

PARALLELS BETWEEN ISLAMIC AND ETHICAL BANKING

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Islamic banks often describe themselves as being providers of ethical financial services, but they do not spell out explicitly what is meant by this or its significance. The word ethical is used as a label, and equated with Islamic, but there is no attempt to make the link between what is ethical and the specific methods of conducting financial transactions. This is unfortunate, as if Islamic banks are to build their customer bases, then they have to be convincing and persuade potential clients that there are worth switching to. For Islamic banks it is not so much a matter of competing on price, but rather in stressing the unique quality of the services they provide. This means they have to be believable, and be able to engage the customer by appealing to his or her conscience.

Quite rightly the major concern of Islamic banks is that their financial practices should comply with the *shariah* law. Having a *shariah* advisor or committee of respected *fiqh* scholars who can endorse the bank's activities is seen as crucial to ensure the institution's reputation. In their publicity material however the emphasis by the banks is often on the standing of their *shariah* regulators rather than stressing the moral teaching that governs Islamic finance. There is little attempt to explain the ethical merits of how the bank conducts its business directly to the clients. Islamic banks can and do primarily attract clients because of their religious beliefs, and their desire to translate these into everyday financial dealings. Merely stating that a product is *shariah* compliant is insufficient however; Islamic banks need to be more closely

engaged with their clients and make a convincing moral argument for their business methods.

As the requirements and aspirations of societies change there is a need to appeal to the intelligence as well as the beliefs of the client. Islamic banks must convince their customers of the advantages of their innovative financial products, and demonstrate that the products are both *shariah* compliant and at the same time related to new business circumstances. There is in other words an education role for Islamic banks and other providers of Islamic financial services. This should not undermine *shariah* advisors by bypassing them, but rather enhance their role as they can help underline the merits of Islamic finance to a wider but well informed and demanding customer base. In Islamic terms this is a matter of *ijtihad* or application of fundamental principles to changing circumstances. The *shariah* advisors or committee should, in other words, be involved in marketing as well as regulation, and play a more pro-active rather than reactive role.

THE CO-OPERATIVE BANK'S ETHICAL POLICY

There is undoubtedly much that Islamic banks can learn from conventional banks that designate themselves as being involved in ethical finance. Admittedly there are fundamental differences between ethical practices derived from religious teaching and those designed to appeal to popular secularist morality. Those involved in Islamic finance would regard their ethics as being enduring, as ultimately they are based on holy revelation, whereas ethics derived from social values are inevitably more transitory. With this important proviso it is nevertheless instructive to examine the experience of a leading western "ethical" bank.

As the Co-operative Bank is the sole, self-designated, ethical retail bank in the United Kingdom, it is instructive to look at its policy and dealings. Of particular relevance is its publicity on ethical financial practice and its engagement with ethically aware clients, who recognise, and get satisfaction from, their wider social responsibilities rather than simply personal material gain. The bank adopts a stakeholder approach which is of potential relevance for Islamic

banks, the aim being to identify and build on stakeholder synergies to secure benefits for the widest possible constituency.

The bank seeks to build on its name and history by defining what it sees as the underlying principles of co-operation. These include participation that the bank interprets in terms of welcoming the views and concerns of customers and in encouraging bank staff to take an active part in the life of their local communities. As the bank's origins was in the industrial heart lands of northern England, where it was viewed as a bank for working class people, this stress on local solidarity and community identity seems natural. Its headquarters remains Manchester, where arguably financial institutions are in greater contact with the local community than in an international banking centre such as London.

The bank seeks to develop close affinities with organisations that “promote fellowship between workers, customers, members and employers.”¹ The bank was historically, and still remains, the manager of most trade union finances and was an offshoot of the Co-operative Wholesale Society (CWS) which distributed goods to local consumer co-operatives throughout the north of England and Scotland. As the members of these local co-operative societies are their customers, this reference to customers and members in the mission statement on ethical policy is derived from past business traditions.

