis are evaluated in stage two.

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. *Physical resources and environmental contribution*: This includes activities directed towards environmental conservation or alleviation of environmental deterioration – the environment being a further key external stakeholder to the firm.

<sup>2</sup> Wood's (1991) model has been chosen as the measurement model in this study as it is by far described in the literature as the key contribution to CSP modeling in the 1990s (Igalens and Gond, n.d.: 3).

<sup>3</sup> "Financial practitioners" is the general term used in this study to include bankers, investment or fund managers, and financial experts working in IFIs.

How does the IFI rank financial gains vis-à-vis social objectives? Do financial practitioners place more emphasis on efficiency/profits or ethics/social responsibility/equity?

- Do financial practitioners perceive the existence of a conflict between profitability and the social objectives of their financial institution?
- Do financial practitioners believe that being socially responsible can create value for their organisation?
- Would financial practitioners rather shift the responsibility of undertaking morally motivated economic and financial activities to ‘social organisations’ instead of attributing the responsibility to IFIs?

### 4.3 Evaluating IFIs’ Corporate Responsiveness to CSR Issues

In stage three, the ensuing questions are raised to evaluate whether IFIs are reactive, defensive, accommodative or proactive towards CSR issues, as defined by Carroll’s (1979) processes of firms’ responsiveness towards CSR issues.<sup>4</sup> An institution is defined as “reactive” when it fulfils its legal responsibilities; “defensive” when it meets its legal and economic responsibilities; “accommodative” when it accomplishes its legal, economic and ethical responsibilities; and lastly, “proactive” when it discharges the four expectations that society imposes upon it.

- Does the IFI publicize its criteria of investment selection?
- Do financial practitioners classify their organisations as “socially responsible”?
- Does this declaration of “social responsibility” by the IFI reflect in a further declaration of socially responsible objectives or socially responsible mission and vision statements?
- How far does the IFI report its social, ethical and environmental effects arising out of its economic activities to particular interest groups or to society at large? In other words, how well-grounded is “corporate social reporting” within the firm?

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<sup>4</sup> Faced with a CSR issue, a firm’s initial “reaction” could be to resist a change in its behaviour, or at best, ensure that its actions are in the first instance strictly legal. According to Sethi (1979), “reactive” firms are motivated by the “search for legitimacy”. If its actions are raising social pressures and turning into an economic issue where its profitability is at stake, it can “defend” these issues through public relations approaches. If the issue is however turning into an ethical and economic concern, it can perhaps adopt the “accommodative” stance by changing its response to conform to society’s expectations. A “proactive” firm progresses to “solve the problem” and “lead the industry” through exemplary behaviour.

#### **4.4 Measuring the Outcomes of CSR Actions for IFIs**

Socially responsible actions of the financial institution could be measured through the firm's commitment of its resources towards such issues. Hence, in stage four the following questions are asked in an attempt to appraise the CSP of IFIs.

- If the IFI includes a social responsibility function among its objectives, does this reflect in the organisation's participation in activities which add positively to the community, human resource development, product or service contribution and/or environmental contribution?
- What percentage of its profits does the IFI attribute to activities which enhance community development, human resource development, product or service contribution and/or environmental contribution?
- What is the view of financial practitioners on the contribution of IFIs towards sustainable development or socio-economic welfare?
- Based on the activities the IFI is involved in, does CSR seem to constitute a peripheral or minimalist activity of the institution? Or does CSR appear to form part of an integral management strategy?

### **5. Research Methodology**

As a means of drawing information on firms' activities and performance, Igalens and Gond (n.d.) quote Decock-Good (2001) who suggested the following five data sources: (i) annual reports; (ii) pollution indices as a measure for environmental impact; (iii) questionnaire-based surveys; (iv) corporate reputation indicators produced by magazines of international repute; and (v) data produced by specialised organisations assessing socially responsible corporate behaviour, for example in the form of indices. In this study, analysis will be based upon mainly the responses to a questionnaire-based survey. In addition, data cross checks will be carried out through the information made available on the institutions' websites and published in annual reports.

To this effect, the methodology employed in this study is empirical, including both qualitative and quantitative approaches. It has required the collection and gathering of data from a sample of IFIs. Around 250 Islamic banks and NBFIs, from a wide number of countries, were contacted to complete a questionnaire-based survey which included mostly closed-ended questions. The questionnaire sought to gauge the financial practitioners' ethical and theoretical understanding of Islamic finance and establish the social responsibility function of the institutions by questioning, among others, the definition of Islamic finance, the role of IFIs in meeting social objectives, activities the IFIs are involved in and their screening criteria of investment selection. In this way financial practitioners' theoretical understanding of the discipline of Islamic economics and finance was compared to

the practise of IFIs to evaluate any divergence referred to in current debates. About 20% of the questionnaires were completed. Respondents were from both banks and NBFIs from some 19 different countries.

The quantitative approach of the study involved the statistical analysis of the data received from the institutions using the statistical package SPSS. The qualitative approach emerged through discourse analysis of mission statements, annual reports and data posted on websites.

## **6. Gauging the Social Responsibility of Islamic Financial Institutions: An Empirical Analysis**

Some 20% of the questionnaires (48 in total) were received from financial institutions from 19 different countries. 70% of the responses were from banks. The highest returns received were from the UK, Turkey, Pakistan and Bahrain. The age group of the respondents was mainly from the range 35-45 years (38.5%) and 25-35 years (26.9%). Most of the respondents were highly qualified with 46.2% holding a Masters degree and 30.8% PhDs.