The Co-operative Bank aims to attract investment and make sufficient surplus funds to ensure that its future development can be adequately financed. Although it was restructured as a public law company, it is not quoted on the stock market, which means it is not primarily concerned with increasing shareholder value. Its sole shareholder is the CWS, a complex association of local consumer co-operatives whose origins date back to the Rochdale Equitable Partners Society. This was founded in 1844 by 28 working men who wanted to ensure good value in their food purchases. The bank was established as the loan and deposit department of the CWS in 1872, and was

¹ www.co-operativebank.co.uk/ethics/ethical_ethics_our_mission.html

recognised by the Bank of England as an authorised bank in its own right in 1947. Checking accounts were introduced for purchases outside the co-operative organisations in 1975 when the bank joined the London Clearing House.

Because of the Co-operative Bank's unique ownership structure it is not vulnerable to take-overs, as the CWS has no interest in divesting. Furthermore de-mutualisation is not an issue, as the Bank is already a company, not a mutual society. There are nevertheless disadvantages in not being a quoted company, notably the inability to raise equity capital from the market. The Bank has issued preference shares as a means of raising capital for expansion, which are at present held by 1,500 institutions.

There is much stress on group loyalty and identity in the Co-operative Bank's mission statement. One purpose of staff education and training is to "encourage commitment and pride in each other and in the group".² In some respects this group ethos could be compared to loyalty to the *ummah*, the whole Muslim community, although no Islamic bank mentions this in its mission statement. In the case of the Co-operative Bank under its support for freedom of association it stresses the importance of being non-partisan in all social, political, racial and religious matters, although the bank was traditionally associated with the Labour Party.

WIDENING THE CO-OPERATIVE BANKS CLIENT BASE

The ethical policy of the bank was first launched in 1992 in an effort to attract new, more affluent, customers outside the predominately working class clients that the bank traditionally served. The target group was the left of centre middle classes, who were perceived as having a social conscience and concern over issues championed by the more radical press such as ecology. At the same time, as the bank did not want to lose its existing clients, a large survey was carried out to find their reactions to the proposed ethical policy. Over 30,000 customers were approached, and of those who responded 84

² Ibid.

percent felt it was a good idea for the bank to have an ethical policy and only 5 percent believed ethics had nothing to do with banking. Sixty percent of respondents agreed with the issues included in the ethical policy, the major reservation amongst clients being with respect to the bank's proposal to no longer finance companies involved in tobacco production and distribution.

The ethical policy involves five major areas of concern: human rights, armaments, trade and social involvement, environmental impact and animal welfare. The Bank pledges not to invest in or provide financial services to any organisation or regime violating human rights or involved in the manufacture of equipment used in violating human rights. On armaments the bank will not finance the manufacture of armaments sold to oppressive regimes, although the finance of armaments sold to democratic governments is permitted. To safeguard animal welfare the bank will not provide financial services to organisations involved in animal testing, exploitative factory farming, blood sports or the fur trade. These can be regarded as "negative" ethical criteria.

On the more positive side the bank supports companies which are involved in "fair" trade or are socially involved. This includes business customers and suppliers who take a pro-active stance on ethical purchases from Third World countries or organisations participating in the United Kingdom "social" economy such as charities. The environmental stance could also be interpreted positively, as it encourages business customers to be pro-active on the environmental impact of their own activities. There are also negative prohibitions specified including the avoidance of companies involved in the production of fossil fuels that cause acid rain, the manufacture of "unnatural" chemicals that result in ozone depletion and the unsustainable harvesting of timber which results in deforestation.

Critics could argue that these are concerns for the developed world that poor countries can ill afford. There is also the criticism that too many of the concerns are negatively expressed, and that the Bank lacks positive policies on issues such as renewable energy by wind, sea or river power or on organically produced foodstuffs and other similar matters. There is also the

criticism that the Bank has been too involved in gimmicks such as its 99.99 PVC Greenpeace Affinity Card or its charity cards that involve the Bank making a donation of 1.25 pence for every £100 charged to the card. This demonstrates a minimal level of generosity, with the returns even worse in terms of value than air mile awards.

There is nevertheless a continuing high level of customer engagement by the bank, with clients voting on which four charities should be nominated to receive a donation each year. There have also been consultation exercises on the ethical policy following the initial 1991 survey, with major surveys carried out in 1994 and 1998. By 1994 the ethical policy had received greater support with over 80 percent of respondents approving of the Bank's stance on every issue, an improvement of 20 percent over 1991.

Islamic banks can also learn from the way the Co-operative Bank disseminates its services, given that its branch network beyond the north of England is limited. In 1997 the Co-operative Bank signed an agreement with the Post Office to provide banking services, including deposit and withdrawal facilities throughout its 18,000 branches in the United Kingdom. This year there have been discussions between the government and the major retail banks about providing a "Peoples Bank" through automated services in every post office. However the Co-operative Bank's scheme is already up and running, unlike the proposed scheme which is attempting to replace the payment of social security benefits and pensions in cash.

The Co-operative Bank also has a telephone banking service and in 1999 launched its fully interactive banking service, Smile, on the Web. This has attracted over 200,000 clients, probably because it pays very competitive rates on savings deposits rather than because of its ethical stance. The bank also participates in the Link scheme, which means that clients have access to 29,000 cash dispensers throughout the United Kingdom.

THE DISSEMINATION OF ISLAMIC FINANCIAL IDEALS

In their publicity material and on their Web sites Islamic banks generally provide much more limited information than the Co-operative Bank. The information is often not up to date, and Web sites are too often neglected after they are set up, even though they are potentially important for communicating information to present and future possible clients, especially as Islamic banks have often, at best, limited branch networks. The Web sites are often harder to locate using standard search engines, and designed in too graphic intensive a manner that means that rapid access is limited to those possessing computers with fast processors and abundant memory and with access to the latest telecommunications or fibre optic cable links.

The **Al Rajhi Banking and Investment Corporation** has one of the best Web sites and some of the most well designed publicity material in the Islamic banking community. It provides details of the major principles on which Islamic banking is based, namely the avoidance of advancing money on the basis of a predetermined return in the future.³ The rationale for this is not adequately explained however, as *murabahah* earns a predetermined return, but is nevertheless regarded by most Islamic scholars as legitimate. The publicity material links the *Shariah* with “viable projects” and “reliable borrowers” but this is misleading, as though these are laudable objectives there are no *sura* or *hadiths* that mention these issues. The Bank stresses the values on which it conducts its business, and there is explicit mention that the Bank’s “journey is a search for righteous rewards via the right path”, with references made to noble values, high principles and the trust of customers.⁴

Although there have been surveys of Al Rajhi customers by independent researchers, the organisation itself has not carried out systematic consultation exercises with its clients in a similar manner to the Co-operative Bank. It refers to the hundreds of thousands of customers who have given it a mandate to carry out its business in line with Islamic principles, but the stress

³ www.alrajhibank.com.sa/islamicbanking.htm

⁴ www.alrajhibank.com.sa/history.htm

is on the validation from the *Shariah* board.⁵ The members of the board are listed, and their mandate is briefly explained. The Koranic verses dealing with *riba* are set out on the Al Rajhi Web site in Arabic and English,⁶ and although *riba* is correctly equated with both interest and usury, the link between the two is not discussed. An account of the views of the *Shariah* board on these matters would be instructive, as would more details of the merits of the Islamic financing instruments on offer.

The Director and General Manager of the Bank, Abdullah Suleiman Al Rajhi, was presented with the Islamic Banker of the Year award in 1998. It is largely through his efforts that the Bank has become the most profitable bank in Saudi Arabia and the second largest in the kingdom in terms of assets. Improvement is a continuous process however, and despite the Bank's achievements there is much can be learnt from benchmarking good international ethical practice in the banking field.