### **6.1 Identifying the CSR Principles Endorsed By IFIs**

About 41.7% of the respondents related the concept of ‘social responsibility’ to the role played by IFIs towards community development (Table 2). They utilised key wordings like “responsive to social needs”, “community development”, “civic awareness”, “social obligation to the public and themselves”, and “community oriented” in their definitions. The second largest group (27.8%) associated ‘social responsibility’ with social justice, against financial exploitation, concern of the haves for the have-nots. Key words like “ethical” were used by 13.9% of the respondents while “concern for the environment” or “sustainable development” was used by only 5.6%.

On the other hand, 70.8% of the respondents who defined ‘Islamic finance’ attributed a comprehensive definition to the discipline, equating it with the prohibition of *ribā*, trade without interest, a socially acceptable just financial system, and a human-oriented environmentally-friendly financial system (Table 3). The social responsibility of Islamic finance was therefore seen by the majority as inclusive of community development, social justice, environmental policies, non-usurious and trade related activities. Those who chose this response were mainly from the age group 25-35 (26.7%) and 35-45 (40.0%) years old, showing their agreement to the socially committed Islamic economics literature which evolved in the 1970s, some 30 years ago. The respondents were from countries like Pakistan, Bahrain, Brunei, and Malaysia. Those from the UK (62.5%) and Turkey (80%), for instance, attributed Islamic finance to the more limited definition of “trade without interest” and “a socially acceptable just financial system”, excluding environmental policies and community-oriented policies. This corresponds to the fact that most of

the IFIs in the UK and Turkey mainly pursue trade financing activities (Tables 4 and 5).

About 60.9% also tend to agree that Islamic finance is a third way between capitalism and socialism. Some 17.4% however remained neutral to the statement and 21.7% disagreed. Consistent with the earlier broad definition of Islamic finance, about 53.1% ranked "Islamic finance represents an integrated system of financial affairs which includes the civil society, the state and the private sector" as the first criterion for equating Islamic finance with the third way concept. Only 18.8% classified this criterion as fifth in the ranking they assigned to the definition of Islamic finance. This again shows that financial practitioners believe in conveying a larger responsibility to the role of Islamic finance. Another equally large group of 53.8% however also viewed the answer "Islamic finance prohibits *ribā* and encourages trade" as their first reason for the discipline to be defined as the third way. This reflects a more limited role being equated with Islamic finance. Table 6 in the Appendix provides more details of the results.

Further evaluating the theoretical understanding of Islamic finance by financial practitioners, the latter were queried whether they would attribute a socio-economic purpose, in addition to financial and legal responsibilities, to IFIs. Some 80.9% of the respondents agreed to the statement of which 75.0% were from the age groups 25-35 and 35-45 years. It was further observed that those who strongly agreed or agreed to assign a social responsibility function to IFIs also favoured the broad definition of Islamic finance incorporating the prohibition of *ribā*, trade without interest, socially acceptable just financial system, and human-oriented, environmentally friendly financial system (70.2% as reflected in Table 7).

At the same time, those who strongly agreed or agreed to allocate a socio-economic responsibility attribute to IFIs (37 respondents out of 45 or 82.2%) equally favoured the idea that IFIs should emulate the social, ethical, environmental (SEE) objectives of SRI funds which are prevalent in the West (28 out of 37 or 75.6%). Overall, otherwise, 63.0% of Islamic financial practitioners agreed that IFIs should adopt the SEE objectives of SRI funds in their quest for sustainable development; 23.9% remained neutral to the idea and 13.0% disagreed.

Around 84.4% of the respondents also believed that IFIs should not hesitate to spell out their ethical policies in their mission statements – a practise which is adopted by SRI funds. However, when questioned whether their financial institution publicize its ethical criteria for investment selection, a relatively lower percentage of 77.8% responded positively, indicating that one's belief is not always translated to practise. Around 79.2% of the respondents revealed the criteria of selection for their institutions' investments. These screening criteria are delineated in Table 8.

It is noticed from Table 8 that criteria like "not investing in impermissible activities", "not investing in *ribā*", and "not investing in the arms industry" ranked

the highest in the IFIs' choice of screening criteria. This result reflects the common attitude of Muslims to primarily define Islam, and by extension Islamic finance, with what 'we should not do' as compared to being positive and proactive. It is interesting to note that even the western SRI movement initially started by defining negative screening criteria to determine the reasons for not investing in a company. Gradually, the movement shifted to positive screening and advanced to other proactive criteria like promoting "thematic investment" (selecting companies that represent industries of the future), "shareholder advocacy" (e.g. voicing out ethical concerns by accessing board meetings), and "community investment" (e.g. Investing in projects that improve local areas). The results could therefore be said to be reflecting the early stage that Islamic finance is currently in. Yet the data would indicate a progressing state of the practise since, as observed from the table, a slightly significant percentage of 55.3% would choose investments in companies that contribute positively to society. This is suggestive of a move in the understanding of financial practitioners towards inclusion of positive screening or more proactive investments within Islamic finance.

A percentage of 44.7% would however still invest in forward currency transactions and not invest in profit-and-loss sharing instruments. The latter evidence supports the commonly cited criticism raised in the Islamic finance literature about the lesser prevalence of financing instruments like *mushārah* and *muḍārah* as compared to *murābahah* and *ijārah*. As regards the non-avoidance of forward currency instruments, a possible explanation could be the use of these instruments as hedging tools.

Environmental issues appear to be of minor concern to Islamic financial practitioners. As shown in Table 8, about 52.6% would not be concerned about investments in environmentally polluting economic activities and about 60.5% would not take initiatives for investing in environmentally friendly activities. Thus, it is observed that although *sharī'ah* prohibits waste and excessive exploitation of non-renewable resources and encourages the maintenance of environmental and ecological balance, IFIs are yet to incorporate such essential values as a deliberate decision policy to be practised within the Islamic financial arena.

## 6.2 Assessing the Management of CSR Issues by IFIs

On basis of the high percentage of respondents who agreed to allocate a social responsibility function to IFIs (80.9%), the survey queried whether financial practitioners perceived the existence of any conflict between profitability and the social objectives of their institutions. To the question "how does the financial institution rank financial gains vis-à-vis social objectives?" the majority (63.8%) said they are equally important. About 27.7% viewed financial gain as more important, 6.4% ranked it as less important and 2.1% were of the opinion that it is not important. Of those who viewed profits and social objectives as equally important, 82.7% were of the opinion that an IFI should be socially oriented. About 77.0% of those who considered financial gain as more important paradoxically still



agreed/strongly agreed to this assertion. We would have believed that their inclination in favour of the profit motive would have resulted in a higher percentage disapproving the idea of ascribing a social mission to IFIs on the ground that community oriented projects may be less remunerative compared to projects focused on high-net-worth individuals or institutions. Instead, as reflected in Table 9, only 7.7% did so. As such, a socially responsible attribute to IFIs primed among the opinions of financial practitioners.

To further ascertain the abovementioned conflictive outcome, the financial practitioners were evaluated on whether they would prefer that 'social organisations' rather than 'financial institutions' be made responsible for undertaking morally-motivated economic and financial activities which have a socio-economic purpose. In general, 48.0% agreed/strongly agreed to this statement; 20.0% remained neutral; and 32.0% disagreed/strongly disagreed. Cross-tabulating the results of the "ranking of financial gains in comparison to the social objectives of IFIs" with the question relating "social organisations versus financial institutions to be made responsible for socially-oriented economic activities", it was observed that among those who considered financial gain as more important, 85.7% viewed social organisations as more suitable to carrying out socially-geared economic activities (agreed and strongly agreed). Although upon first perusal of the data, the respondents whose objective was high returns appeared to allocate a socio-economic responsibility to IFIs, they still seemed to prefer social organisations to take over this role. Consistently, among those who allocated equal importance to profits and social objectives, 46.7% disagreed/strongly disagreed with the statement that social organisations should be made responsible for morally-motivated economic transactions (Table 10).

Cross-checking whether those who disagreed to attribute morally-motivated socio-economic responsibilities to social organisations (and rather preferred that IFIs should shoulder these responsibilities) would indeed assign a socio-economic responsibility to IFIs, it was observed that 66.7% agreed/strongly agreed to do so (Table 11).

With a view to further evaluate how IFIs manage CSR issues the question "whether financial practitioners believe that acting in a socially responsible manner can create value for their organisation" was posed. 29.8% strongly agreed and 66.0% agreed. Nonetheless, 4.3% was neutral to the statement whilst nobody disagreed. In the light of this highly positive belief that there is a business case for CSR, the results were cross-tabulated with the earlier question "should IFIs adopt the SEE objectives of SRI funds". It was noticed that 65.1% approved that IFIs should assume such objectives. Still the results show that a significant 25.5% was neutral to this question. This could imply that a number of financial practitioners do not perceive a link between SRI funds and IFIs and therefore would not suggest the sharing of objectives by the institutions.

### 6.3 Evaluating IFIs' Corporate Responsiveness to CSR Issues

To verify how responsive IFIs are to CSR issues, we reiterate the financial practitioners' response to the question whether their organisation publicized their ethical screening criteria: although 84.4% believed that IFIs should emulate the approach of SRI funds and publicize their ethical policies, a relatively smaller percentage of 77.8% admitted that their institution publicized these criteria of investment selection.

This percentage was close to the number of respondents who classified their organisation as being 'socially responsible' – about 78.3% agreed/strongly agreed to this statement (Table 12). However, as mentioned earlier, although the financial practitioners categorised their organisation as being socially responsible, environmental issues ranked least within their investment policies. Similarly, 44.7% of the respondents do not invest in companies that contribute positively to society nor invest in profit sharing arrangements which have long term beneficial effects on society (Table 8).

To substantiate to what extent the social responsibility affirmation of the financial institutions, as pointed out by the respondents, reflected in an open or published declaration of socially responsible objectives, the vision and mission statements of the institutions were verified on their websites and through physical inspection of their annual reports. These were assessed in comparison to Carroll's (1979) definition of the processes of response to CSR issues which classified organisations as reactive, defensive, accommodative or proactive towards CSR.

All the financial institutions were concerned with financial gains and economic viability, making them reactive to CSR. Key words like "optimizing shareholders value", "improving efficiency", "aiming at superior financial performance" were commonly used in the mission statements of the financial institutions. Reference to shari'ah compliancy was also often made in the mission statements of the IFIs, signifying fulfilment of their legal responsibilities under Islamic law and to some extent their ethical responsibilities as they shun unjust principles like *ribā* and *gharar*. However, being shari'ah compliant does not necessarily imply being ethical. Ethicality embraces consistency of financial products with Islamic legal principles as well as broader concepts involving processes which build good relations between management and employees, and steps to have a positive impact on the environment and larger society. Unless the institution has clearly specified 'ethical' principles such as 'ensuring equity and justice in economic activities', abidance by values like honesty, trust, integrity, accountability, transparency, it was not considered that they fulfilled their ethical responsibilities. Those who were accommodative to CSR issues (i.e. Meeting their economic, legal and ethical responsibilities) totalled 30.6% of the respondents (Table 13). Nevertheless, none of the respondents – except for Emerging Markets Partnership, an infrastructure fund in Bahrain, which mentions investment in Greenfield ventures – make allusion to environmental issues as an ethical strategy adopted by their institution.