The **Al Baraka Investment and Development Company**, as one of the leading international Islamic financing organisations, provides a clear statement of the philosophy and mission on which its operations are based. It states that its "principle philosophy is that capital should be harnessed in full conformity with *Shariah* principles, for purposes which are socially as well as economically viable, as it increases brotherhood and solidarity and reduces the reliance on debt finance."⁷ Through its involvement with 43 subsidiaries in 29 countries, Al Baraka has become increasingly aware of the problems that arise when there are varying *fatwas* applied by individual *Shariah* boards. It has therefore established a Unified Board for *Shariah* whose rulings apply to all institutions within the Dallah Al Baraka Group. This body liases with the *Fiqh* Academy in Jeddah, regarded by many Muslims as the most authoritative body of *Shariah* scholars in the Islamic world.

⁵ www.alrajhibank.com.sa/shariaboard.htm

⁶ www.alrajhibank.com.sa/islamicrevelations.htm

⁷ www.albaraka.com/english/corporate/philosophy.html

While admirable for its brevity the statement of Al Baraka's philosophy could arguably say more on the organisations values, and explain more fully the principles on which it operates. Both the short term and long term objectives are essentially about how the business aims to organise and manage its affairs, which could apply to any business, Islamic or secular. There is no elaboration on the principal philosophy, or explanation of how this translates into practice through the financing instruments and methods offered by the bank. Arguably too much is assumed, and no reference is made to engagement with bank clients or the wider community of potential customers in the markets in which the bank operates.

This also applies to the subsidiaries of Al Baraka that enjoy considerable autonomy. The London office simply refers to its mission as being to "invest capital and resources in an Islamic manner in order to achieve the best possible level of profit compatible with acceptable risk."⁸ The latter applies to any commercial financial institution, but the former deserves more explanation. One of the most successful affiliates of the Al Baraka Group, the **Jordan Islamic Bank**, has a similar low key approach when referring to its mission. It mentions that its operations are carried out in accordance with the *shariah* and refers to the "concept of economy based on a unique view of the role of money in society."⁹ Although it has 500,000 accounts, 1336 employees and 49 branches, it appears to consign itself to a niche role in Jordanian banking when it could do much more to persuade potential clients of the merits of its operations.

The **Shamil Bank**, the renamed Faisal Islamic Bank of Bahrain, has a new Web page and publicity material to project its new image. It continues to be under the control of the **Dar al Maal al Islami Trust**, which owns 53 percent of its share capital. Although it does not say much about its priorities in ethical terms it stresses how all its operations are performed in strict adherence to the *Shariah* and it describes in some detail how its religious supervisory board

⁸ www.albaraka.co.uk/info.html

⁹ jordanislamicbank.com/inner_about.html

operates.¹⁰ The management must seek prior approval from the board for new operations and activities. Once given the board monitors how they are being performed in practice. A designated member of the board undertakes field inspections of the bank's operations and at least one member of the internal audit team is required to have a *shariah* background. This transparency over policy and procedures is to be welcomed, although as with other Islamic banks there could be more details given of the actual products on offer and how they are designed to comply with religious law.

Other Islamic banks in the Gulf which have elements of best practice in their publicity and reporting include the **Kuwait Finance House** and **ABC Islamic Bank** of Bahrain. The Kuwait Finance House, which has built up a stake in the local deposit market of around 20 percent, stresses that it is an interest free financial institution that has competed successfully with its rivals which offer interest on their deposits.¹¹ It provides summary details of its major financing facilities, *murabahah*, *mudarabah*, *ijarah* and *istisna*. The ABC Islamic Bank provides more detail on the products it offers that include not only *mudarabah*, *ijarah* and *istisna*, but also *ijarah wa iktinan*.¹² This allows the client to purchase a leased good at a predetermined price. Other Islamic financing products offered by ABC include *salam* sale, *qard hassan* against deferred payment and *sanadat al moqarada* bonds that entitle the holder to a profit share rather than a fixed rate of interest. The different systems of transliteration used by for Islamic financing products can cause confusion however, and it would be desirable for all the banks in the Gulf to be consistent, as Arabic is the common language for all the institutions. Both the Kuwait Finance House and ABC Islamic Bank provide full details of who is on their *shariah* committees as well as a list of the senior managers.