About 41.7% was classified as adopting a “defensive” approach to CSR as they only seemed to be meeting their economic and legal responsibilities (Table 13). One of the responding IFIs in particular emphasized the provision of innovative shari‘ah compliant financial services to “affluent individuals, businesses and institutions”, suggestive of a higher concern for efficiency gains which target an elite society than socio-economic development involving the larger society.

Still, 27.8% of the respondents were observed to be “proactive” towards CSR issues, specifically highlighting their roles in uplifting socio-economic development and fulfilling the needs of low-income communities. Some were even transparent about their community involvements, reporting these activities to the society at large. Examples of those classified as “proactive” in this study, on basis of their expressed social objectives, were Bahrain Islamic Bank (Bahrain), Arab Banking Corporation International Bank (Bahrain), Al Baraka Bank (South Africa), Islāmī Bank of Bangladesh (Bangladesh) and National Commercial Bank (Saudi Arabia). The Islāmī Bank Bangladesh has even established a foundation through which it operates its social activities. However, based on the information available on the IFIs, they did not appear to have a well-grounded corporate social reporting policy to promote their SEE policies.

#### **6.4 Measuring the Outcomes of CSR Actions for IFIs**

The financial institutions’ commitment of resources towards socially geared activities was examined in an attempt to measure the outcomes of CSR actions. The assumption is that spending of a percentage of the institutions retained profits on social projects or philanthropic activities will have positive impacts on the wellbeing of society members.

The majority of the respondents (47.2%) stated that their institutions spend about 0-2% of the annual profits on community enhancing activities (Table 14). The results equally revealed that 33.3% spend 2-5% of the annual profits; 11.1% spend 5-7%; and 8.3% spend 7-10%. The 0-2% range ranked the highest even among the 76.5% respondents who believed that Islamic finance should be defined in broad terms incorporating a human-oriented socially-acceptable just financial system. The 0-2% range also corresponded with 76.4% of the respondents who agreed/strongly agreed that their organisations were socially responsible. The small percentage of retained profits that is attributed to activities which improve community development would indicate that being socially responsible tends in practise to be connoted to “donations related activities” by financial practitioners. It could also be suggestive of a peripheral practise of CSR management by IFIs where CSR issues entail a limited commitment of resources. This view conflicts with the financial practitioners’ earlier belief and understanding of social responsibility where “community development” scored the highest ranking.

The contention that socially responsible activities are related in practise to donations-like activities could also be seen from the main activities chosen by

respondents in which their institutions participate, delineated in Table 15. Apart from abstention to false advertising (ranked 3rd) and promotion of ethical values among staff (ranked 4th), other core activities included donations to charities, donations to community causes, staff welfare, and sponsorship of community events. Again, from Table 15, it is noted that environmental causes ranked among the last observations in the list of activities subscribed by IFIs. Equally, of relatively minor importance were investments in deprived areas, support to employees for their involvement in community causes and even application of fair recruitment practises.

## **7. Comparing the Theory and Practise of Islamic Banking and Finance**

To reiterate, the aim of the study was to assess the internalisation of socially responsible practises by IFIs based on the contention of academicians that the social commitment emphasised by the Islamic economics literature is being neglected within the practise of Islamic finance which appears to focus more on the efficiency/profit aspects and less on equity/social aspects. The responses to a questionnaire-based survey of a sample of 48 IFIs from different parts of the world were used to analyse this argument.

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. The discipline of Islamic finance appeared to be broadly defined by the financial practitioners, embracing the common understanding of *ribā* elimination, trade encouragement and efficiency as well as social objectives such as a social justice and environmentally-friendly financial policies, thus advancing a human oriented approach and encouraging the participation of the civil society, the state and the private sector. Thus defined, most of the respondents would attribute a socio-economic role to IFIs, in addition to the responsibilities assigned to them by the conventional financial laws as well as the *sharī'ah*. Being profitable was viewed by the majority of the respondents as being of equal importance to the social objectives of the institutions. Acting in a socially responsible manner was strongly perceived as creating value for IFIs. A number of the respondents however saw the objectives of profitability and social concerns as conflictive, preferring social organisations to undertake morally motivated economic and financial activities. However, as Professor Nejatullah Siddiqi stated in an interview we conducted on this subject, "finance has an important role which can not be taken over by social organisations in toto....the socio-economic purpose has to be an inalienable feature of Islamic finance. It can not be outsourced". He called for an internalisation of Islamic moral and social values by individual members of society, which by extension should reflect in the policy decisions of financial institutions.

The practise of Islamic finance, as reflected by the empirical analysis of the activities of IFIs, was not thought to be as socially responsible as the views voiced out by financial practitioners. It was observed that all the IFIs did not disseminate the ethical screening criteria of investment selection. Publicizing the institution in broad terms as being shari'ah compliant does not explicitly reveal details of the areas of involvement or disengagement of the institution. An explanation of the underlying ethical principles is deemed necessary to express Islam's concern for a socially just financial system, thus advancing cooperation between people of other faith who equally advocate this goal. From the screening criteria disclosed by the respondents, it was further observed that negative criteria like prohibition of *ribā* and impermissible activities ranked the highest whilst positive criteria like investment in companies that contribute positively to society or investment in environmentally-friendly activities were the least endorsed by the IFIs. Issues like avoidance of *ribā* contribute certainly to building a socially responsible financial system – albeit at a higher analytical level. Popular secularist ethical concerns like sustainability of the environment were, nonetheless, of little concern to IFIs as reported by the activities in which the institutions participate. The reported practises also showed little commitment towards ethical employment policies and community involvement, except for making donations to charities, community and staff causes. The amount they spent on community causes ranged mostly between 0-2% of their profits despite the fact that they called themselves 'socially responsible' institutions. This compares with the statement of a UK company which offers financial advice on SRI:

“Ethical Investors Group is unique in that we pledge to distribute at least 50% of our business profits each year to charities and socially responsible groups working in the areas nominated by our clients. To date this distribution amounts to £390,000. I take the view that financial advisers should share some of the commission their businesses earn from ethical investment advice, in order to help the groups and charities working in the front line, trying to build a better society and environment for us all” (Lee V. Coates, Chartered Insurance Practitioner, Ethical Investors Group, 2005).

An analysis of the mission and vision statements of the IFIs further classified the majority (41.7%) as embracing a 'defensive' approach to CSR, fulfilling primarily their economic and legal responsibilities (Table 13). A smaller percentage of 27.8% was nonetheless proactive in their practise of CSR. This finding corresponds with Parker's (2005: 2) observation that IFIs lacked a proactive CSR culture in the light of their slow and disappointing response to the 2004 tsunami disaster which struck the Indian Ocean Rim countries.

These results are indicative of a peripheral approach assumed by IFIs towards CSR issues, compared to a more integral and deliberate ethical policy that SRI funds appear to embrace. Shari'ah compliance and efficiency gains remain largely the concern of IFIs; yet the more comprehensive objective of welfare of the

society, which would equally include social values, seems to be neglected within the practise. Given the enduring Islamic values upon which Islamic finance is founded, and guided by the belief in the multiplied rewards in the Hereafter for every pound spent for the pleasure of God, it is believed that IFIs should have higher motivations to act more proactively in the social interest – to deliver what the literature promises.

## 8. Conclusions

Both IFIs and SRI funds target a niche market, particularly those who wish to place their investments in line with their ethical or religious values. Like the institutionalisation of Islamic finance which developed in the 1970s out of the search for an alternative financial system away from the prohibited *ribā* and other Islamically impermissible transactions, the modern origins of the SRI movement is said to have evolved as early as the 1920s and is related to the longstanding concerns of religious institutions which sought to avoid so-called “sin industries” involved in alcohol, gambling or tobacco (Schlegelmilch, 1997: 49). Driven by several major social, economic, political, legal and regulatory changes in society, the SRI movement has expanded from its originally US base to include the UK as the most developed institutional SRI market in Europe and other growing European markets like Germany, France, the Netherlands, Switzerland as well as surfacing in Asia and Australia (Eurosif, 2003). Today, the SRI industry is said to encompass a US\$ 2.4 trillion worldwide industry, incorporating 760 retail funds and a larger and more complex SRI institutional market (Hamid, 2003). SRI providers comprise high street banks, building societies, mutual societies, investment groups, insurance companies, pension funds, foundations, cooperatives, community development funds, venture capital funds and several speciality ethical funds and banks – taken to equate to the terms ‘SRI funds’ in this research.

IFIs could usefully emulate the successful dissemination of the ethical and socially responsible values endorsed by SRI funds so that the moral teachings central to the Islamic approach to financing would be easily accessible to prospective clients. Friends Provident Stewardship Ethical Investments, the first ethically-screened fund set up in the UK in 1984, in a document introducing the fund uses catching marketing phrases like “the world’s a better place with Friends” and “Friends take responsibility” to promote its ethical values, in addition to detailing information such as “what Friends will and won’t do”, “how Stewardship applies its ethical policy”, “some examples of Stewardship approved companies” ([www.friendsprovident.co.uk](http://www.friendsprovident.co.uk)). Publicizing a “statement of ethical investment policy” is even common among religious investment groups like that of The Church of England’s Ethical Investment Advisory Group ([www.cofe.anglican.org](http://www.cofe.anglican.org)). On the other hand, HSBC *amānah* Finance which started to offer Islamic home financing in the UK since 2004, describes its services in its brochure in a few words as “entirely *ḥalāl*”, “in accordance with shari‘ah” but lengthily delineates the high qualifications of its shari‘ah supervisory committee which validates its

financial products (HSBC Bank plc, HSBC *amānah* Finance brochure). This emphasis placed by Islamic banks on “the standing of their shari‘ah regulators rather than stressing the moral teaching that governs Islamic finance” was pinpointed by Wilson (2000). Five years after Wilson’s paper, HSBC *amānah* Finance could have positively learnt from the practical experiences of its counterparts which operate within a similar business environment.

In view of the institutionalisation of the practise of Islamic finance, IFIs should further see a commitment towards CSR as an act that brings benefit to the institution. Similar to reputable organisations like Ford and Toyota which set up trusts or foundations as part of their businesses’ philanthropic activities, IFIs should endeavour to follow such a strategy to benefit society.<sup>5</sup> In the light of the highly positive attitude of respondents (95.8%) who believed that acting in a socially responsible way would create value for IFIs, it is expected that IFIs’ commitment towards community involvement should in practise draw closer to the belief held by financial practitioners. SRI funds explicitly cite inclusion or exclusion of issues of social concerns to show their commitment towards the welfare of the community. IFIs should follow suit.