Bank Muamalat, the Islamic retail and business bank of Indonesia, has an admirably focused mission statement. It strives to “enhance the role of the Muslim people and entrepreneurs (in the nation's economy) and maximise its

¹⁰ www.shamilbank.com.bh/pfil/pfil.html

¹¹ www.kfh.com/kfh/who/who.html

¹² www.arabbanking.com/islamic6.html

economic value to shareholders while addressing its social responsibilities in line with Islamic teaching.”¹³ This stress on social responsibility mirrors that of ethical institutions such as the Co-operative Bank. It also tries to “identify customers’ needs and offer a wide range of products and services, with emphasis in promoting the establishment, servicing and development of small and medium sized enterprises.”¹⁴ The bank is therefore very clear about where its market lies, and whom it aims to serve.

The government ministers involved in Bank Muamalat’s establishment and leading founding members are listed in the interests of transparency, the latter including many well-known Indonesian Muslim entrepreneurs.¹⁵ The Association of Muslim Intellectuals also has an important input into the bank, and reference is made to B.J. Habibie who has played such an important role in the restoration of democracy in Indonesia and in trying to salvage the economy from the Asia crisis. Like the Co-operative Bank the Bank has particular respect for the interests of its staff whom it describes as professional and committed to Islamic teachings. It is committed to provide opportunities for the advancement of their *ibadah* and career.

IMPROVEMENT IN COMMUNICATION, GOVERNANCE AND PARTICIPATION

Although Islamic banks and western ethical institutions such as the Co-operative Bank have dissimilar values and aspirations and they are operating in different environments, there are numerous lessons that each can gain from the other’s experience. For Islamic banks it is perhaps appropriate to highlight five issues.

- **Ethical banking principles and *Shariah* law**

The *shariah* law in the finance sphere is essentially concerned with economic justice. How each bank’s practices and products contributes to a more just financial system needs to be spelt out more clearly and fully.

Although the Co-operative Bank’s prospectuses are far from adequate in

¹³ www.yellowpages.co.id/partner/muamalat/mission.htm

¹⁴ Ibid.

¹⁵ www.yellowpages.co.id/partner/muamalat/brief.htm

this regard, its statement of ethical policy is an approach that Islamic banks could usefully emulate.

- **Fair trading practices and *murabahah***

Although Islamic banks continue to be heavily involved in trade finance through *murabahah* and other Islamic financing instruments, they seldom refer to fair trading practices. The fair trade agenda of ethical institutions like the Co-operative Bank involves helping organisations such as Tradedcraft that promote higher prices for Third World producers. The Islamic Development does much to promote Third World trade, but many Islamic commercial banks in developing countries are in practice largely involved in the finance of imports from the advanced industrial countries rather than export finance. *Murabahah* essentially involves an alternative means of financing, but the ends also matter to the ethically concerned.

- **Client endorsement from the Muslim community**

The Co-operative Bank undertakes regular customer consultation exercises on a highly organised basis to ascertain the views of its clients on ethical issues. Islamic banks tend to take the beliefs and values of their customers for granted, yet where clients are committed Muslims they have potentially much to contribute to the development and endorsement of new products and services, as well as to the overall aims and objectives of Islamic banks.

- **Corporate governance issues and *shariah* advisors**

The Co-operative Bank could be more explicit about its obligations to the preference shareholders and the aims of its sole shareholder, the CWS, regarding the Bank. Likewise while many Islamic banks are admirably transparent about who their *shariah* advisors are and the role they perform, much less information is given about the aims and objectives of their major shareholders.

- **Affinity debit cards as a vehicle for *zakat***

Some critics view the Co-operative Bank's affinity cards as a marketing gimmick which yields only modest returns for charity, but there is scope for Islamic banks running similar schemes, hopefully on a more generous basis. *Zakat* is a tax on wealth rather than spending, but affinity card

revenue which the banks contribute to charity on behalf of individual card holders could be offset against personal *zakat* contributions.