At the same time, it may be argued that the lack of transparency in data reporting, especially regarding funds spent on community causes, could be the cause for the lower reported profits spent on community enhancing activities. This corresponds to the results drawn from the survey whereby about 87.5% of the respondents failed to allocate a percentage of profits to the communal activities their institutions participate in. The underlying belief could be that it is best to keep charitable donations undisclosed. If this assessment were correct, it would to some extent lend further support to the claim that CSR is considered only as a peripheral practise of IFIs. If, on the other hand, it were treated as part of business policy, it would have been included within corporate reporting and made aware to the members of staff. Nonetheless, in line with modern developments in corporate social reporting, IFIs could opt for greater transparency in their activities – a practise that would certainly enhance confidence and trust among users and the public at large.

Another worthwhile experience that could be learnt from the SRI movement is in respect of the qualitative screening of the social responsibility performance of companies. Within Islamic finance, progress has been made in the development of quantitative measures that help to establish whether a company suits Islamic investments. The Dow Jones Islamic Index (DJII) and the FTSE Global Islamic Index, introduced in 1996 and 1999 respectively, have laid out cut-off rules that determine shari‘ah permissibility based on the financial ratios of companies. These indices are also designed to track the financial performance of publicly traded

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<sup>5</sup> One IFI, namely the Islami Bank of Bangladesh, has been noted to operate its welfare services from the separate foundation it has set up.

sharī'ah compliant companies. An index to track the social performance of companies whose activities are consistent with sharī'ah principles is yet to be introduced. Given that welfare of the society is the prime objective of Islamic law, establishing principles that can gauge whether IFIs are contributing significantly to this objective is deemed essential. This call to measure the performance of IFIs with reference to their social responsibilities has been recently made by Ḥasan (2005) and Tag el-Din (2005).

Within the SRI literature, we note that Business in the Community (BITC) – a movement with a core membership of 650 companies across the UK – has established since 2002 a corporate responsibility index defined as “a business management tool, which has been developed to support companies in improving their impact on society and the environment. By participating in the Index companies are able to assess the extent to which their corporate responsibility strategy is translated into responsible practise throughout the organisation, in managing four key areas – Community, Environment, Marketplace and Workplace” (Business in the Community, 2004). The BITC Index supplements other major ethical and social indices like FTSE4Good, Dow Jones Sustainability Index and Domini 400 Social Index, which publicly rank major international companies according to their SEE performance (Hopkins, 2004: 9). It is deemed desirable that comparable social indices be developed within the field of Islamic finance to benchmark the responsible business practises of Islamic institutions.

These would require allowing more time for the Islamic finance industry to become more firm-footed, education of the financial community as well as Muslim investors, and certainly more resources to take on the challenge.

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**Appendix**

*Table 1: Models of Corporate Social Performance*

Author	Definition of CSP	Modelling Approach
Carroll (1979)	"The articulation and interaction between (a) different categories of social responsibilities; (b) specific issues relating to such responsibilities; and (c) the philosophies of the answers to such issues" (p. 499)	Principles of CSR (CSR1) Economic, Legal, Ethical and Discretionary Responsibilities Identification of CSR Issues. E.g. Profitability, viability, product safety, employee safety, environment, fair recruitment, community investment Philosophy of Responsiveness (CSR2) Reactive, Defensive, Accommodative, Proactive
Wartick and Cochran (1985)	"The underlying interaction among the principles of social responsibility, the process of social responsiveness and the policies developed to address social issues" (p.758)	Principles of CSR (CSR1) Economic, Legal, Ethical and Discretionary Responsibilities Social Issues Management Identification of CSR Issues Analysis of CSR Issues Response to CSR Issues Philosophy of Responsiveness (CSR2) Reactive, Defensive, Accommodative, Proactive
Wood (1991, 1997)	"A business organization's configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and observable outcomes as they relate to the firm's societal relationships"	Principles of CSR (CSR1) Economic, Legal, Ethical and Discretionary Responsibilities Levels of CSR Actions Institutional level: Society grants legitimacy and power to businesses and businesses must use their power in a way that society considers responsible Organisational level: Businesses are responsible for outcomes related to their primary and secondary areas of

Author	Definition of CSP	Modelling Approach
		<p>involvement with society</p> <p>Individual level: Managers are moral actors and are expected to act towards bringing about socially responsible outcomes</p> <p>Processes of Corporate Social Responsiveness (CSR2)</p> <p>Identification of CSR Issues</p> <p>Analysis &amp; Management of CSR Issues</p> <p>Environmental Assessment &amp; Analysis</p> <p>(e.g. Gather information about the external environment)</p> <p>Stakeholder Management (e.g. Managing the corporation's relationships with its different stakeholders which affect or are affected by its operations)</p> <p>Issues Management (e.g. Developing responses to issues that may affect the corporation)</p> <p>Outcomes of Corporate Behaviour (CSP)</p> <p>Societal Impacts, Corporate Social Programmes and Policies</p>
Clarkson (1995)	"The ability to manage and satisfy the different corporate stakeholders"	Model adopts a stakeholder approach whereby it distinguishes the specific CSR problems and impacts on each of the stakeholder categories, including employees, shareholders, consumers, suppliers, state, competitors, the community, etc.

Table 2

**Key words to describe social responsibility**

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Ethical	5	10.4	13.9	13.9
	Pro Community	15	31.3	41.7	55.6
	Divine based or shariah compliant	2	4.2	5.6	61.1
	Not only profit geared	1	2.1	2.8	63.9
	Social justice	10	20.8	27.8	91.7
	Not socially irresponsible	1	2.1	2.8	94.4
	Sustainable development	2	4.2	5.6	100.0
	Total	36	75.0	100.0	
Missing	System	12	25.0		
Total		48	100.0		

Table 3

**What Islamic finance is Equal to?**

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Only Prohibition of Riba	1	2.1	2.1	2.1
	Trade without interest	6	12.5	12.5	14.6
	Socially Acceptable Just Financial System	5	10.4	10.4	25.0
	Human oriented, environmental friendly financial system	2	4.2	4.2	29.2
	All the above	34	70.8	70.8	100.0
	Total	48	100.0	100.0	

Table 4: Financing Methods in Turkey

Method	2000
<i>murābahah</i>	74%
<i>muḍārabah</i>	15%
<i>ijārah</i>	10%

Source: Baskan (2004: 227)

Table 5: The Core Businesses of Islamic Financial Institutions in the UK

Institution	Status	Core Business
Islamic Finance Unit, Dawnya Day Global Investments Ltd	Investment Bank	Trade Finance, Realty
Islamic Banking Unit, ANZ Investment Bank	Investment Bank	Trade Finance, Leasing
HSBC <i>amānah</i> Finance	London Office	Trade Finance, Leasing
Islamic Banking Unit, UBS Warburg	Investment Bank	Trade Finance/Asset Mgt
ABCIB Islamic Asset Management Ltd	Bank Subsidiary	Trade, Leasing, Realty
Islamic Finance, United Bank of Kuwait	General Bank	Leasing, Mortgages
Islamic Finance, Corporate Banking, Citibank Plc	General Bank	Trade Finance
AlBaraka Investment Company	Investment Company	Trade Finance
Dallah AlBaraka (UK) Limited	Finance Company	Trade Finance
Faisal Finance (Jersey) Limited	Mutual Fund Vehicle	Equities
Parsoli (UK) Ltd.	Commercial Company	Equities
I-hilal (UK) Limited	London Office	Financial Platform

Source: Islamic Banker (2002: 10)



Table 6: Islamic Finance is a Third Way between Capitalism and Socialism because it is...

	Against <i>ribā</i> and Pro-Trade (%)	Pro-Equity Finance (%)	Against Speculation and Pro-Production (%)	Efficient Financial System (%)	Integrated System of Financial Affairs (%)	Highest Scores in Rank 1 to 5
Rank 1	53.8	12.5	8.3	8.0	53.1	Against <i>ribā</i> and pro-trade
Rank 2	26.9	16.7	20.8	16.0	12.5	Against <i>ribā</i> and pro-trade
Rank 3	3.8	25.0	20.8	36.0	6.3	Efficient financial system
Rank 4	11.5	20.8	25.0	24.0	9.4	Against speculation and pro-production
Rank 5	3.8	25.0	25.9	16.0	18.8	Against speculation and pro-production
Total	100.0	100.0	100.0	100.0	100.0	

Table 7

Socio-economic responsibility attribute to IFIs \* What Islamic finance is Equal to? Crosstabulation

			What Islamic finance is Equal to?				Total	
			Only Prohibition of Riba	Trade without interest	Socially Acceptable Just Financial System	Human oriented, environmental friendly financial system		All the above
Socio-economic responsibility attribute to IFIs	Strongly agree	Count % within Socio-economic responsibility attribute to IFIs		3 18.8%	1 6.3%	1 6.3%	11 68.8%	16 100.0%
	Agree	Count % within Socio-economic responsibility attribute to IFIs	1 4.5%	2 9.1%	3 13.6%		16 72.7%	22 100.0%
	Neutral	Count % within Socio-economic responsibility attribute to IFIs		1 12.5%		1 12.5%	6 75.0%	8 100.0%
	Strongly disagree	Count % within Socio-economic responsibility attribute to IFIs			1 100.0%			1 100.0%
Total	Count % within Socio-economic responsibility attribute to IFIs	1 2.1%	6 12.8%	5 10.6%	2 4.3%	33 70.2%	47 100.0%	

Table 8: Screening Criteria for Selecting Investments

Screening Criteria	YES		NO	
	Frequency	Valid %	Frequency	Valid %
Not investing in impermissible activities	37	97.4	1	2.6
Not investing in <i>ribā</i>	34	89.5	4	10.5
Not investing in the arms industry	28	73.7	10	26.3
Not investing in forward currency transactions	21	55.3	17	44.7
Investing in companies that contribute positively to society	21	55.3	17	44.7
Investing in profit and loss sharing arrangements	21	55.3	17	44.7
Not investing in environmentally polluting economic activities	18	47.4	20	52.6
Investing in environmentally friendly activities	15	39.5	23	60.5
Other screening criteria, e.g.,	9	23.1	30	76.9
Not investing in conventional banking and insurance				
Seeking high return investments				
Not investing in companies that promote religions other than Islam				
Investing in care home for elderly people				
Investing in trade related transactions				
Investing in real transactions				

Table 9

**Ranking of financial gain in comparison to social objectives of IFI \* Socio-economic responsibility attribute to IFIs Crosstabulation**

			Socio-economic responsibility attribute to IFIs				Total
			Strongly agree	Agree	Neutral	Strongly disagree	
Ranking of financial gain in comparison to social objectives of IFI	Less important	Count % within Ranking of financial gain in comparison to social objectives of IFI	1 33.3%	1 33.3%	1 33.3%		3 100.0%
	Equally important	Count % within Ranking of financial gain in comparison to social objectives of IFI	11 37.9%	13 44.8%	5 17.2%		29 100.0%
	More important	Count % within Ranking of financial gain in comparison to social objectives of IFI	4 30.8%	6 46.2%	2 15.4%	1 7.7%	13 100.0%
	Not important	Count % within Ranking of financial gain in comparison to social objectives of IFI		1 100.0%			1 100.0%
<b>Total</b>		Count % within Ranking of financial gain in comparison to social objectives of IFI	16 34.8%	21 45.7%	8 17.4%	1 2.2%	46 100.0%

Table 10

**Ranking of financial gain in comparison to social objectives of IFI \* Whether social org should be responsible for morally motivated activities Crosstabulation**

			Whether social org should be responsible for morally motivated activities					Total
			Strongly agree	Agree	Neutral	Disagree	Strongly disagree	
Ranking of financial gain in comparison to social objectives of IFI	Less important	Count % within Ranking of financial gain in comparison to social objectives of IFI		1 50.0%			1 50.0%	2 100.0%
	Equally important	Count % within Ranking of financial gain in comparison to social objectives of IFI	3 20.0%	2 13.3%	3 20.0%	6 40.0%	1 6.7%	15 100.0%
	More important	Count % within Ranking of financial gain in comparison to social objectives of IFI	1 14.3%	5 71.4%	1 14.3%			7 100.0%
	Not important	Count % within Ranking of financial gain in comparison to social objectives of IFI			1 100.0%			1 100.0%
<b>Total</b>		Count % within Ranking of financial gain in comparison to social objectives of IFI	4 16.0%	8 32.0%	5 20.0%	6 24.0%	2 8.0%	25 100.0%

Table 11

Whether social org should be responsible for morally motivated ec and fin activities \* Socio-economic responsibility attribute to IFIs Crosstabulation

			Socio-economic responsibility attribute to IFIs			Total
			Strongly agree	Agree	Neutral	
Whether social org should be responsible for morally motivated ec and fin activities	Strongly agree	Count % within Whether social org should be responsible for morally motivated ec and fin activities		3 100.0%		3 100.0%
	Agree	Count % within Whether social org should be responsible for morally motivated ec and fin activities	3 37.5%	4 50.0%	1 12.5%	8 100.0%
	Neutral	Count % within Whether social org should be responsible for morally motivated ec and fin activities		4 80.0%	1 20.0%	5 100.0%
	Disagree	Count % within Whether social org should be responsible for morally motivated ec and fin activities	3 50.0%	1 16.7%	2 33.3%	6 100.0%
	Strongly disagree	Count % within Whether social org should be responsible for morally motivated ec and fin activities	1 50.0%		1 50.0%	2 100.0%
	Total	Count % within Whether social org should be responsible for morally motivated ec and fin activities	7 29.2%	12 50.0%	5 20.8%	24 100.0%

Table 12

Whether IFI is socially responsible?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly agree	11	22.9	23.9	23.9
	Agree	25	52.1	54.3	78.3
	Neutral	7	14.6	15.2	93.5
	Disagree	3	6.3	6.5	100.0
	Total	46	95.8	100.0	
Missing	System	2	4.2		
Total		48	100.0		

Table 13

**Is the Institution Reactive, Defensive, Accommodative or Proactive to CSR?**

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Defensive	15	31.3	41.7	41.7
	Accommodative	11	22.9	30.6	72.2
	Proactive	10	20.8	27.8	100.0
	Total	36	75.0	100.0	
Missing	System	12	25.0		
Total		48	100.0		

Note that by definition, the IFIs are reactive as they are legal identities

Table 14

**Percentage of profits spent on community enhancing activities \* Whether IFI is socially responsible? Crosstabulation**

Count		Whether IFI is socially responsible?				Total
		Strongly agree	Agree	Neutral	Disagree	
Percentage of profits spent on community enhancing activities	0-2 %	6	7	3	1	17
	2-5 %	1	9	2		12
	5-7 %		3	1		4
	7-10 %	1	2			3
Total		8	21	6	1	36

Table 15

Types of activities in which organisations would get involved	Yes	Valid %	No	Valid %	Total Response	Missing
1. Staff welfare (loans, health schemes, etc.)	34	94.4	2	5.6	36	12
2. Donations to charities	33	86.8	5	13.2	38	10
3. Abstaining from false advertising	33	97.1	1	2.9	34	14
4. Promoting ethical values among staff (e.g. Against-bribery, corruption, conflict; pro-honesty, trust, brotherhood, justice)	32	100	-	-	32	16
5. Donations to community causes	30	81.1	7	18.9	37	11
6. Sponsorship of community events	26	74.3	9	25.7	35	13
7. Provision of benevolent loans ( <i>qard al-hassanah</i> )	24	72.7	9	27.3	33	15
8. Sharing best practise on social, ethical and environmental responsibility with other organisations	24	85.7	4	14.3	28	20
9. Investment in Research & Development	23	76.7	7	23.3	30	18
10. Working with local schools, colleges, universities	22	66.7	11	33.3	33	15
11. Investing according to ethical guidelines	22	78.6	6	21.4	28	20
12. Scholarship to students	20	64.5	11	35.5	31	17

Types of activities in which organisations would get involved	Yes	Valid %	No	Valid %	Total Response	Missing
13. Establishing fair recruitment practises, including engaging people traditionally excluded from the labour market e.g. Disabled, homeless, ethnically discriminated	19	76.0	6	24.0	25	23
14. Supporting employee involvement with community causes	16	64.0	9	36.0	25	23
15. Commitment to sustainable development	16	66.7	8	33.3	24	24
16. Investing or encouraging investment in deprived areas	15	60.0	10	40.0	25	23
17. Taking initiatives to protect the environment (e.g. Recycling) or enhance environmental management	14	60.9	9	39.1	23	25
18. Working with NGOs for sustainable development	13	52.0	12	48.0	25	23
19. <i>Zakāh</i> collection and distribution	11	45.8	13	54.2	24	24
20. Lobbying for a particular social, ethical or environmental cause	7	30.4	16	69.6	23	25



**COMMENTS**

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